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SMART NOTES

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P6

Advance Taxation

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CHAPTER 1

Income Tax Computation, Trust Income, Tax Reducer & Pension

INCOME TAX is paid by individuals on his taxable income in a tax year.

Taxable income: Income from all sources except exempt income, *minus* reliefs & personal allowance.

Tax Year: income tax is calculated for tax year which runs from 6th April to 5th April. 6th April 15 to 5th April 16.

Individual: All individuals including children are called taxable person and pay income tax *Non UK Residents* Pay UK Income tax on their UK Income only while *UK residents* Pay UK income tax on their worldwide income.

1 TAXABLE PERSON:

STEP 1: Automatic Non UK Resident:

A person will *automatically be treated as not resident* in the UK if he is present in UK for:

- Maximum 15 days in a tax year.
- Maximum 45 days in a tax year, and who has not been UK resident in previous three tax years.
- Maximum 90 days in a tax year, and who works full-time overseas.

STEP 2: Automatic UK resident person:

- 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.

Remember:

- *If a person meets both step 1 &step 2 then step 1 will be preferred and he will be considered non UK resident.*
- *Individual is in UK if he is in UK at midnight*

STEP 3: Sufficient ties test:

If a person is not treated UK resident as per automatic tests, then his status will be based on *no of ties* with the UK and *no of days* they stay in the UK during a tax year.

UK Ties:

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

Days in UK	Not UK Resident in any of previous 3 tax years	UK Resident in any of previous 3 tax years
Upto 15	Automatically non resident	Automatically non resident
16 to 45	Automatically non resident	Resident if ≥4 UK ties
46 to 90	Resident if 1st 4 UK ties	Resident if ≥3 UK ties
91 to 120	Resident if ≥3 UK ties out of 1st 4 ties	Resident if ≥2 UK ties
121 to 182	Resident if ≥2 UK ties out of 1st 4 ties	Resident if ≥1 UK ties

2 TYPES OF INCOME

Exempt Income:

- Interest from national savings and investments certificates
- Gaming winning, Batting, lottery and premium bonds winnings
- Scholarship paid to taxpayer is exempt while scholarship paid to taxpayer's family member is taxable.
- Income received from individual saving account (ISA)
- State benefits paid in the event of accident, sickness or disability.
- Interest on repayment of tax

Employment income: Income earned by an employee from his employment. e.g salary, bonus & Benefits.

Trading income: Profit generated by a self-employed individual from his trade or profession.

Property income: Income received from land and building situated in UK.

Pension income: Income received after retirement.

Dividend Income: Dividend income must be gross up as follows: *(Dividend received X 100/90)*

Saving income: Interest is received net of 20% tax so it is gross up as follows: *(Interest received X 100/80)*

Interest received is Exempt.	*Interest received is Gross & Taxable*
• New Individual saving account (NISA) • National saving and investment certificates	• National saving and investment bank A/c, gilt edges secutities • Government securities and Debentures of listed companies

Remember: Employment income, trading income & pension income are called earned income while saving income & dividend income are called investment income.

Individual Saving account

NISA can be opened by individual aged ≥18 (16 for cash NISA) and resident in UK.

Income received is exempt from income tax and gain on disposal of investment is exempt from CGT.

➢ **Types of Investment:**

a) Cash and cash like equity Products: Bank and building society interest, national saving and investment products which are not exempt.	**b) Stocks, Shares and insurance Products:** ordinary shares, preference shares fix & convertible, fix interest corporate bonds & gilts both with at least 5 year to run until maturity, investments in unit trusts.

➢ **Subscription limits:** For the tax year 2015-16 a person can invest up to £15,240 in ISA. The £15,240 limit is completely flexible, so a person can invest £15,240 in a cash ISA, or they can invest £15,240 in a stocks and shares ISA, or in any combination of the two – for example £10,000 in a cash ISA and £5,240 in a stocks and shares ISA.

3 INCOME TAX PERFORMA

Mr. A Income Tax computation 2015/16

		Other Income	**Saving Income**	**Dividend Income**
Trading income		XX		
Employment income		XX		
Property income		XX		
Interest income (gross) (100/80)			XX	
Dividend income (gross) (100/90)				XX
Income from discretionary trust	Gross income= Net X 100/55	XX		
Income from interest in possession trust.				
Paid from non-saving income	Gross income= Net X 100/80	XX		
Paid from saving income	Gross income= Net X 100/80		XX	
Paid from dividend income	Gross income= Net X 100/90			XX
	Total Income	XX	XX	XX
Less: Reliefs	(See Note 1)	(1)	(2)	(3)
	Net Income	XX	XX	XX
Less: Personal Allowance	(See Note 2)	(1)	(2)	(3)
	Taxable Income	XX	XX	XX
Calculation of income tax liability:	(See Note 3 & 4)			
Other Income X Tax rate of other income		XX		
Saving income X tax rate of saving income		XX		
Dividend income X tax rate of dividend income		XX		
	Income Tax	XX		
Less: Marriage Allowance	(See later in this chapter)	(XX)		
Less: Tax Reducer	(See later in this chapter)	(XX)		
Less: Double Taxation Relief		(XX)		
	Income Tax Liability	XX		
Less: Tax Deducted At Source				
Interest Income @ 20 %		(XX)		
Dividend Income @ 10%		(XX)		
PAYE		(XX)		
Trust (10%, 20%, 45%)		(XX)		
	Income Tax Payable	XX		

Remember: *All incomes are included GROSS in the pro-forma.*

NOTE 1: **Reliefs against Total Income:**

Trading losses (covered in next chapters)

Eligible interest: interest paid on *qualifying loan* is eligible interest. Loan is qualifying if taken for following purposes:

- To purchase equipment by an employee for use in job.
- On a loan to purchase plant or machinery used in business, by a partner
- To invest in employee-controlled UK resident unquoted trading company by a full time employee.
- To invest in partnership
- To purchase shares in close trading company. (company having shareholders ≤ 5)
- To pay inheritance tax of a deceased person (for 1 year only.)

NOTE 2: **PERSONAL ALLOWANCE:** Tax free income of a person is called personal allowance. It is deducted from income in the following order: **(i)** other income **(ii)** saving income **(iii)** dividend income. Any surplus personal allowance will be wasted.

Date of Birth	Personal Allowance	Adjusted net Income
Born on or after 6 April 1948	£10,600	£100,000

Adjusted net income (ANI):

Total Net income	XX
Less: Gross Gift aid donation (100/80)	(XX)
Less: Gross Personal Pension Contribution (100/80)	(XX)
Adjusted net income (ANI):	XX

Transferable amount of personal allowance or Marriage Allowance:

- A spouse/civil partner can elect to transfer £1,060 of their personal allowance to the other spouse/civil partner if certain conditions are met. This is sometimes known as the marriage allowance.
- Neither the spouse/civil partner making the transfer nor the spouse/civil partner receiving the transfer can be a higher rate or additional rate taxpayer.
- The spouse/civil partner receiving the transfer do not have an increased personal allowance. Instead, they are entitled to a tax reducer of £1,060 × 20% = £212. If income tax liability is less than £212 than it cannot create repayment.

Election:

- For the tax year 2015/16, if the election is made before 6 April 2016, it will have effect for 2015/16 and subsequent tax years unless it is cancelled by the transferor spouse
- If the election for the tax year 2015/16 is made on or after 6 April 2016 it must be made within four years of the end of the tax year (ie by 5 April 2020) and will only apply for the tax year 2015/16.

NOTE 3: Calculation of Income Tax Liability:

Starting Band Rate:	£1 ------------ £5,000		20%	0%	10%
Basic Rate Band:	£5,001 ------------ £31,785	(£26,785)	20%	20%	10%
Higher Rate Band:	£31,786 ------------ £150,000	(£118,215)	40%	40%	32.5%
Additional Rate Band:	£150,000 ------------ Above		45%	45%	37.5%

NOTE 4: **Extension of Basic and Higher Rate Band:**

Basic and Higher rate bands will be extended by the gross amount of gift aid donations and personal pension contribution.
Gross amount = Net amount X (100/80)

4 DONATIONS

Individual can donate any amount so there is no maximum limit for donations. There are two types of donations:

(i) Donation under payroll deduction scheme:

(These will be paid gross and deducted from employment income)

(ii) Donation under gift aid scheme:

- Individuals contribute net donation of 80% while remaining 20% will be contributed by HMRC.
- Basic and Higher rate bands will be extended by the gross amount of donation under gift aid donations. *Gross amount = Net amount X (100/80)*
- **Relief:** *Basic rate tax payer* 20%, *higher rate tax payer* 40% and *Additional rate taxpayer* 45%.

5 Taxation of Spouses Family:

Income received on jointly owned assets will be taxable on both partners on equal basis (50:50). However individual can elect for the actual proportion of income to be assessed on each partner by declaration to HMRC.

Every child has its own income tax computation and avails full personal allowance. Income of ≤£100 which is transferred by a parent to minor child will be treated as child's income. Income of > £100 which is transferred by a parent to minor child will be treated as parent's income.

6 CHILD BENEFIT INCOME TAX CHARGE

Child benefit: It is a tax free payment from government for children of a taxpayer.

Child Benefit Income Tax Charge: It removes the benefit of child benefit. It is paid to HMRC with income tax under self-assessment system. It arises in the following situations:

(i) An individual has received child benefit and his or his spouse or civil partner Adjusted net income is ≥£50,000.

(ii) An individual has received child benefit and his previous spouse or previous civil partner with whom they are living have Adjusted net income is ≥£50,000.

Where adjusted net income is between £50,000 and £60,000, the income tax charge is 1% of the amount of child benefit received for every £100 of income over £50,000. For people whose adjusted net income exceeds £60,000, child benefit income tax charge will be equal to child benefit received.

7 TAXATION OF TRUSTS

Trust: "A trust (also known as a settlement) is an arrangement in which a property is transferred to a group of persons (known as the trustees) by a person (known as the settlor) for the benefit of other persons (known as the beneficiaries)." The powers and duties of the trustees and the wishes of the settlor are laid out in the trust deed.

A trust may be created during the **lifetime of the settlor**, in which case the terms of the trust will be contained in the trust deed. Alternatively a trust may arise on the **death of the settlor**, in which case the terms of the trust will be laid down in the will, or by the statutory provisions which apply on intestacy.

Types of Trust: The main types are discretionary Trust and interest in possession trust (also known as life tenant trust).

7.1 Discretionary trusts:

"A discretionary trust is a flexible settlement where the beneficiaries have no legal right to benefit from the income or capital of the trust; any distribution of income or capital out of the trust is at the complete discretion of the trustees."

In a typical discretionary trust the trustees may have power to decide:

- whether or not trust income is to be accumulated or distributed
- how the trust assets are managed and invested to generate income and capital growth
- how the trust income and the capital of the trust is to be shared between different beneficiaries.

7.2 Interest in possession trusts (or life interest trust):

"An interest in possession (IIP trust) exists where a beneficiary has an interest in the assets of the trust."

"An IIP can be the legal right to receive income generated by the trust assets, and/or to use a trust asset or live in a property owned by the trust."

- **Life tenant of Trust:** Beneficiary who receives the right to income or use of an asset under an IIP.
- **Remainder man:** Beneficiary who receives the capital assets ('reversionary interest') in the trust when the life interest comes to an end.

This form of trust is a popular arrangement to protect the capital assets for the benefit of the children where, for example, the spouse remarries. The capital will eventually be transferred to the children of the first marriage and not to the new spouse and their family.

7.3 Income tax implication of Trusts:

Trustees account for income tax on income generated by trust assets each tax year under self-assessment and beneficiary receives income net of tax @20%/10% from interest in possession trust and @45% from discretionary trust. So income is gross up for income tax computation. Tax credit is given @ 10%, 20% or 45% by deducting it from income tax liability.

Income from discretionary trust	***Income from interest in possession trust:***	
Gross income= Net income X 100/55	If paid from non-saving	Gross income= Net income X 100/80
	If paid from saving income	Gross income= Net income X 100/80
	If paid from dividend income	Gross income= Net income X 100/90

Remember: *IHT and CGT implication of trust is not examinable.*

8 TAX REDUCERS

	Enterprise Investment Scheme (EIS)	**Seed Enterprise Investment Scheme (SEIS)**	**Venture Capital Trust (VCT)**
Company			
Objective	Designed to encourage investors to purchase shares of unquoted trading companies.	Designed to encourage investors to purchase shares of unquoted trading companies.	Designed to provide funds to unquoted companies through a quoted company.
Risk	It is high risk investment.	It is high risk investment.	It is comparatively low risk investment.
Qualifying company	• Unquoted trading company with a permanent establishment in the UK • Effective 90% interest subsidiary will also qualify for relief • Full time employees of max 250 • Gross assets of ≤£15m prior to and ≤£16m after share issue.	• Unquoted trading company with a permanent establishment in the UK • Full time employees of max 25 • Gross assets of ≤£200,000 before share issue.	*Qualifying Company for VCT:* • VCT must be quoted company, • 70% of its total investment must be in ordinary shares of unquoted companies. • Maximum 15% investment a single co. • Must distribute at least 85% of its income as dividend. *Qualifying CO. for investment in by VCT:* • EIS Qualifying companies
Funds Used	Used by company for qualifying trade (See Note) within 2 years of share issue. Funds raised can't be used to another business.	Used by company for qualifying trade (See Note) within 3 years of share issue. Funds raised can't be used to another business.	Used by company for qualifying trade (See Note) within 2 years of share issue. Funds raised can't be used to another business.
Funds raising limit	• £5 million in any 12 month • £12 million life time total (EIS, SEIS & VCT)	Max £150,000 in any three year period.	• £5 million in any 12 month • £12 million life time total (EIS, SEIS & VCT)
Investor			
Investment & investor	• the investor must: – subscribe, in cash, for new ordinary shares in a qualifying company – not be an employee or director of company • Be independent of company at the time of investment in EIS shares (not already held shares in company at the time of investment except EIS shares or SEIS shares) – have an interest of 30% or less in the company's ordinary share capital (OSC)	• Investor must subscribe for ordinary shares wholly in cash and • Must not be connected. (*Not employee but can be Director* nor own >30% shares by himself or associates ie spouse/civil partner or child, not brother or sister)	Anyone can invest.

Annual Limit	Max investment is £1,000,000 in a tax year.	Max investment is £100,000 in a tax year.	Max investment is £200,000 in a tax year.
Carry back facility	If an individual wants to invest more than annual limit then he can invest in previous year but can't get relief of >£1million in any one year	If an individual wants to invest more than annual limit then he can invest in previous year but can't get relief of >£100,000 in any one year	Not available
Dividend	Taxable.	Taxable.	Exempt.
BPR	Available if shares are owned for ≥ 2 years.	Available if shares are owned for ≥ 2 years.	Not Available
EIS Reinvestment	EIS reinvestment relief is available.	SEIS reinvestment relief available	
IT Reducer	30% of investments. Can't create tax repayment As max annual investment is £1million so max IT reducer is = £300,000.	50% of investment. Can't create tax repayment As max annual investment is £100,000 so max IT reducer is = £50,000.	30% of investments. Can't create tax repayment As max annual investment is £200,000 so max IT reducer is = £60,000.
Tax implication on disposal of shares	Shares sold after 3 years – full income tax reducer will available – Capital gain is exempt. – Capital loss can be treated as trading loss	Shares sold after 3 years – full income tax reducer will available – Capital gain is exempt. – Capital loss can be treated as trading loss	• If Shares are sold after 5 years full income tax reducer will available. • Capital gain on disposal of shares is exempt whether sold before or after 5 years.
Withdrawal of Relief	Shares sold before 3 years: • **CGT implication** – Capital gain will be taxable, • **IT implication** – Repay full IT reducer If not sold at arm's length – If sold at arm's length then repay lower of : Full income tax reducer & 30% of selling price	Shares sold before 3 years: • **CGT implication** – Capital gain will be taxable, • **IT implication** – Repay full IT reducer If not sold at arm's length – If sold at arm's length then repay lower of : Full income tax reducer & 50% of selling price	Shares sold before 3 years: • **IT implication** – Repay full IT reducer If not sold at arm's length – If sold at arm's length then repay lower of : Full income tax reducer & 30% of selling price

- **Qualifying Trade:** Qualifying trades include all trades except dealing in land, shares & securities, financial activities, legal, shipbuilding, coal and steel production, accountancy services and properties.

9 PENSION

OCCUPATIONAL PENSION SCHEME (OPC)	PERSONAL PENSION SCHEME (PPC):
• Only employees can contribute into employer's OPC scheme. • Both employee and employer (for employee) contribute. • Employee Contribution is deducted from his employment income and employer contribution (exempt benefits for employee) is deducted from his trading profit. • Contribution made to OPC is gross.	• Anyone may contribute in a personal pension for himself or for anybody else. • PPC is managed by private institutions.(eg banks) • Contribution in PPC is gross up by 100/80 and basic & higher rate bands will be extended by this gross amount

- **Relief:** Relief is only available if pension is registered scheme, individual is UK resident and aged under 75.
- **Contribution:** Any amount can be contributed but *relief is available on higher of £3,600 and 100% of relevant earning.* (Relevant earnings include employment income for employee; tax adjusted trading profit for self-employed and income from furnished holiday letting for both.)
- **Annual Allowance:** Individual can contribute any amount into pension scheme but relief is available on maximum £40,000 per annum for 2014/15 and 2015/16.. However this annual limit of £40,000 will be extended by the unused annual limits in previous three tax years. The annual limit of 2011/12, 2012/13 and 2013/14 was £50,000. Annual limit is only available if a person is a member of a pension scheme for a particular tax year. Annual contribution = employee cont + employer cont.
- **Annual Allowance Charge:** Contribution (by the individual, their employer and third parties) made in excess of annual Allowance will be added in other income by name of annual allowance charge.
- **Life Time Allowance:** An individual can contribute £1.25 million during his life time. If contribution exceeds £1.25 million then There will be a tax charge of:
  - 55% on excess, if the excess pension funds are taken lump sum.
  - 25% on excess, if the excess pension funds are used to provide pension income.
- **Pension Benefit:** Received when an individual is aged 55 years or more. At eligible age Individual can take tax free lump sum payment of lower of:

  a) 25% of amount in fund b) 25% of Life time allowance

  Remainder 75% amount in fund is used to provide pension income. Pension can be claimed before this age if the individual is incapacitated due to ill health.
- **Benefits of Pension contribution: T**he following benefits are available if pension is registered with HMRC.

  (i) Tax relief (ii) employer contribution into pension is exempt benefit for employee.

  (iii) On retirement some pension can benefit can be obtained as tax free lump-sum payment.
- **Spreading employer Contributions:** if employer contribution to pension scheme exceeds 210% of previous year then it is spread as follows:

First 110% in current year and excess over 110% of previous year can be dealt with as follows:

(i)	Less than £500,000 all in current year		**(ii)**	between £500,000 - £1,000,000	spread evenly over 2 years
(iii)	Between £1,000,000 - £2,000,000	spread over 3 years	**(iv)**	£2,000,000 or more	spread evenly over 4 years

CHAPTER 2
PROPERTY INCOME & INVESTMENT INCOME

1 Premium Received on Grant of Short Lease (lease for a period of ≤50 years)

Taxable Premium = Total Premium X (51 - Number of complete years of lease)/50

Grant of Sub Lease: In case of sublease premium received by tenant is taxable and calculated as follows:

Amount assessable on sub lease	XX	Relief = Taxable premium for head lease × $\frac{\text{Duration of sub lease}}{\text{Duration of head lease}}$
Less: Relief *	(XX)	
	XX	

2 Rental income

Property income is calculated for a tax year on accrual basis.

	£
Rent (accrual basis)	**XX**
Less: Allowable Expenses (only revenue expenditure on accrual basis)	
- Repairs, Redecoration, or replacements (not capital expenses)	(XX)
- Interest on loan to acquire or improve property (Not for companies)	(XX)
- Insurance, Agents fees, Advertisement, Management expenses	(XX)
- Water rates (if paid by landlord)	(XX)
- Council tax (if paid by landlord)	(XX)
- Bad Debts (actual bad debts not provisions)	(XX)
- Other expenses incurred for earning the above rent	(XX)
Expenses allowable to furnished property only:	
- *Wear & tear allowance*	
10% of (Rent due less bad debts less water rates and council tax') or	(XX)
Property Business Profit/Loss	**XX**

- if there are more than one properties which are let out then profit or loss of each property will be calculated in the same and then profits are aggregated together to find total property income with the exception of furnished holiday letting profit which is dealt with separately.
- Depreciation is not an allowable expense.

3 Property Business Loss

1st Current year property income/loss is aggregated but if there is overall loss then this loss is carry forward indefinitely and set off against first available future property business profit.

4 Rent a Room Relief

- If an individual lets furnished room in his main residence then rental income will be lower of:

1		2	
Rent	XX	Rent	XX
Less: allowable deductions	(XX)	Less: £4,250 (rent a room relief)	(XX)
Less: 10% wear & tear allowance	(XX)		
Profit	XX	Profit	XX

NOTE: If gross annual receipts are £4,250 or less income is exempt from income tax. Limit of £4,250 will be reduced if more than persons are receiving rental income or property is owned jointly by married couple. Individual may elect to ignore exemption if there is property loss.

5 Furnished Holiday Letting (FHL)

Conditions to qualify as FHL:

- Must be furnished and let commercially to earn profit.
- Available for letting to general public for ≥210 days in a tax year.
- Actually let for ≥105 days in a tax year (Excluding long term letting) (≥105 days on average if more than one FHL accommodation.)
- Available for short term letting (≤31 regular days). If let on long-term then total of such letting should ≤155 days

Benefits of FHL:

- FHL income Qualifies for personal pension scheme.
- CGT roll-over & entrepreneur relief is available.
- Capital allowances available on plant and machinery including furniture and furnishings.

NOTE: Loss of FHL can only be set off against future income of same FHL

6 Real Estate Investment Trust (REIT)

It is a trust which is quoted/ listed in stock exchange and it holds diversified portfolio of investment property to earn rentals and capital appreciation. Dividend received from REIT is net of 20% tax and not treated as dividend income instead it will be treated as property income and grossed up by 100/80.

7 Accrued Income Scheme

It is applicable upon Govt. securities & debentures having value more than £5,000 at any time during tax year. In this scheme interest is deemed to be accrued on daily basis (calculate on monthly basis in exams) so the price of debenture is apportioned between interest & capital element.

CHAPTER 3
EMPLOYMENT INCOME

1 Determination of Employment

The following factors are considered in order to determine whether a person is employee or not.

- **Contract of Service**
- **Obligation of Work:**
- **Place of work:** Decided by employer
- **Payment:** Fix Monthly/ weekly payment.
- **Equipment:** Provided by employer.
- **Insurance:** Provided by employer.
- **Financial risk:** Employees have No financial risk.
- **Control:** Employer decides work and time of work.

2 Calculation of Employment Income:

Earnings: It includes statutory sick pay, statutory maternity pay, golden hellos, third party payments, golden handshake and restrictive covenant payments.

Salary (Receipt basis rule)	X
Bonus/commission (Receipt basis rule)	X
Add: Benefits in kind	X
	X
Less: allowable deductions	(X)
Employment income	X

Employment income is calculated for a tax year (6April—5April) on receipt basis rule.

Receipt basis rule for all employees

Earning are deemed to be received on earlier of:

a) Payment date
b) Entitlement date

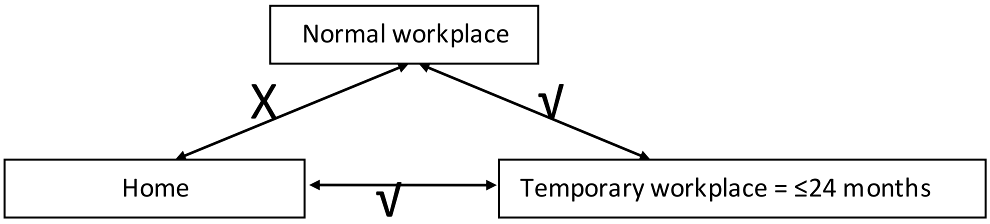
Receipt basis rule for all Directors

Earning are deemed to be received on **earlier of:**

a) Payment date
b) Entitlement date
c) When amount is received as liability in company accounts.
d) Later of year end date of employer or determination date of earnings.

3 ALLOWABLE DEDUCIONS

- Qualifying travel expenses.



- Fee and subscriptions to professional bodies
- Gift aid donations/payment to charity under payroll deduction scheme.
- Contribution to occupational pension scheme.
- Capital Allowances in respect of equipment which is being used in employment.

Approved Millage Allowance (AMA):

Millage allowance is paid by employer to employee if employee used his own vehicle. Amount up to AMA is exempt, excess is taxable and less is allowable deduction.

	Up to 10,000 miles	Above 10,000 miles
Cars & Vans	45pence/mile	25pence/mile
Passenger rate	5pence/mile	5pence/mile
Motor-cycle	24pence/mile	24pence/mile
Pedal-cycle	20pence/mile	20pence/mile

4 EXEMPT BENEFITS

- Free or subsidized meals at on-site canteen or restaurant if available to all employees.
- Provision of parking space at or near place of work including reimbursement of cost of such parking place.
- Workplace childcare, sports or recreation facilities.
- Payment to approved child career is exempt per week upto £55 for basic, £28 for higher and £25 for additional rate taxpayer.
- The provision of one mobile phone including balance.
- Employer's contribution to an approved pension scheme.
- Entertainment to employee by reason of his employment, by a third party, e.g. a ticket at sporting or cultural event.
- Gifts, received, by a reason of his employment, from genuine third parties, provided the cost from any one source doesn't exceed £250 in a tax year.
- Long service awards in kind (e.g. gold watches) are exempt up to £50 for each year of service of 20 years or more.
- Home workers additional household expenses of up to £4 per week or £18 per month can be paid tax-free without any evidence.
- Work buses, subsidized public bus service, and the provision of bicycles and cycling safety equipment.
- Christmas parties, annual dinner dances, etc for staff are exempt, if employer incurs up to £150 p.a. per head.
- The provision of a security asset or security service by reason of employment.
- Welfare counseling service if available to all employees Relocation and removal expenses are exempt up to £8000, excess is taxable.
- Premium paid by employer for employee's Permanent Health Insurance.
- Reimbursement of expenses by employer when employee is away from home.
  – £5/night in UK and £10/night if overseas. If exceeds whole amount is taxable.
- Pension advice of upto £150 per employee per tax year is exempt if available to all employees.
- Awards for upto £25 under staff suggestion scheme, which is available to all employees for suggestions outside their duties.
- The cost of work-related training course.
- Some beneficial loans (see later)
- An annual £500 exemption per employee has been introduced where an employer pays for medical treatment due to ill-health or injury.
- Scholarship paid to taxpayer is exempt while scholarship paid to taxpayer's family member is taxable.

5 BENIFITS TAXABLE ON ALL EMPLOYEES

GENERAL RULE:

Cash equivalent value of benefits is taxable to employees unless they have specific statutory rules.

5.1 Vouchers: All kinds of vouchers (e.g. cash vouchers, goods vouchers, lunch vouchers) provided to employees are taxable on the cost to employer.

5.2 Living Accommodation: Taxable benefit will be

Annual value /Annual value	X
Plus: Additional Benefit if cost of accommodation is > 75000 (note 1)	X
	X
Reduction for unavailability	(X)
Contribution by employee for use of house.	(X)
Taxable benefit	X

Note 1: Additional benefit: Additional benefit = (cost of providing accommodation - £75000) x 3%

Cost of providing accommodation:

a) It is the purchase price plus the cost of any improvements made before the start of the tax year.

b) If the employer bought the accommodation more than six years before first providing it to the employee, the market value when first occupied by employee is used in the calculation instead of purchase price plus any improvement capital expenditure but before start of current tax year.

➢ **Accommodation Provided is Rented By Employer:**

Taxable benefit will be higher of:

a) Rent actually paid be employer

b) Annual value/Ratable value.

There is no concept of expensive or inexpensive accommodation in this case.

➢ **Job Related Accommodation:** It is Exempt.

Accommodation is job related if provided for:

a) Proper performance of the employee's duties

b) Better performance of the employee's duties

c) Security arrangement for threat to employees' life.

* Directors can claim exemption under first two points.

6 BENIFITS TAXABLE ON P11D EMPLOYEES AND DIRECTORS

Higher paid employees or P11D employees: employees earning ≥£8,500 p.a. or directors (Unless Directors earning <£8500 and less than 5% shares of company and full time working director)

GENERAL RULE: As a general rule *cost of providing Benefits* (mean Marginal or Additional cost) is taxable to employees unless they are specific statutory rules.

6.1 Expenses Connected With Living Accommodation:

Expenses such as lighting and heating are taxable on the employee if they are paid by employer. If accommodation is job related, the taxable limit is 10% of other employment income.

6.2 Car Benefit:

Pool cars: No taxable benefit will arise if car provided is a pool car. Car is considered pool car if:

a) It is used by more than one employee. **b)** Any private use is incidental.

c) It is not normally kept overnight at or near the residence of an employee.

Not Pool Car: if car is not pool car then Taxable benefit will be.

List price (Note 1) x CO2 emission %	X
Less: Non availability (if car not available whole year)	(X)
Less: Employee contribution for private use	(X)
Taxable benefit	X

List Price:

- It is market price including taxes but ignoring the bulk discount
- ***Plus*** cost to employer of additional accessories.
- ***Less*** any capital contribution by employee for use but maximum of £5,000.

CO2 Emission Percentage:	Petrol	Diesel
Upto ----------- 50g/km	5%	8%
51g/km ----------- 75g/km	9%	12%
76g/km ----------- 94g/km	13%	16%
95 g/km	14%	17%

If CO2 emission >95g/km then 1% increase for each complete additional 5 grams of CO2 emission. Maximum percentage is 37%

No extra benefit will arise for cost of insurance, repair & maintenance and running cost because it is included in car benefit. An additional separate benefit (cost to employer) will arise if chauffeur (driver) is also provided for private use of car.

6.3 Fuel Benefit:

If Employer provide fuel for private use of motor car then fuel benefit will be calculated as:

Fuel benefit = £22,100 x CO2% (calculated for car benefit)

If employee reimburses the full fuel cost to employer then no fuel benefit will arise however full fuel benefit will arise if employee reimburses partial fuel cost to employer. Fuel benefit will be reduced if not available for whole year.

6.4 Van Benefit:

If van is provided to employee for private use then taxable benefit of ***£3,150 p.a.*** will arise. If employer also provides fuel for the van then additional taxable benefit of ***£594 p.a.*** will arise. Both Van benefit & fuel benefit will be divided equally if van is used by more than 1 employee. Both benefits will be reduced if van is not available for whole year.

6.5 Use Of Asset:

If employer provides asset (except those which have special rules e.g. car, vans etc.) to employee for use Then Taxable Amount is the higher of:

a) 20% × market value of the asset when first provided (reduce if not available whole year)

b) Rent paid by employer (if asset is rented)

6.6 Gift Of Asset:

- **Gifted New Asset to Employee:** Taxable benefit will be equal to ***cost to employer.***
- **Gifted Used/2nd hand Asset to Employee:** Market value at time of transfer is taxable.
- **1st Asset was Provided For Use Then Subsequently Gifted To Employee:** Taxable benefit will be higher of:

1	
Market value when gifted to employee	X
Less: Price paid by employee	(X)
Benefit	X

2	
Market value of Asset when 1st provided	X
Less: benefits already taxed for use of Asset	(X)
Less: Price paid by employee	(X)
Benefit	X

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6.7 Beneficial Loans: A beneficial loan is one made to an employee below the official rate of interest of 3%. Taxable benefit will be calculated as follows:

Interest expense as per HMRC	X
Interest expense actually paid	(X)
Taxable benefit	X

➢ **Interest Expense As Per HMRC:** Interest as per HMRC is lower of:

1) Average Method:	***2) Strict Method/Precise Method***
{(Loan outstanding at start of tax year + Loan outstanding at end of tax year)/2} x 3% (official rate %)	Balance of Loan outstanding in months X $\frac{months}{12}$ X 3%

- If amount of loan is <£10,000 then this will be treated as small loan and is exempt.
- Qualifying loan (see ch. 1) is not taxable. Loan written off is taxable.

7 Redundancy payment/ Termination Benefits

Fully Exempt	Fully Taxable	Partially Exempt
• Payment for injury, disability or death. • Lump sum payment from an approved pension scheme. • Statutory redundancy payment.	• Payment in lieu of notice • Payment which is contractual or usual employer practice. • Restrictive covenants.	• Genuine ex gratia termination payment – First £30,000 is exempt. (Limit reduced by statutory redundancy payment)

Genuine ex gratia termination payments includes Compensation for loss of office, Redundancy payment and Damages for breach of contract of wrongful dismissal.

Note: Termination payments are received *Net of PAYE if paid before the employer issues the employee's P45, or Net of 20% tax if received after the cessation of employment* (i.e. after the P45 has been issued). Taxed as top slice means taxed after dividend income.

If a person is receiving ex-gratia payments and he is approaching his retirement age then £30,000 exemption will be withdrawn and it will become fully taxable. It is called unapproved retirement benefit.

8 Dispensation

It is an arrangement between employer and HMRC not to report certain benefits provided to employee to reduce administration burden.

9 Approved and Unapproved Share option Schemes:

	Grant of option	Exercise of option	Disposal of Shares
Approved	No tax	No tax (may arise in EMI only)	**Capital gain arises.** Sale proceed X Cost of option (X) Cost of shares (X) Capital Gain/Loss (Note:1) X
Unapproved	No tax	**Income tax charge:** MV @ exercise date X Cost of option (X) Cost of shares (X) Employment income X Class 1 primary & Secondary arise if quoted and Class 1A if unquoted.	**Capital gain arises.** Sale proceed X MV @ exercise date (X) Capital Gain/Loss X

Note:1 Entrepreneur relief may be available in an employee owns ≥5% ordinary shares for ≥12 months. (5% holding is not required for EMI shares)

Cost of setting up scheme and operating any approved scheme is an allowable trading expense for the company.

9.1 Approved Share Option Scheme

Saving Related Share option scheme (SAYE):

- Under this scheme companies provides small no of share options to their employees.
- Employees pay maximum £500/month for a period of 3, or 5 years.
- Amount in fund is reinvested and related interest is added into funds on tax free basis. At the withdrawal date accumulated amount in fund will be used to take up Share options free of income tax & CGT. Alternatively he can convert them in cash.

Conditions to set up scheme:

- Participation in scheme should be available to all employees on similar terms, however minimum ownership period may be required.
- Exercise price of the option must be fixed at grant date of option and should greater than 80% of the market value of shares at grant date.

Tax implication: Same as for approved scheme. (see above table)

Company share option plan (CSOP):

Company allocates share options to selected employees (on its own discretion) and no contribution from employees is required.

Conditions to set up scheme:

- Company can allocate share option to any employee (part time or full time) or full time working director (working ≥25 hours per week). Participation need not to be opened to all employees nor on equal terms.
- Share options must be exercised between a period of 3 – 10 years from grant date.
- Market value of shares held under options could be ≤£30,000/employee at grant date.
- Exercise price must be fixed at grant date will be equal to market value at grant date.
- Employees having ≥ 30% shares of CO. are not eligible.

Tax implication: Same as for approved scheme. (see above table)

Enterprise Management Incentive (EMI):

Company allocates share options to selected employees (on its own discretion) and no contribution from employees is required.

Conditions to set up scheme:

- Under this scheme an employee is granted share options having value up to maximum of £250,000. However total value of share options granted under this scheme should not exceed £3 million.
- Company must be a trading company, less than 250 full time employees, Gross assets of less than £30 million and not under the control of any other company.
- The options must be exercised within 10 years from grant date.

Tax implication:

- Same as for approved scheme. (see above table)
- A taxable benefit may arise at exercise date if exercise price is less then market value of shares at grant date. Taxable benefit = market price @ grant date − exercise price

10 Share Incentive

If employer grants shares to employee either at free of cost or at discount price a taxable benefit will arise as follows:

MV of shares @ grant date	XX
Less: price paid (if any)	(XX)
Taxable benefit for income tax.	XX

NIC: Class 1 primary & Secondary arise if quoted shares and Class 1A if unquoted.

Share Incentive Plan (SIP)

- Under this scheme employer can grant shares having value up to £3,600/ employee free of cost.
- On the basis of free shares employee can purchase further share up to £1,800 these are called partnership shares. The cost of partnership shares incurred by employee is an allowable deduction under employment income but up to maximum of 10% of salary.
- On the basis of partnership shares employer can further grant free shares as 2 for 1 matching shares.
- Dividend upon shares in plan can be invested into purchase of further shares in tax free environment.

Conditions to set up scheme and Tax implication:

- All the employees can participate in the scheme.
- Plan should not have any arrangement for loan to employees.

Income tax	• Shares in plan are retained for ≥5 years then No income tax or NIC arise. • Shares are withdrawn after 3 years but before 5 years, income tax and NIC arise on lower of: a) Value of shares when assigned and b) Value at date of withdrawal. • Shares are withdrawn before 3 years; income tax and NIC arise on market value of the shares at the date of withdrawal.
CGT	• Capital gain arises on disposal of shares and calculated as: Capital gain = Disposal proceeds less value of shares at withdrawal date.

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11 The tax treatment of employee shareholder shares

An employee shareholder is an employee who has agreed to give up some of his employment rights, for example in relation to statutory redundancy pay in exchange for an award of shares in his employer or a parent company.

The employee must not pay anything for the shares; the only consideration is the change to the employee's employment rights. The shares received must be worth at least £2,000.

There are both income tax and capital gains tax advantages to receiving employee shareholder shares.

Income tax implication:	**Capital gains tax implication:**
Employee is deemed to have paid £2,000 for shares. The excess of the value of the shares over £2,000 is subject to income tax in the normal way. Class 1 NIC will only be payable on excess value of the shares over £2,000 if share are quoted shares. An employee who holds ≥25% of voting rights will pay income tax and NIC on whole value of the shares received.	Any chargeable gain arising on the first £50,000 in value of employee shareholder shares received by an employee in respect of a particular employment is exempt. (£50,000 value is value at time of acquisition not disposal) If a loss arises on a disposal of employee shareholder shares, that loss will not be an allowable loss. Shares are not treated as exempt assets if the employee holds at least 25% of the voting rights in the company.

CHAPTER 4
NATIONAL INSURANCE CONTRIBUTIONS

- **Class 1 Employee:** Payable by employees employed in UK, above 16 years until state pension age(60 or 65.)

- It is payable on cash employment income paid by employer only which includes: Wages, salary, overtime pay, Sick pay, Commission, Bonus, Remunerations, tips and gratuities from employer, Quoted shares, vouchers, payment of travel between home and work, all vouchers, Approved millage allowance of above45p/mile
- Contribution by employee is calculated as follows.

Cash Earnings	Contribution Rates
£1 – £8,060 per year	Nil
£8,061 – £42,385 per year	12%
Above £42,385 per year	2%

- Contribution is not allowable deductions for employee.
- It is Employer's responsibility to calculates NIC, deduct it from employee's wages and pay to HMRC.
- Contributions are payable by 19th of each month while 22nd of each month in case of electronic return.

- **Class 1 Employer:**

- It is payable by employer for employee on same cash earnings calculated for class 1 primary contribution.
- It is paid in respect of employees aged ≥16 until employee ceases employment.
- Class 1 secondary contribution is calculated as follows:

Cash Earnings	Contribution Rates
£1 – £8,112 per year	Nil
Above £8,112	13.8%

- **Employment Allowance:** No class 1 secondary NIC will be payable by employer if amount of total class 1 secondary NIC of all employees is ≤2,000/annum. If class 1 secondary NIC exceeds 2,000 then NIC above 2000 will be payable.
- Allowable exp for employer & exempt benefit for employee
- Contributions are payable by 19th of each month while 22nd of each month in case of electronic return.

- **Class 1A:**

- It is payable by employer on **taxable non-cash benefits** (e.g. living accommodation benefit, car benefit, fuel benefit, beneficial loan, use of asset, gift of asset etc.) provided to P11D employee at the rate of 13.8%.
- It is allowable deduction for employer and exempt benefit for employee.
- It is paid by 19th July following the end of the tax year. 19 july 2016 for 2015/16.

- **Class 2:**

- Payable by self-employed aged≥16 until pension age.
- Paid £2.8/week if trading profit of tax year exceeds £5,965.
- It is not allowable deduction from trading profit.
- Class 2 NIC is now payable under the self-assessment system and will be due on 31 January following the tax year. This is the same due date as for capital gains tax. Therefore, class 2 NIC for the tax year 2015–16 will be payable on 31 January 2017.

- **Class 4:**

Payable by self-employed aged ≥ 16 at the start of tax year until end of the tax year in which he reaches state pension age.

It is calculated on taxable trading profits after deducting trading losses if any follows:

Trading Profit	Contribution Rates
£1 – £8,060 per year	Nil
£8,061 – £42,385 per year	9%
Above £42,385 per year	2%

- It is not allowable deduction from trading profit.
- Payable with income tax under self-assessment system.

CHAPTER 5
INCOME FROM SELF EMPLOYMENT

- **BADGES OF TRADE:** The following tests are used to identify trade. **Subject matter, Ownership duration, Frequency of transactions, Improvement/Supplementary work on goods, Reason for sale, Motive.**

TRADING PROFIT ADJUSTMENTS

	Net profit per accounts	X
ADD BACK:	Expenditure not deductible for tax but deducted	X
ADD BACK:	Income not included in but taxable under trading profit	X
LESS:	Expenditure deductible for tax but not deducted	(X)
LESS:	Income included but not taxable under trading profit	(X)
	Tax adjusted trading profit	X

- **Income included but NOT taxable under trading profit:** Capital Gains, Property Income, Interest Income and Dividend received.
- **Income not included but taxable under trading profit:** Drawings by owner.

ALLOWED AND DISALLOWED EXPENSES

Capital Expenditure is disallowed and Revenue Expenditure is Allowable.

- Initial purchase price and improvement is capital expenditure and is disallowed.
- Replacement of an asset with extended capacity is disallowed.
- Repair to an asset is revenue expenditure and is allowable while initial repair to bring an asset in useable condition is disallowed.

Entertaining and Gifts

- entertaining is disallowed, unless entertaining employees
- gifts to employees are allowable
- gifts to customers are only allowable if
  - They cost less than £50 per person per year, and
  - Gift is not food, drink, tobacco or vouchers exchangeable for goods and services
  - Gift carries a conspicuous advertisement for the business.

If cost exceeds £50 per year then whole amount of gift is disallowed.

- Gift of samples of goods for advertisement purpose is allowable.

Bad Debts/Allowance For Receivables

- Bad debts are allowable and Recovery of bad debts is taxable income.
- Doubtful debts or allowance for receivable are allowable as per IAS and reduction in allowance is taxable income.
- Non-trade bad debts are disallowed. (E.g. bad debt on loan given to employees, customers and suppliers.)

Legal and Professional Charges

- Legal and professional charges are allowable if for trade and not capital.
- Cost incurred for new issue of shares is disallowed.
- Cost incurred for purchase of new assets is disallowed.
- Costs of; obtaining loan finance for trade, renewing a short lease (50 years or less) or issuing debt finance is specifically allowed by statute

Drawings

- Drawing by the owner in the form of salary, cash or goods are disallowed.
- Interest on capital is disallowed.
- Excessive salary paid to owner's family member is disallowed.

Subscriptions and Donations

- Trade or professional association subscriptions are allowable
- Donation to a local charity is allowable and to National charity & political parties is disallowed.
- Donations to other parties are allowable only if
  - It must be wholly and exclusively for trading purposes.
  - It must be reasonable in size in relation to the business.
  - Charity must be working for educational, religious, cultural etc. purpose.

➢ Rental Expense

- Any rent paid for the purpose of trade is allowable.
- Leasing charge of car emitting 130 g/km Co2 or less is allowable.
- If CO2 emission of car exceeds 130g/km then 15% of Rental/leased charges are disallowed.

➢ Car Leasing

- Premium received is considered as property income.
- Premium paid on grant of short lease is allowable and is calculated as follows:

$$\frac{(51 - n)/50}{N} \text{ X Premium}$$

n = no of years of lease.

➢ Other Expenses

- Qualifying (eligible) interest is disallowed.
- Interest paid on borrowings for trading purposes is allowable. Interest paid on overdue tax is not deductible and interest received on overpaid tax is not taxable.
- Payment for infringement of Law (e.g. Fines) is disallowed unless car parking fine paid on behalf of an employee.
- Damages are allowable if related to trade and not a fine for breaking the law.
- Provisions for future costs as per IAS are allowable.
- Pre-trading expenditure is allowable if it is incurred in the seven years before a business start to trade and follows the above rules.
- Depreciation, amortisation and loss on sale non-current asset is disallowed.
- Expenditure relating to proprietors car, telephone ------ etc is disallowed.
- Salaries accrued at year end are allowable if paid within 9 month after year end.
- Redundancy, loss of office, Removal expenses and counseling service for redundant employees is allowable
- Insurance expense and Patent Royalties are allowable.
- Loss due to theft or fraud by employee (not owner or not director) is allowable if not covered by insurance.
- Payment of class 1 (employee) NIC, Class 2 NIC, Class 4 NIC are disallowed.
- Payment of class 1 (employer) NIC, and Class 1A NIC is allowable.
- Employer contribution to pension scheme for employee is allowable.
- Business portion of owner's private expenses or is allowable (e.g telephone).
- Capital allowances are allowable.
- The **general rule** is that expenditure not wholly and exclusively for the purpose of the trade is not allowable. **Remoteness test** and the **duality principle** are considered for this purpose.

CHAPTER 6

CAPITAL ALLOWANCES

Capital allowances are available on plant and machinery, *calculated for a trader's period of account and deducted from trading profit.* If Period of account exceeds 18 months then it must be split in two periods of account 1st of 12 moths and 2nd of remaining months. Capital allowances are calculated for each period of account separately.

- Plant and machinery is something with which a trade is carried on except doors, walls, windows, ceiling, floors and water system, electrical system, gas system.
- If a business is VAT registered all additions of plant and machinery are recorded at the VAT exclusive price except cars which are included at the VAT inclusive price.
- If a business is not VAT registered all additions are included at the VAT inclusive amounts.
- Pre-trading capital purchases (if incurred in the seven years before trade commenced) are treated as acquired on the first day of trade at its market value on that day.

- Capital allowances are given on original cost and any subsequent capital expenditure. Cost of alterations to the building needed for installation of plant and computer software cost will also become part of plant & machinery.
- **Replacement expenditure** also qualifies for capital allowance where more than 50% of an asset is replaced in a 12-month period. This prevents substantial repairs being treated as revenue expenditure for tax purposes.
- **Hire Purchase (finance lease) assets** are recorded as plant & machinery at date of contract at market value exclusive interest. Interest paid is allowable trading expense.
- Partial claim for capital allowances are allowed so an individual claim full, partial or no capital allowance if he considers it advantageous.

Classification of Plant and Machinery

➢ SPECIAL RATE POOL

Following P&M will become part of special rate pool

- **Long-life assets:** it includes P&M with a working life of 25 years or more (when asset is brought into use for the first time) and annual running cost of ≥£100,000. ***Note:*** Cars and P&M in a building which used as a retail shop, showroom, hotel or office, can never be classified as long life asset.
- **'Integral features' of a building:** it includes Electrical & general lighting systems, Cold water systems, Space or water heating systems, Powered systems of ventilation, cooling or air purification and Lifts and escalators
- **Motor cars (both new & second hand) with co2 emissions > 130g/km**
- **Thermal insulation of building.**

➢ GENERAL POOL OR MAIN POOL

- The cost of most of the plant and machinery purchased by a business becomes part of a pool called main pool on which capital allowances may be claimed.
- New or second hand Cars having co2 emission between 76g/km–130g/km are included in main pool.
- Second hand cars with co2 emissions of 75g/km or below
- Addition increases the amount of pool and disposal reduces the amount of pool.

➢ SHORT-LIFE ASSETS (SLA)

- P&M except cars which individual wishes to sell or scrap within 8 a year after the end of the period of account in which asset is purchased are called short-life assets. Every short life asset is kept in separate pool.
- Election (written notice to HMRC) must be made for SLA this is called de-pooling.
- AIA and WDA are available as normal.
- Balancing allowance or charge arises on disposal..
- If no disposal takes place within eight years after the accounting period of purchase the remaining balance is transferred to the general pool immediately.

➢ PRIVATE USE ASSETS

- If owner uses an asset for private purposes, capital allowances are given only on business proportion. Every private use asset is kept in separate pool.
- On disposal of asset, balancing charge (if profit) or a balancing allowance (if loss) will arise which is then reduced to business proportion.
- Private use of an asset by an employee has no effect on capital allowances.

➢ SALE OF PLANT AND MACHINERY

On disposal of P&M deduct the lower of the sale proceeds and the original cost from the total of; TWDV brought forward on the pool **plus** Additions to the pool.

Categories of Capital Allowance.

➢ ANNUAL INVESTMENT ALLOWANCE (AIA)

- It is allowance of £500,000 p.a. on new purchased P&M other than cars.
- Value of new purchased P&M which exceeds £500,000 p.a. will be transferred to relevant pool and WDA of 18% or 8% may be claimed.
- £500,000 limit is prorated for short and long period of accounts.
- No AIA is available in the year of cessation of trade.
- Taxpayer has the option to claim full or partial AIA or even no AIA if it does not want to. However any unused AIA will be wasted.
- It is most beneficial to claim the AIA in the following order:

a) Special rate pool **b)** General pool **c)** Short life assets **d)** Private use assets

Related Businesses

- Only one AIA is available to related businesses.
- Businesses owned by the same individual are regarded as related where they engage in the same activities or share the same premises.
- In such circumstances the owner of the businesses can choose how to allocate a single AIA between them.
- Unrelated businesses owned by the same individual will each be entitled full AIA.

➢ WRITTEN DOWN ALLOWANCE (WDA)

- WDA is available on **net value** (WDV plus addition less disposal).
- WDA of 18 % on reducing balance method is given each year on "Main Pool" If net value is positive.
- WDA of 8% on reducing balance method is given each year on "Special Rate Pool" net value is positive.
- If net value in special rate pool or main pool is negative then Balancing charge will arise and deducted from capital allowance column.
- Full WDA is given in year of purchase and no WDA is given in the year of disposal.
- WDA of 8% or 18% is prorated where a period of account is ≤ 12 months.
- WDA will be restricted to business proportion if there is a private use of the asset.

➢ FIRST YEAR ALLOWANCE (FYA)

- FYA of 100% is available in the year of purchase on Purchase of new low emission cars. (75 g/Km co2 or less).
- Taxpayer has the option to claim full FYA, partial FYA or even NO FYA. However if partial FYA is claimed then remaining amount will go to main poll but no WDA will be given in that year.
- FYA is not time apportioned if accounting period is short or long than 12 months.
- No FYA is available in year of cessation of trade.

➢ Small balance claim

- If the Balance in the main pool or special rate pool remains less than £1000 than all amount in the pool is written off and transferred to allowance column.
- £1000 limit is for 12 month period so it must be prorated for short and long period of accounts.

➢ CARS

- Cars emitting ≤ 75 g/km co2 (low emission Cars) are eligible for FYA of 100%.
- Second hand motor cars emitting 75 g/km co2 or less are included in main pool.
- Both new and second hand Cars emitting CO2 between 75 g/km to 130 g/km are included in main pool.
- Both new and second hand Cars emitting CO2 over 130 g/km are included in special rate pool.
- If there is private usage of car by proprietor (Not employee) than only business proportion of the capital Allowance can be claimed.

➢ Cessation of trade

- Not FYA, AIA and WDA is available in last year of trade.
- Add addition and deduct disposals made in last period of account from the relevant pool.
- Calculate balancing allowance (if loss) or balancing charge (if profit) as appropriate.
- If business is sold (transfer controlling interest) to a connected person as a going concern; an election can be made to HMRC to transfer the asset TWDV (instead of market value) and avoid Balancing Charge or Balancing Allowance.

Balancing Allowance (BA)/Balancing Charge (BC)

Net Value = (WDV plus addition less disposal).

Main Pool **(MP)** and Special Rate Pool **(SRP)**		Private Use Asset and Short Life Asset	
NET value Positive	**NET value Negative**	**NET value Positive**	**NET value Negative**
Regular years = WDA (8% /18%) Cessation Year = BA	Regular years = BC Cessation year = BC	Regular years = WDA (8% /18%) Disposal Year = BA Cessation year = BA	Regular years = BC Disposal Year = BC Cessation year = BC

Proforma capital allowances computation:

		Main Pool	Special Rate Pool	Short Life asset 1	Short Life asset 2	Private Use Assets 1 (Business %)	Private Use Assets 2 (Business %)	Allowance
	£	£	£	£		£		£
WDV b/f		X	X	X		X		
Purchase of CAR which Qualify for FYA								
Motors Cars CO2 ≤ 75 g/Km	X							
FYA @ 100%	(X)							X
Purchase of CAR which don't Qualify AIA								
Cars CO2 emission 76 – 130 g/km		X						
Cars CO2 emission of > 130 g/km			X					
Additions qualify for AIA (£ 500,000)								
a) Special Rate Pool Additions	X							
Less: AIA	(X)		X					X
b) Main Pool Additions	X							
Less: AIA (Remaining Amount)	(X)	X						X
c) Short Life Assets	X							
Less: AIA (Remaining Amount)	(X)				X			X
d) Private Use Assets	X							
Less: AIA (Remaining Amount)	(X)						X	X
Disposals:								
Lower of cost and Selling Price		(X)	(X)	(X)		(X)		
		X	X	X/(X)	X	X/(X)	X	
WDA @ 18%		(X)						X
WDA @ 8%			(X)					X
WDA @ 18%/8%					(X)		(X)	X
Balancing Allowance/Balancing Charge				X/(X)		X/(X)		X/(X)
		X	X	X	X	X	X	X

CHAPTER 7
BASIS PERIOD

Rules for matching tax adjusted profits of business with tax years are called basis period rules.

<table>
<tr><td>1st Year Rule</td><td colspan="3">1st Basis period will be from start of trade to following 5th April.</td></tr>
<tr><td rowspan="5">2nd Year Rule</td><td colspan="3">Closing date of 1st period of account falls in 2nd tax year.</td></tr>
<tr><td colspan="2">Yes</td><td>No</td></tr>
<tr><td colspan="2">Check length of 1st period of account</td><td rowspan="3">B.P = 2nd Tax Year</td></tr>
<tr><td>≥ 12 Months</td><td>< 12 Months</td></tr>
<tr><td>B.P will be 12 month back from closing date of 1st period of account.</td><td>B.P will be next 12 month from start of trade.</td></tr>
<tr><td>3rd &amp; subsequent year Rule</td><td colspan="3">B.P will be 12 month back from closing date that falls in relevant tax year.</td></tr>
<tr><td colspan="4">NOTE: Some profits may fall into more than one basis period in the opening years and are known as <i>overlap profits.</i> An 'overlap', relief will be available on cessation, or sometimes, on change of accounting date.</td></tr>
<tr><td>Closing Year Rule</td><td colspan="3">1) Identify the last tax year 2) Make B.P by using subsequent year rule except last tax year.
3) Last B.P will be from next date of previous B.P till date of cessation.</td></tr>
<tr><td>Change of accounting Date.</td><td colspan="3">An unincorporated business is allowed to change its accounting date if certain conditions are met.
Conditions to be met:
• Must be notified to HMRC on or before 31 January following the tax year in which change is to be made.
• The first new period of account must not exceed 18 months in length,
• If first new period of account is longer than 18 months, then two sets of accounts will have to be prepared.
• There must not have been another change of accounting date during the previous five tax years. (This condition may be ignored if HMRC accept that present change is made for genuine commercial reasons.)</td></tr>
</table>

Basis Period for the tax year in which accounting date changes			
Short period of account and one closing date end in a tax year.	**Short period of account and two closing dates end in a tax year.**	**Long period of account and closing date end in a tax year.**	**Long period of account and no closing date end in a tax year.**
B.P will be 12 month back from new accounting date.	B.P will be from start of previous period of acc. till new accounting date.	B.P for that year will be same as new accounting period.	1. Take new accounting date. e.g. 30 June 04 2. Deduct 12 month from this date. 30 June 03 3. B.P will be 12 month back from this date.
This will create further overlap profit	Overlap profit relief will be given upto months exceeding 12 months.	Overlap profit relief will be given upto months exceeding 12 months.	This will create further overlap profit

Choice of accounting date

➢ Just after 5 April. • Maximum time to pay tax. • Increased overlap profit. • Maximum time for planning	➢ Just before 5April • Less time to pay tax. • No overlap profit • Less time for planning

CHAPTER 8
TRADING LOSSES

If the basis period has a trading loss, the trading profit assessment to include in the income tax computation is nil. But remember trading loss can never be overlapped.

➢ Carry forward of trading losses (S.83)

- Trading loss may be carry forward and set-off from first available future trading profits from same trade.
- Losses may carry forward for indefinite number of years until all the loss is relieved.
- Partial claim is not allowed.
- Claim must be made to carry forward trading losses within 4 years from the end of year of loss. E.g until 5 April 2020 for losses arising in 2015/16.
- It is disadvantageous from perspective of *cash flow, time value of money, uncertainty about future profit and relief may take long time to materialise*.

➢ Loss relief against total net income

- Trading Losses may be set-off from total net income of:

a) Current year only **OR** b) Previous year only **OR**

c) Current year and then previous year **OR**

d) Previous year and then current year.

- Partial claim is not allowed.
- Remaining loss after claim against total income may be:
  - Set off against capital gains
  - Set off against future trading profit.
- *CAP limit for Current Year:* Maximum loss that can be deducted from current year is *higher of:*
  - £50,000
  - 25% of adjusted total income

Adjusted Total Income: Total net income less gross personal pension contribution.

- *CAP limit for previous Year:* Maximum loss that can be deducted from previous year is *previous year CAP limit (as above) plus previous year trading profit.*
- Claim for loss relief must be made by 31 January which is 22 months after the end of tax year of loss. E.g until 31 January 2018 for losses arising in 2015/16.

➢ Relief of trading losses against capital gains

- Under this section current year trading loss can be set off against the chargeable gains of:

a) Current year only **OR** b) Previous year only **OR**

c) Current year and then previous year **OR**

d) Previous year and then current year.

- Claim against chargeable gain can only be made if a claim against total income has been made in that tax year first.
- Partial claim is not allowed.
- Claim for loss must be made by 31 January which is 22 months after the end of tax year of loss. E.g until 31 January 2018 for losses arising in 2015/16.

➢ Relief of trading losses incurred in early years of trade (opening years loss relief)

- Loss can never be overlapped. So loss considered in B.P of one tax year will not be considered in next tax year.
- Trading loss incurred in any of the first Four Tax years of trade then this loss may be set off against total income of previous 3 years on FIFO basis.
- Early years trading loss can be relieved through:

a) Opening year loss relief **OR b)** Relief against total income **OR c)** From Capital gains **OR d)** From future trading profit

- Partial claim is not allowed.
- Claim for loss relief must be made by 31 January which is 22 months after the end of tax year of loss. E.g until 31 January 2018 for losses arising in 2015/16.

- **Terminal loss relief:** If trade ceases then Loss of last 12 month of trade may be set off against trading income of previous 3 years on LIFO basis. The terminal loss is loss of the final 12 months of trade, calculated as follows:

Trading loss from 6 April (before cessation) till date of cessation.	(XX) nil if profit
Trading loss for period starting 12month before date of cessation till the following 5 april.	(XX) nil if profit
Overlap Profits	(XX)
Terminal loss	(XX)

- Claim must be made within 4 years from the end of year of loss. E.g until 5 April 2020 for losses arising in 2015/16.

- **Business transferred to a company:** Relief is available for trading losses on incorporation of an unincorporated trade. Trading losses are carried forward by individual and deduct from first available income from the company eg salary, dividends or interest. Losses are set off firstly against earned income and then unearned income

  Conditions: At least 80% of the consideration for the business given by the company must be in the form of shares and owner must continue to own the shares in the year that he relieves the loss.

	Opening year	Ongoing years	Closing years
Relief against total income	√	√	√
Relief against chargeable gains	√	√	√
Carry forward of trading losses	√	√	x
Opening years loss relief	√	x	x
Terminal loss relief	x	x	√
Incorporation relief	x	x	√

- **Choice between loss reliefs:**

  a) Quick loss Relief **b)** maximum tax saving **c)** personal allowance do not waste

CHAPTER 9
PARTNERSHIP

A partnership is a single trading entity. Each individual partner is effectively treated as trading in his own right and is assessed on his/her share of the adjusted trading profit of the partnership.

- **Trading income:** Partnership's tax adjusted profits or loss for an accounting period is computed in the same way as for a sole trader and Partners' salaries & interest on capital are not deductible: these are an allocation of profit.
- **Allocations of trading profit/trading loss:** Trading profit/trading loss for the accounting period is divided between partners according to their profit sharing ratio but after deduction of Partner's salaries and interest on capital.
- **A change in the profit sharing agreement:** If the profit sharing agreement is changed during a period of account, the profit must be time apportioned before allocation to partners.
- **Partnership capital allowances:** Capital allowances are deducted as an expense in calculating trading profit. If assets are used privately, the business proportion is included in the partnership's capital allowances computation.
- **Commencement and cessation:**
  - Rules for commencement and cessation are same as for sole trader. Profit is allocated between the partners for accounting period; then the assessment rules are applied and each partner is effectively taxed as a sole trader.
  - When a partner joins a partnership, he is treated as commencing and when a partner leaves a partnership he is treated as ceasing. Each partner has his own overlap profit available for relief.
- **Change in members of partnership:** Until there is at least one partner common to business before and after the change, partnership continues. Commencement or cessation rules apply to individual joining or leaving partnership.
- **Partnership Losses:** Losses are allocated between partners in same way as profits & Loss relief claims available are same as for sole traders. A partner joining the partnership may claim opening year loss relief, for losses in the first four years of his membership of partnership. A partner leaving a partnership may claim terminal loss relief.
- **Partnership investment income:** Interest and dividend income is kept separate from trading profit but are shared among partners according to their profit sharing ratio. After sharing income each partner is taxed independently.
- **Limited Liability Partnership:** If partnership is limited liability partnership then the partners share the trading loss among themselves up to maximum of capital they have contributed in the partnership.

PARTNERSHIP CAPITAL GAINS

Each partner:

- Deemed to own a fractional share (as per profit sharing ratio) of every asset of partnership.
- Taxed in his own right on his share of partnership gains along with his own personal gains.
- Annual exemption and CGT relief is available in normal way.

➢ **Disposal of partnership Assets to third party:**	➢ **Distribution to partners**
• Calculate gains as normal • Allocate the gain between partners	Chargeable gain arise on a partner selling his partnership share Partner purchasing partnership share is also liable to gain as per partnership share but It can be deferred against base cost of asset.

➢ **Change in partnership agreement after Revaluation:**

- No charge to CGT unless occurs after a revaluation in the accounts.
- If there has been revaluation, Normal gain computation Using statement of financial position value of asset as consideration.

CASH BASIS FOR SMALL BUSINESSES

Cash basis means profit will be calculated on the basis of cash received and expenses paid in the period of account.

Unincorporated businesses (i.e. sole traders and partnerships) having **annual turnover under the VAT registration limit** £82,000 can **choose** to calculate profits / losses on **cash basis rather than the normal accruals basis.**

Note:

- The cash basis option is not available to companies, and limited liability partnerships (LLPs)
- If annual turnover is twice the VAT registration limit (£162,000) then business will not allowed using this scheme.

➢ **Under the cash Basis:**

- A business can prepare its accounts to any date in the year on the basis of cash receipts and payments.
- there is no difference between capital and revenue expenditure on plant & machinery for tax purposes:
  - Purchases are allowable deductions when paid for, and
  - Proceeds are treated as taxable cash receipts when an asset is sold.
- *A flat rate expense deduction for motor car expenses is claimed instead of capital allowances.*

➢ **Advantages of cash basis:**

- Simpler accounting requirements as there is no need to account for receivables, payables and inventory
- Profit is not accounted for and taxed until it is realised so cash is available to pay the associated tax liability.

➢ **Disadvantages of cash basis:**

- Losses can only be carried forward to set against future trading profits, whereas under the accruals basis many more options for loss relief are available.

➢ **Flat rate expense deduction option for any unincorporated business**

The flat rate expense adjustments replace the calculation of actual cost incurred in the following cases:

Type of expense	**Flat rate expense adjustment**
Motoring expenses	Allowable deduction = Approved millage allowance of 45p and 25p as in employment
Private use of part of a commercial building (e.g. private accommodation above a shop)	Private use adjustment re household goods and services, food and utilities = fixed amount based on the number of occupants (will be given in exam question)

CHAPTER 10
CAPITAL GAIN TAX - INDIVIDUALS

1 Introduction

CGT is charged on gains arising on chargeable disposals of chargeable assets by chargeable persons.

➢ **Chargeable Disposal:** An asset is regarded as disposed, if its ownership changes. E.g. Sale of whole or part of an asset, Gift of an asset, Loss or total destruction of an asset.

Date of disposal:

Event	**Date of disposal**
Normal	Date of contract or agreement for disposal of asset.
Conditional contract	Date when all the conditions are satisfied and contract become legally binding.
Death transfer or transfer to charity	No CGT implication

➢ **Chargeable Assets:** All assets are chargeable unless specifically exempt. E.g. land & building, goodwill, short lease, long lease, unquoted shares, quoted shares, unit trusts, some chattels.

Exempt assets include:

- Motor vehicles (including vintage cars)
- National Savings & Investment certificates
- Cash, Debtors and trading inventory
- Decorations awarded for bravery
- Works of art given for national use
- Gilt edged securities
- Qualifying Corporate Bonds
- Company loan notes

- Damages for personal injury
- Shares in VCT
- Endowment policy proceeds
- Foreign currency for private use
- Some Chattels
- Investments held in an NISA
- Prizes and betting winning

- **Chargeable Person:** An individual who is resident in the UK is liable to pay UK CGT on his worldwide gains and non-resident person in UK will pay CGT on his UK gains only.

Pro Forma to Calculate Capital Gain/Loss on Individual Assets

Disposal proceeds	X
Less: Incidental cost of disposal	(X)
Net proceeds	X
Less: Allowable Costs (Purchase price, Incidental cost for purchase, Capital improvements)	(X)
Capital Gain / (Capital loss)	X/(X)

- **Disposal proceeds**

- Disposal Actual consideration is used when the transaction is made at arm's length.
- Market value is used in other cases for example when the disposal is a gift
- Disposal proceeds will be the Actual Selling price if Disposal is made to an **unconnected Person** and Disposal proceeds will be the Market value of asset disposed off if Disposal is made to a **connected.**

- **Other Allowable Costs**
  - Cost of acquisition and any incidental costs of acquisition (Normally actual purchase price or market value in case of gift at gift date or probate value for inherited assets.)
  - Capital expenditure on enhancing the value of the asset
- **Incidental costs:**
  - Fee & commission of agent, legal fee, advertising cost, auctioneers fee, agency fee

2 DISPOSALS TO CONNECTED PERSONS

Definition of connected persons

An individual is connected to the following persons:

- Spouse
- Direct relatives (brothers, sisters, ancestors and lineal descendants) and their spouses
- Spouse's direct relatives and their spouses
- Business partners and their spouses and direct relatives.

Disposal to connected persons other than spouse

- Where an asset is disposed of to a connected person full market value of the asset at the date of disposal will be considered as disposal proceeds.
- If a disposal results in an allowable loss, it can only be set against gains from disposals in the current or future years to the same connected person.

Inter-spouse transfers

The transfer of assets is at No gain/ No loss (in other words at cost).

- **Tax Planning**

- Utilising Annual Exemption
- Utilising Basic Rate Band
- Timing of disposal
- Utilising Capital Loss: Capital loss cannot be transferred between spouses. It is possible to transfer loss making asset between spouse at no gain no loss so that the other spouse can utilize the loss resulting from that asset.

Pro Forma to Calculate Capital Gain Tax (CGT)

Capital Gain on disposal of asset	X
Less: Capital loss on disposal of asset	(X)
Net Capital Gains in tax year	X
Less: Capital losses brought forward	(X)
Less: Trading loss (S-261B)	(X)
Net Capital Gains	X
Less Annual exemption	(11,100)
Taxable Gains	X

- **Annual exemption:** Every individual has an exempt amount for each tax year. For 2015/16 it is £11,100
- **Rates of CGT:** CGT rates are determined after considering a taxable income. CGT rate of 18% is applied on gains up to remaining basic rate band of £31,785. CGT rate of 28% is applied on gains in excess of the basic rate band.

- **Payment of CGT**

Normally: CGT is due in one amount with income tax under self-assessment on 31 January following the tax year (2015/16 by 31 January 2017)

Payment by installments: CGT can be paid by installments if disposal proceeds are received in more than 18 months. CGT can be paid over the period in which consideration is received but upto maximum of eight years.

CGT can also be paid by installments in case disposal through gift but only if this gift does not qualify for gift relief. In this case CGT may be paid in ten equal annual installments starting from normal due date.

3 Capital Losses

a) **Current Year Capital loss:** Capital losses are deducted from capital gains of the same tax year; the unrelieved capital losses may be carried forward and deducted from future capital gains but up to the level that the annual exemption do not waste.

b) **Brought forward Capital Loss:** Still any unrelieved capital loss will be carried forward and deducted from capital gains of future years.

c) **Death year capital loss:** capital losses in the year of death can be deducted from net capital gain of last 3 years on LIFO basis.

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

4 Capital Gains: Special Rules

4.1 Asset Lost or Destroyed

Asset Lost or Destroyed

No Insurance Proceed	**Insurance Proceed Received**		
	No Replacement of Asset	**Replacement of Asset within 12 Months**	
		Full Reinvestment: No gain/no Loss	**Partial Reinvestment:**
Disposal Proceed Nil Allowable cost (X) Capital Loss ...X....	Normal CGT calculation.	Insurance Proceed X Less: Allowable cost (X) Capital Gain X Roll-Over Relief (X) Nil Base Cost of New Asset. Cost of new Asset X Gain Roll Over (X) Base cost of new asset ...X...	Some gain is chargeable immediately which is lower of: a) Total gain b) Proceed not reinvested Gain Deffered will be = total gain less gain chargeable immediately

4.2 Asset Damaged

Asset Damaged

No Insurance Proceed	**Insurance Proceed Received**	
No Disposal	**Not Used to Restore the Asset:** Treat as Part Disposal. Disposal Proceed X Allowable cost: Original cost X $\frac{A}{A+B}$ (X) Gain/ Loss X A= insurance proceed B= M.V of damaged asset	**USED TO RESTORE ASSET WITHIN 12 MONTHS** **Used ≥ 95% of insurance proceed to restore asset:** Part disposal unless Taxpayer can elect to defer the gain. If defer there is no part disposal and deduct insurance proceed from the cost of restored asset. Cost of restored asset (original + restore cost) X Less: Insurance Proceed (X) Revised base cost (X) **Used < 95% of insurance proceed to restore asset:** *Part disposal unless Taxpayer can claim relief:* If relief is claimed then still it will be part disposal but using after restoration value as: DP (insurance proceed – restoration cost) X Allowable cost: Original cost X $\frac{A}{A+B}$ (X) Gain/ Loss X A= insurance proceed – restoration cost B= M.V of asset after restoration

4.3 Part Disposal if there is a part disposal of an asset then gain or loss on that asset can be calculated as follows.

Disposal Proceed	X
Less: Allowable cost **[** Cost x A/A+B **]**	(X)
	X

A= market value of part disposed off
B= market value of remaining part

Small Part Disposal of Land and Buildings:

- It is applicable on land and buildings only. Proceeds are considered small if proceed from part disposal:

a) ≤ 20% of M.V of land & buildings before part disposal
b) Proceeds are ≤ £20,000 from all land sales in whole tax year

- If proceed from disposal of land and buildings are small then it can be treated as **Part disposal or an election can made to defer the capital gain** arise on small disposal.
- **If election is made**, there is no part disposal and gain is deferred by deducting the Small Part Disposal proceed from original cost of land and building.

4.4 Chattels: A chattel is a tangible moveable asset.

➢ **Non-Wasting Chattels:**

Chattels with remaining life of >50 years are called **Non-wasting chattels.** E.g. Antiques and paintings.

chargeable gain or capital loss is calculated as follows:

Cost	Proceeds	Treatment
≤ £6,000	≤ £6,000	Exempt
> £6,000	> £6,000	Normal calculation

➢ **Wasting Chattels:**

Chattels with remaining life of ≤50 years are called **wasting chattels.** These are exempt from CGT. E.g. racehorses, boats, plant & machinery and greyhounds.

Plant & Machinery: There is an exception for P & M on which capital allowances have been claimed.

- If asset is sold at a gain then we apply £6,000 rule.
- If asset is sold at loss it will be ignored for CGT purpose.

➢ **Other Wasting Assets not Chattels:** It includes those wasting assets that are not tangible and/or not moveable. The allowable cost of these assets is deemed to be reduced over the life of asset on straight line basis.

Disposal Proceed	X
Less: Allowable cost = (Cost – Scrap Value) X $\frac{\text{Remaining life at disposal}}{\text{Total useful life}}$	(X)
Less: Scrap Value	(X)
Chargeable Gain/Loss	X

4.5 Lease **Assignment of lease** means complete disposal of the leasehold interest in property.

Assignment of short lease (≤ 50 years)

Allowable cost = original cost X $\frac{\text{\% of remaining life of lease}}{\text{\% of total life of lease}}$

Assignment of long lease (> 50 years)

Treat as normal disposal

5 DISPOSAL OF SHARES (individuals)

5.1 Valuation rule for shares

➢ **Unquoted shares:** Market value will be given in exam.

➢ **Quoted shares:** When quoted shares are gifted, Market value of share will be mid-price based on the day's quoted price:
(Highest quoted price + Lowest quoted price)/2

❖ **Matching Rules on Sale of Shares (Individuals)**

Shares sold will be matched in the following order:

a) Shares purchased on the same day
b) Shares purchased on the following 30 days of sale
c) Shares from Share Pool

Share Pool: Contains all shares purchased before date of disposal and consist of two columns; 1st of Number of shares and 2nd of Cost of shares.

5.2 RIGHT SHARES:

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

5.3 BONUS SHARES:

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

5.4 Sale of right nil paid:

If shareholder who is offered right issue does not wish to purchase further shares instead sell right to buy shares to another person this is known as sale of right nil paid.

Selling Price received is: >5% of the value of shares on which right offered **&** Amount is >£3,000	
YES	**NO**
Deemed part disposal of original shares held.	• No disposal at time of sale of right nil paid • SP is deducted from original cost of shares

5.5 REORGANISATION AND TAKEOVER

REORGANISATION: Exchange of existing shares in a company for other shares of another class in the same company.

TAKE-OVER: When a company acquires shares in another CO. either in exchange for shares, cash or mixture of both.

➢ **Consideration in Shares only**

- No CGT at the time of takeover or reorganisation.
- Cost of original shares becomes cost of new shares
- Where more than one type of shares is received, then cost of original shares is allocated to new shares by reference to market value of new shares.

➢ **Consideration in cash and shares**

- **Value of cash element is small:** If cash received is *≤5% of Market value of total consideration received* **or** *≤ £3,000*.

No CGT implications deduct cash from original cost of shares

- **Value of cash element is not small:** It is treated as part disposal and gain or loss is calculated is follows:

Disposal Proceed (cash)	X
Less: Allowable cost	
Cost of original shares $\times \dfrac{\text{Cash Received}}{\text{Cash Received + M.V of new shares}}$	(X)
	X

➢ **Mixed consideration including QCBs:** Capital gain is calculated at the time of takeover as QCB were cash but gain is not taxable at that time instead it is frozen until the disposal of QCBs at later date.

At subsequent disposal gain arise on QCBs is exempt but gain frozen previously will be taxable at that date.

5.6 Liquidation of a company:

Assets & liabilities of business are settled and surplus assets are distributed among shareholders. Shareholders are deemed to dispose their shares for receipt from liquidator resulting capital gain/loss

CAPITAL GAIN	CAPITAL LOSS (we have two choices)	
Normal treatment	Normal treatment.	Treat it as trading loss and deduct it from total income of current year and/or previous year if following conditions are satisfied: **Conditions:** • Loss has arisen at liquidation of the company. • Loss has arisen from ordinary shares of unquoted company. • The company must be a trading company not involved in excluded trading activities. • Shares must have been subscribed for not purchased.

5.7 Transfer of assets into trust:

Lifetime gift to trust: considered as chargeable disposal for CGT and disposal proceeds will be the market value at date of gift. Gift relief may be available as there is an immediate charge to IHT (see later in the chapter)

Death Gift to Trust: Exempt from CGT. Trustees acquire the asset at probate value (market value at death date)

6 CGT Reliefs for Individuals

6.1 Principal Private Residence Relief (PPR relief):

It applies when an individual disposes off his only or main private residence or dwelling house which he owned. If an individual has more than one residence, he can nominate one residence as his principal residence by notifying HMRC in written. *Married Couple/Civil Partners* are entitled to only one residence between them for the purpose of Principal Private Residence exemption.

➢ **Calculating the Relief:** If a person lives in PPR during the whole period of ownership the whole gain is exempt. Where there has been a period of absence from PPR the procedure is as follows.

Capital gain on disposal	X
Less: PPR Relief = Gain $\times \dfrac{\text{Period of occupation}}{\text{Period of ownership}}$	(X)
Chargeable gain after relief	X

➢ **Periods of occupation:** Period of occupation includes periods of both ***Actual occupation and Deemed occupation***

Deemed occupation: Periods of deemed occupations are:

a) Last 18 months of ownership

b) Up to 3 years of absence for any reason

c) Any period spent working abroad

d) Up to 4 years of absence while working in the UK.

- Point's ***b-d*** will only apply if at some time both before & after period of absence there is a period of actual occupation by the owner. Reoccupying is not necessary for point c and d if prevented by terms of his employment.

- **Business use:** Where part of a residence is used for business purposes throughout period of ownership, relief is not available on gain related to that part.
- **Letting relief:** Letting relief is available to cover any gain not covered by PPR if Owner is absent (not covered by deemed occupation rules) and the property is rented out or Part of the property is rented out, the remaining part being occupied by the taxpayer. Letting relief is the *lower of*:

  a) PPR relief given **b)** £40,000
  c) Gain related to letting period **{**Total gain x (letting period/ownership period)**}**

6.2 Entrepreneurs' relief: Relief covers the first £10m of qualifying gains that an individual makes during **their lifetime.** This gain qualifying is taxed at a lower capital gains tax rate of 10% regardless of a person's taxable income. *Relief must be claimed within 22 months from end of tax year of disposal*. For 2015/16 by 31 January 2018.

- **Qualifying Business Disposals:**
- Disposal of the whole or part of a business (which can operate independently) runs as an unincorporated business (both sole trader & partnership.)
- Disposal of assets of sole trader or partnership trading business within 3 years from cessation.
- Disposal of shares if:
  - Shares are in individual's *personal trading company* and he is also an *employee* (full time or part time) of CO. (CO. in which individual owns ≥5% of ordinary shares & ≥5% voting right is called personal trading company.)
- **Qualifying Ownership Period:** The assets must have been *owned for one year* prior to the date of disposal
- **Further points**
- Relief is not available on gains arising from disposal of individual assets or assets held for investment purpose.
- The annual exemption and any capital losses should however be deducted from gains that do not qualify for entrepreneurs' relief as they are taxed at a higher capital tax gains rate (18% and/or 28%)
- Easy way is to keep the gains, qualifying for entrepreneur's relief and not qualifying in separate column.
- **Restriction of ER in respect of goodwill:** gains in respect of goodwill will not qualify for ER if the goodwill is transferred to a close company and individual and company are related (individual is shareholder in company or an associate of a shareholder.)
- **Associated disposals:** Entrepreneurs' relief is also available in respect of associated disposals.

Associated disposals are disposals of assets:

- owned by an individual but used by his personal trading company or a partnership in which he is a partner **and**
- Disposal takes place at the same time as the sale of the partnership/company.

For full relief the individual must not have charged rent from business for use of these assets.

6.3 Roll-Over Relief: Roll-over relief means postponed or deferred gain. The gain is not taxed immediately but is postponed until the individual makes a disposal of the replacement asset.

- This relief is available if a *qualifying business asset is sold* and another *qualifying business asset is purchased* within the *qualifying time period*.
- Base cost of new asset is calculated by deducting the gain on old asset against the cost of new/ reinvested asset.
- An individual must claim the relief within 4 years from the end of the tax year of later of:
  a) When the disposal is made **or**
  b) Replacement asset is acquired
- **Qualifying Business Asset:** Rollover relief is available on assets which are used in business. Qualifying assets include *Land and buildings, Fixed plant & machinery (unmovable) and Goodwill.*
- **Qualifying Time Period:** New asset must be purchased within *1 year before and 3 years after disposal* of old asset.
- **Partial Reinvestment of Proceeds:** If there is full reinvestment of net sale proceeds roll-over relief is available on full gain. If there is partial reinvestment of net proceeds then part of the gain is taxable at the time of disposal. Gain Chargeable at the time of disposal **is lower of: a) Amount of proceed not reinvested. b) Full gain**
- **Non-business use** Full rollover relief is only available if asset being disposed was used entirely for business during whole period of ownership. If there is private use of asset rollover relief is only available on business portion.
- **Reinvestment in depreciating assets** "An asset with an expected life of ≤60 years (e.g. Fixed plant & machinery) is called depreciating asset." If replacement asset is a depreciating asset then gain deferred is not deducted from

cost of new asset (no calculation of base cost) Instead gain is postponed and will be taxable on earlier of:

(i) disposal of new asset **(ii)** Date the new asset ceases to be used in trade
(iii) 10 years after new asset was acquired

- **Tax planning**

- Unused annual exemption of current year & b/f capital losses is also available then do not claim roll over relief.
- If individual wants to retain some amount of cash out of disposal proceeds before reinvestment then it should be equal to the b/f capital loss plus annual exemption plus 261-B trading loss.
- If on disposal of whole of business, individual decide to reinvest the disposal proceeds then rollover relief and entrepreneur relief both will be available. However individual has to claim 1st rollover & then entrepreneur relief.

6.4 RELIEF FOR THE GIFT OF BUSINESS ASSETS

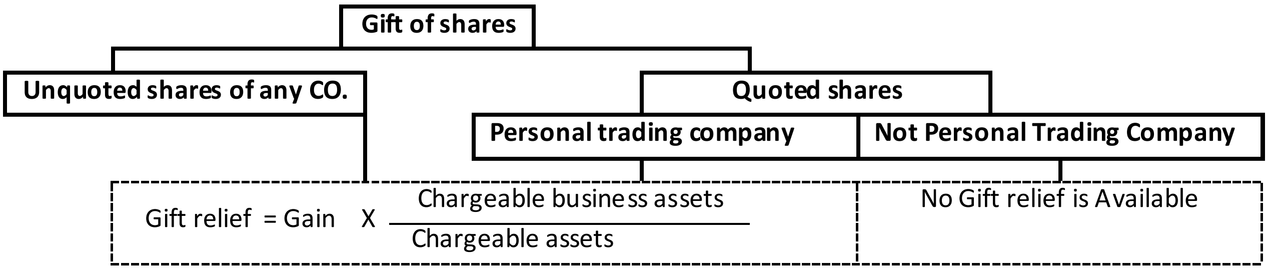
A gift relief is only available on **gift of qualifying business assets gifted or sold at under value by an individual.** Donor (person making the gift) is treated as making a disposal at market value and donee (person receiving the gift) is treated as if he had acquired a gift at market value. *When gift relief is claimed, the donor has no gain. The gain is deducted from the donee's cost (market value) In order to claim gift relief Donee must be Uk resident.* This can be illustrated as follows:

DONOR		**DONEE**	
Proceed	MV	Cost	MV
Less: Cost	(X)	Less: gain deferred	(X)
Gain	X		X
Less: Gain held over	(X)		
	Nil		

- **Availability of the relief:** Claim must be made by both donor & donee and must be made 4 years from the end of the tax year in which the disposal occurred. For a gift made in 2015/16 the claim must be made by 5 April 2020.

NOTE: Gift relief is optional, if not claimed the donor has a capital gain so he can utilize his annual exemption, entrepreneur relief, and may have to pay tax @ 0%, 10%, 18% or 28%.

- **Qualifying assets:** Gift relief may be claimed on the gift of the following assets:
  a) Assets used in the trade of Donor (Sole trader or partner in partnership) or Donor's personal trading company
  b) Unquoted shares and securities of any trading company.
  c) Quoted shares or securities of the individual donor's personal trading company. (CO. in which individual owns ≥5% of ordinary shares & ≥5% voting right is called personal trading company.)
  d) Agricultural property provided the conditions for inheritance tax agricultural property relief are satisfied
  e) Any asset put into a relevant property trust as there is an immediate charge to inheritance tax (note that gift relief is available even if no inheritance tax is actually payable)
- **Non-business use**: if an asset has some private use then only the business portion of the gain is eligible for relief.
- **Sale at undervalue:** (Gift relief is also available for sales made below market value and above cost.) Proceeds received above original cost are chargeable to CGT immediately and the remaining gain can be deferred.
- **Gift of Shares:**


Gift of shares
Unquoted shares of any CO.
Quoted shares
Personal trading company
Not Personal Trading Company
Gift relief = Gain X Chargeable business assets / Chargeable assets
No Gift relief is Available

- **Chargeable assets (CA):** Any asset, if sold would give rise to capital gain or loss is called chargeable asset.
- **Chargeable business assets (CBA):** Any chargeable asset that is used by business in his trade is called chargeable business asset. Shares, securities and other assets held as investments are not chargeable business assets.

- **The emigration of Donee:** Gift relief is available if Donee is UK resident at gift date. If donee emigrates from UK within 6 years from end of tax year of gift then amount of gift relief will be taxable for Donee the day before emigration. However gift relief will not become taxable if: done goes overseas for full time job; don't dispose of the asset whilst abroad and resume his status as UK resident within next 3 years.

6.5 Incorporation relief:

Incorporation relief is available when an individual transfers his business into company. On transfer into company, assets of the business are deemed to be disposed of at market value to the company.

➢ **Conditions for the relief:**	➢ **Operation of the relief:**
• All the assets of the business (other than cash) must be transferred • The transfer must be of a business as a going concern • Consideration must be wholly or partly in shares.	• Capital gain on business assets transferred to company is deferred by deducting it from the market value of the company's shares acquired. • If some consideration given by company for the assets is not shares (e.g. in cash) the capital gain eligible for incorporation relief is: $\text{Capital Gain} \times \frac{\text{Value of share consideration}}{\text{Total consideration}}$

➢ **Election to disapply incorporation relief:**

- An individual can elect not to receive incorporation relief. Election must be made by 31 January, 34 months after the end of tax year of disposal. This election might be made if the taxpayer has losses and/or annual exemption which would otherwise be deferred under incorporation relief.
- Incorporation involves disposal of whole or part of business so entrepreneurs' relief can also be claimed. If election is made to disapply incorporation relief, entrepreneurs' relief can then be claimed. This may be beneficial if only a very small amount of gains are left in charge and are taxable at the advantageous rate of 10%.

6.6 EIS deferral relief:

➢ **The operation of the relief:**

- An individual may defer a gain arising on disposal of any chargeable asset if he reinvests the disposal proceed into Enterprise Investment Scheme (EIS) shares.
- Deferred gain is not deducted from EIS shares but frozen and become chargeable on:

  a) Disposal of EIS shares or **b)** investor becomes non-UK resident within 3 years of issue of share.
- The amount of the gain that can be deferred is the *lower of:*

  A) Total gain **B)** The amount subscribed by the investor for his shares, and

  C) Any smaller amount than (a) and (b).
- Any amount not reinvested is charged to CGT.
- If both EIS deferral relief and entrepreneurs' relief can be claimed, individual must choose which relief to claim.

➢ **Conditions for the relief**

- The investor must be an individual who is UK resident at time the claim to defer the gain was made and at the time the investment was made in the shares.
- Reinvestment must be in the form of subscription of new shares for cash; in an unquoted UK trading company.
- Both Company and shares must be a qualifying company under the EIS rules. (See CH 1).
- Reinvestment must be made within four years which runs one year before and three year after disposal.
- A claim for relief must be made by 31 Jan 2022 for a gain on disposal in 2015/16.

6.7 SEIS reinvestment relief:

If an individual sold any chargeable asset which results a gain; and Reinvests the proceeds in qualifying SEIS shares:

➢ **The operation of the relief:**

Some of the gain arising on old asset will be exempt and calculated as follows:

Maximum SEIS exemption **= 50% of the lower of:**

(i) The amount of the gain

(ii) The amount reinvested in qualifying SEIS shares on which IT relief is claimed.

- Maximum investment can be made in SEIS shares is **£100,000/annum**; so maximum CGT **exemption is £50,000**
- **Carry back facility** is available means if annual limit of previous is unused; investment can be made in previous tax year. Reinvestment relief would be available in respect of gains made in 2013/14.
- The relief must be claimed (it is not automatic), and **partial claim is allowed**. the individual should choose an amount of relief so that the remaining gain is equal to any capital losses and AEA available.
- Reinvestment must be made within **four years** which runs one year before and three year after disposal.
- A claim for relief must be made by 31 Jan 2022 for a gain on disposal in 2015/16.

➢ **Withdrawal of SEIS relief:**

Relief will be withdrawn if shares of SEIS are sold within 3 years.

Not Sold at arm's length: all income tax relief will be withdrawn and capital gain exempted will become taxable.

Sold at arm's length: income tax relief will have to be repaid of lower of:

(i) original income tax relief **(ii)** 50% of selling price received on shares.

A proportion of the gain previously exempted will become taxable and calculated as follows:
Proportion = gain exempted X (Amount of IT relief withdrawn/original IT relief given)

Disposals of UK residential property by non-UK residents

From 6 April 2015, non-UK resident individuals are subject to capital gains tax on the disposal of interests in UK situated residential property.

In general **only the gain or loss accruing since 6 April 2015 is chargeable/allowable.** If the residential property was acquired before 6 April 2015 **the default method of calculating the gain or loss is:**

	£
Proceeds	X
Less market value of residential property at 5 April 2015	(X)
enhancement expenditure incurred after 5 April 2015	(X)
Gain/loss X/(X)	

The individual can make an election to use either of the following methods of calculating the gain or loss:

(a) **Straight line time apportionment of the gain/loss calculated under normal CGT rules** over the whole period of ownership with the part accruing after 5 April 2015 being chargeable/allowable; or

(b) **Whole period gain/loss**. This method may be useful where there is a loss on the property since it was acquired as it will allow the whole of the loss, not just the part accruing since 5 April 2015.

An individual who has NRCGT gains is entitled to the annual exempt amount. The rate of CGT on NRCGT gains depends on the total of the individual's taxable UK income and gains.

7.4.2 Interaction with replacement of business assets relief

If the UK residential property is a business asset under normal rules (for example, furnished holiday accommodation) replacement of business assets relief is only available if the new asset is also a UK residential property.

7.4.3 Interaction with gift relief

If the UK property is a qualifying asset for gift relief (again an example is furnished holiday accommodation), then gift relief is available on a gift to a non-UK resident person. This is an exception to the usual rule that gift relief is available only if the donee is UK resident. The exception applies because the residential property remains within the charge to CGT in the hands of the non-UK resident donee.

7.4.4 Interaction with PPR relief

PPR relief may be available on disposals of UK residential properties by non-UK resident individuals but is restricted for tax years where the individual is neither UK tax resident nor satisfies a 'day count test'. A similar restriction applies to UK residents who dispose of non-UK residential properties.

Where an individual has a NRCGT disposal of a main residence, principal private residence relief may be available for the period of ownership after 5 April 2015.

However, no period of actual occupation after 5 April 2015 is taken into account unless the individual (or his spouse/civil partner) was UK tax resident or satisfied the 'day count test' in the relevant tax year. The day count test is met if the individual (or his spouse/civil partner) stayed overnight at the property for at least 90 days in the tax year. If the property is owned for only part of a tax year, the day count test is scaled down in accordance with the period of ownership (eg if the property is owned for four months (one-third) of the tax year, then 90 days becomes 30 days).

The last 18 months of ownership are always treated as if it were **a period of occupation**, regardless of whether the individual satisfies the residence test or day count test during the tax year(s) for that period.

Letting relief is available if the property is let out regardless of whether the individual satisfies the residence test or day count test during the letting period.

Similar PPR rules apply to UK resident individuals who dispose of a residential property situated in a country in which neither they nor their spouse/civil partner are tax resident nor in which they satisfy the day count test in a tax year.

7 STAMP DUTY & STAMP DUTY LAND TAX

- **STAMP DUTY**

Stamp duty is ***charged on the transfer of shares and securities.*** It only applies to transfers made using a stock transfer form (i.e. paper transactions). ***No stamp duty is charged on the transfer of government stock, units in a unit trust or most company loan stock (unless it is convertible loan stock).*** Stamp duty is ***paid by the purchaser at the rate of 0.5%*** of the consideration. The duty is rounded up to the nearest £5.

- **STAMP DUTY RESERVE TAX:** As seen above, stamp duty only applies to the paper transfer of shares and securities. Where transfers are made electronically, stamp duty reserve tax applies. SDRT is charged at the same rate as stamp duty.
- **STAMP DUTY LAND TAX:** SDLT is payable by purchaser on transactions of UK property. The value on which SDLT is charged includes any VAT payable on the transaction. SDLT is payable with the return which should be submitted within 30 days of completion date (date when contract become legally enforceable).

Rates of duty (The following table will be provided in the exam)

Residential Property		Non-Residential Property	
£125,000 or less	Nil	£150,000 or less	Nil
£125,001– £250,000	2%	£150,001– £250,000	1%
£250,001 – £925,000	5%	£250,001 – £500,000	3%
£925,001 - £1,500,000	10%	£500,001 and above	4%
Above £1,500,001	12%		

Note that relevant rate applies to the whole of the consideration, not just the amount within the relevant band.

- **EXEMPTIONS:** The following exemptions apply to all three forms of stamp duty: stamp duty, SDRT and SDLT. However, for simplicity, the text only refers to stamp duty.

a) **Gifts:** If the transfer is a gift, there is no consideration and hence no stamp duty is payable. This is in contrast to the treatment of gifts for CGT purposes, where market value is used if there are no sale proceeds.

b) **Transfers within groups:** Transfers of assets between 75% group companies are exempt from stamp duty provided that, at the time of the transfer, no arrangements exist for the transferee company to leave the group. However, stamp duty becomes payable if the transferee company does leave the group within three years of the transfer whilst still holding the asset.
Stamp duty is also not chargeable on company reconstructions where there is no change in ownership.

c) **Miscellaneous:** The following transfers are also exempt from stamp duty:
- Assets transferred as part of divorce arrangements
- Property passing to a beneficiary under a will or intestacy
- Variation of a will within two years of the date of death
- Reorganization and takeover
- Unit trust and Changes in trustees.
- Securities traded on AIM (Alternative Investment Market)
- Most company loan notes except convertible loan notes

Note: To qualify for an exemption, the transfer document must state which exemption is being claimed.

CHAPTER 11
OVERSEAS ASPECTS OF INCOME TAX & CGT

1 Status of an Individual

In order to determine the liability of an individual to income tax and capital gains tax it is necessary to know whether or not an individual is Resident and/or Domiciled in the UK.

1.1 Residence:

Rules for UK resident and NON-UK resident have already been discussed in chapter 1.

1.2 Availability of Personal Allowances

Personal allowances are available to UK resident individuals. However, Citizen of EEA, commonwealth countries, Iseland of man & the channel islands may also claim personal allowance.

1.3 Splitting a tax year: Normally tax status on an individual is decided for whole tax year; if residence status of an individual changes during year then it will split in two parts; a UK part and an overseas part. The individual is taxed as a UK resident for the UK part and as a non-UK resident for the overseas part. ***This applies to both income tax and capital gains tax.***

> ***Remember:*** split year rules is not applicable on individuals who are considered non-Uk resident under automatic non UK resident or sufficient ties tests.

➢ **Non UK Resident Individual arriving in the UK**

If a Non UK Resident Individual arriving in the UK during the current tax year, the split year treatment applies in the following situations.

a) A non-UK resident comes to the UK, acquires his only home in the UK. The ***UK part begins when the individual acquires the UK home.***
b) A non-UK resident comes to UK to work full-time for a period of at least a year the ***UK part begins when the individual starts the UK work.***
c) The individual ceases working full-time overseas and returns to the UK. ***The UK part begins when the individual stops working overseas.***
d) Accompanies or later joins their partner (spouse, civil partner or someone with whom the individual lives) in UK to continue to live with them. The individual's partner has returned to UK under criteria (C).
The ***UK part begins on the later of the partner stopping work overseas and the individual joining the partner in the UK.***

➢ **UK Resident Individual is Leaving The UK**

If a UK Resident Individual is Leaving The UK during the current tax year, the split year treatment applies in the following situations and must be *considered in the following order*.

a) The individual leaves the UK to begin full-time work overseas. ***The overseas part begins when the individual starts the overseas work.***
b) Accompanies or later joins their partner (spouse, civil partner or someone with whom the individual lives) abroad to continue to live with them. The individual's partner has left the UK for full-time working overseas. ***The overseas part begins on the later of the partner starting work overseas and the individual joining the partner overseas.***
c) The individual leaves the UK in order to live abroad, sells their UK home, spends a minimal amount of time in the UK (≤15 days) and establishes ties with the overseas country; for example, becoming resident there. ***The overseas part begins when the individual ceases to have a home in the UK.***

1.4 Domicile A person is domiciled in the country in which they have their permanent home.

Domicile of origin: A person acquires a domicile of origin at birth; this is normally the domicile of their father

Domicile of Dependency: Until the age of 16 the domicile dependent of father, if father changes domicile the children also changes domicile.

Domicile of Choice: Individual aged ≥16 can change his domicile by his choice but must sever his ties with former domicile country and settle in other country with clear intention permanent residence.

2 OVERSEAS ASPECTS OF INCOME TAX

2.1 Taxation Of UK Income

As a general rule, all income arising in the UK is subject to UK income tax regardless of the status of the individual.

Status	**UK income**	**Overseas income** (must be gross up for overseas tax suffered)
R and D in the UK	All taxable	All taxable
R but ND in UK	All taxable	All taxable but remittance basis can be used.
NR in UK	All taxable	Exempt

R= Resident; **D**=Domicile

2.2 Overseas Travel And Subsistence Expenses

Where an employee works under a contract of employment for a non-UK resident employer:

Travel costs between individual's UK home and place of work abroad, at the beginning and end of the employment	
Paid by the employee Allowable deduction from employment income	**Paid by the employer** Exempt benefit for employee.

➢ **Additional travel costs** incurred for the employee to make any number of return visits to the UK and overseas subsistence costs (for example, board and lodgings whilst abroad) are treated as a tax exempt benefit where:
- The employment duties can only be performed abroad, and the costs are incurred by the employer.

➢ **Additional travel costs** (from UK home) incurred for the spouse (or civil partner) and/or the employee's children (under 18 at the start of outward journey) to visit the employee are also treated as a tax exempt benefit where:
- The individual has worked overseas for at least 60 consecutive days, and costs are incurred by the employer.

Note: Up to two return trips per tax year per person are allowable.

2.3 Overseas Saving Income: Overseas saving income is taxable in the normal way as UK saving income (gross up by 100/80) *unless remittance basis is applied*. Interest on all gilt-edged securities (UK government securities) is exempt from UK income.

2.4 Overseas Dividend Income: Taxable as UK Dividend income *unless remittance basis is applied*.

2.5 Overseas Property Income:

- Overseas Property income is taxable in normal way as UK Property income *unless remittance basis is applied*.
- Overseas property cannot be treated as furnished holiday letting unless in European Economic area.
- *Overseas property loss* can be carry forward and can only deducted from future overseas Property income.

2.6 Foreign Pensions: 90% of Foreign pension is taxable to UK income tax *unless remittance basis is applied.*

2.7 Overseas Trading Income:

- Overseas Trading income is taxable as UK Trading income *unless remittance basis is applied*.
- Following **travel and subsistence expenses** will be allowable deduction *unless remittance basis is applied*:
  - Travel to and from any place in the UK to the place where the trade is carried on overseas
  - Board and lodging at that overseas place
  - Cost for spouse and children (under age 18) visiting the overseas place of work up to two return trips in any year of assessment, once the individual has been absent from the UK for 60 or more continuous days.
- **Overseas losses:** Overseas trading loss can be relieved in the same way as UK trade losses maximum loss which is relieved is *restricted to total overseas income*.

2.8 Remittance Basis: **Remittance:** The term remittance includes;

- Bringing overseas income into UK,
- Using overseas income to settle debts in UK,
- Using overseas income to purchase goods or services which are subsequently brought into the UK;

Remittance basis means that a person is liable to UK tax only on that overseas income which is brought to UK. If remittance applies all overseas incomes (e.g. interest, Dividend, property etc.) are treated as other income and taxed at 20%, 40% or 45%. *Remittance basis can be automatic or can be claimed.*

A person is **Resident but Not Domiciled** in UK Unremitted income and gains totaling	
≤ £2000	**> £2000**
Automatic Remittance Basis • Personal allowance Available • *Remittance Basis charge* not arise • *DTR available* **Automatic Remittance Basis even if unremitted income & Gains totalling > £2000** • Have no UK income and gains (investment income of ≤ £100 is ignored) • Make no remittances of foreign income or gains, & either: – Aged <18 throughout the tax year**, or** – Have been resident in the UK for not more than six out of the last nine years.	**Automatically taxable in normal way** • Personal allowance available **OR** **Remittance basis can be claimed** If claimed: • Personal allowance is not available • *Remittance Basis charge* can arise • Individual is required to nominate unremitted non-UK income and gains on which Remittance Basis Charge applies. If this income or gain remitted to UK in future then it will not be taxed. • Un-nominated income will taxed when remitted to UK.

- ➢ **Remittance Basis Charge (RBC):** It is a charge on non-UK income and gains not remitted to the UK. The individual remains liable to UK tax on their UK source income and non-UK income remitted to the UK in the usual way.
- Remittance Basis Charge arise if an individual: *is aged 18 or over* in the tax year; and *claim remittance basis* for tax year; and *unremitted income & gains >£2,000* and *UK resident in current tax year*; and has been *UK resident for at least 7 out of 9 tax years*.
- Individuals UK resident for at least 7 of the previous 9 tax years must pay a tax charge of £30,000.
- Individuals UK resident for at least 12 of the previous 14 tax years must pay a tax charge of £60,000.
- Individuals UK resident for at least 17 of the previous 20 tax years must pay a tax charge of £90,000.
- These charges are payable in addition to the tax due on any amounts remitted to the UK.
- If remittance basis is claimed all incomes will be taxed at 20%, 40% or 45% (including dividend income).

2.9 Double taxation relief (DTR): Overseas income is included in UK income may be liable to both UK income tax and overseas tax. In this case, DTR is available and is given by deducting it from total income tax liability. It is given under *DTR treaty agreement* **or** *a credit relief (also known as "unilateral relief")* **or** *Expense Relief*.

- ➢ **Unilateral Relief (only this method will be tested in exams)**
- DTR is a deduction from the UK income tax liability of the *lower of:*
  (i) Overseas income tax suffered on the overseas income **(ii)** UK income tax suffered on the overseas income.
- Overseas income is treated as the top slice of each source of income.

Overseas Aspects of CGT

Residence Status and CGT

Status	UK Gains	Overseas Gains
Resident and Domiciled in UK	All taxable	All taxable
Resident but not Domiciled in UK	All taxable	All taxable but remittance basis can be used.
Not Resident in UK	**Exempt** (both UK and overseas gains.) However a liability to CGT may arise if the person is carrying on a trade, profession or vocation through permanent establishment in the UK and disposes of an asset from the business.	

A person is **Resident but not Domiciled** in UK

Unremitted overseas income and gains totalling

≤ £2000	**> £2000**	
Automatic Remittance Basis • Annual Exemption Available • *Remittance Basis charge* not arise • Overseas losses allowable • DTR available.	**Option 1** **Automatically taxable arising basis** • Annual Exemption available • Overseas losses allowable • DTR available. • No RBC	**Option 2** **Remittance basis can be claimed** If claimed: • Annual Exemption is not available • Gains taxed 28% regardless of income. • *Remittance Basis charge* can arise

Temporary Non-Residence:

A temporary non-resident is an individual who is:

a) UK resident for ≥4 tax years out of last 7 tax years preceding the tax year of departure and
b) Absence period is ≤5 years.

- For disposal of assets by the temporary non-residents, the assets disposed in year of departure are taxed in the same year. Any gains while absent from UK will be taxed in the year of return.
- If absence period is ≥5 years then no CGT on disposals in absence period while gain on disposals after return will be liable to CGT.

Double taxation relief If gains are assessed to both UK CGT and overseas tax, double taxation relief is available.

CHAPTER 12
INHERITANCE TAX

1 INTRODUCTION:

IHT is charged on *transfer of value* of *chargeable property* by a *chargeable person*.

- **Chargeable property:** Every asset to which the individual is beneficially entitled is called chargeable asset.
- **Chargeable person:** An individual who is domiciled in UK will liable to IHT on transfer of their worldwide assets and individual who is not domiciled in UK will liable to IHT on transfer of their UK assets only.
- **Transfer of value:** It is calculated by applying *diminution in value* rule also called *loss to donor* as follows:

Value of estate before transfer	X
Value of estate after transfer	(X)
Diminution in value/ transfer of value	X

> ***Remember:***
> - *Gratuitous disposition means gift*

TYPES OF IHT: **Death IHT & Life time IHT**.

2 LIFE TIME IHT:

IHT is payable on lifetime transfers (Exempt transfer, potentially exempt transfer and Chargeable life time transfer)

EXEMPT TRANSFER

- **Gifts on marriage:**
- £5,000 by parent.
- £2,500 if from a remoter ancestor or grandparents.
- £2,500 if from a party to marriage or civil partnership.
- £1,000 if from any other person.

- **Normal expenditure out of income**

A transfer of value is exempt if:

- Made as part of a person's normal expenditure out of income and
- Does not affect the donor's standard of living.

➢ **Gifts between spouses:**

Any transfers of value between spouses are exempt. However a limit of £325,000 is applied if donor is UK domiciled but donee is not UK domiciled and any excess amount is chargeable to IHT.

However non-UK domiciled individuals whose spouse is UK domiciled can elect to be treated as UK domiciled through an election to HMRC.

➢ **The annual exemption (AE):**

- A.E of £3,000 is available for lifetime transfers and available on both PET and CLT in chronological order.
- Unused A.E can be carry forward for one year only. But A.E of current year must be used first & then any b/f A.E.
- It is beneficial to make CLT before PET.

➢ **Small gifts exemption:**

Transfer of assets having value ≤£250/recipient per tax year are exempt if exceeds then whole amount is taxable

➢ **Transfers to UK charities**

➢ **Transfers to Qualifying Political Party**

Gift to qualifying political party is exempt. Political party qualifies if, at general election prior the gift, either:

- ≥ 2 members were elected to the House of Commons, or
- One member elected & party polled at least 150,000 votes.

➢ **Transfers to National charities**

Eligible recipients include British museum, National gallery, National Trust, Approved museums, Approved libraries and approved art galleries.

POTENTIALLY EXEMPT TRANSFER (PET)

- It includes transfer:
  a) Between individuals other than spouse
  b) To interest in possession (IIP) trust before 22-03-2006
  c) Transfer to disabled trust.
- *No IHT liability on date of transfer only chargeable amount will be calculated and it will be freezed.*
- If individual dies in 7 years from date of transfer then it will become chargeable otherwise it will be exempt.

CHARGEABLE LIFETIME TRANSFER

- It includes transfers to trust.
- *Half IHT will become payable right on the date of transfer. Chargeable amount is calculated and freezed.*
- Remaining IHT will become payable if individual died within 7 years from date of transfer otherwise it will be exempt.

CHARGEABLE AMOUNT: It is calculated for PET and CLT as follows:

Transfer of value (diminution in value rule)	X
Exemptions	(X)
Chargeable Amount	X

Calculation of IHT Liability for CLT

1) Calculate chargeable amount.
2) Apply Nil Rate Band (£325,000) by following *7 year Accumulation Rule*.
   - **7 year Accumulation Rule:** NRB will be reduced by Gross chargeable amount of CLTs made in previous 7 years.
3) Calculate IHT on remaining amount ***@ 25% if paid by donor and @20% if paid by donee.***
4) Calculate Gross Chargeable Amount as:
   - **If donor paid IHT** Gross chargeable Amount = chargeable amount + Tax paid by donor
   - **If donee paid IHT** Gross chargeable Amount = chargeable amount + Nil

Due Date of Payment of IHT For life time tax on CLTs, the due date depends upon date of the gift:

Date of CLT	Due Date of tax payment
6 April --------------- 30 September	30 April just after the end of the tax year of the transfer
1 October -------------- 5 April	Six months after the end of the month of the transfer

3 DEATH IHT ON LIFE TIME GIFTS:

1) B/F Gross Chargeable amount
2) Calculate Death NRB by *Death 7 year cumulative rule.*
   Death 7 year cumulative rule. NRB will be reduced by Gross chargeable amount of CLTs made in previous 7 years from date of transfer (gift) and PETs (only those which become taxable at death).
3) Calculate IHT on remaining amount@ 40%.
4) Deduct *Taper Relief* from IHT liability.
5) Deduct Tax paid in lifetime.
6) Remaining amount is IHT Payable.

Taper Relief:

Years between Transfer & death	Reduction in death tax
3 years or less	0 %
More than 3 but less than 4	20%
More than 4 but less than 5	40%
More than 5 but less than 6	60%
More than 6 but less than 7	80%

Note: Death IHT on lifetime gifts is always paid by recipient of gift, (trustees of trust if CLT and Donee if PET)

4 FALL IN VALUE RELIEF:

- If CLT or PET become chargeable on death and its transfer of value decreases between the date of transfer and death then fall in value relief is available as follows:

Assets are still held by Donee @ Death of Donor	
Value of gift at original date of transfer	XX
Value of gift @ date of donor's death	(XX)
Fall in value Relief	XX

Assets is sold by Donee before Death of Donor	
Value of gift at original date of transfer	XX
Value of gift @ date of sale by Donee	XX)
Fall in value Relief	XX

- It is deducted from Gross Chargeable Amount
- It is available for both PET and CLT if they become chargeable at death but has no effect on lifetime IHT already paid.
- Any increase in value of asset transfer between the date of transfer and death is ignored
- This rule is not applicable on gift assets whose value is expected to decrease over time e.g. plant & machinery and wasting chattels.

5 VALUATION RULES (For Specific Assets)

5.1 Valuation rule for shares:

- **UNQUOTED SHARES & SECURITIES:** Market value will always be given in exams.
- **Quoted shares:** When quoted shares are gifted, Market value of share will be mid-price based on the day's quoted price.

(Highest quoted price + Lowest quoted price)/2

- For quoted shares and securities always use cum-dividend and cum-interest value. If value of quoted shares and securities is given as ex-dividend or ex-interest then, *Cum-dividend and cum-interest value is calculated as follows:*

	Shares	**Securities**
Value using "Lower of Rule"	XX	XX
Add: Next Dividend to be received	XX	
Add: Next Interest to be received		XX
	XX	XX

- **UNIT TRUST:** Unit trusts are only valued at: (Highest marked bargain + Lowest marked bargain)/2

5.2 Related Property Rule:

- The property is related property if the *some kind of property is held by Donor's spouse (or civil partner) or Exempt party (charity, Housing society, National body as a result of gift.) as a result of gift from that person or their spouse (or civil partner)*
- This rule is *applicable upon transfer of unquoted shares, antiques & chattels and adjacent plots of land.*
- **Transfer of Value:**

Value of combined property before transfer X [A/ A + B]	XX
Value of combined property after transfer X [A/ A + B]	(XX)
	XX .

A = Market value of Donor's Property (No of shares for shares)

B = Market Value of related party's Property (spouse or exempt party) (No of shares for shares)

6 Business Property Relief

- It is *automatic relief* on *Worldwide Relevant Business Property* can *reduce transfer of value of property by 50% or 100%*
- It is *available on both lifetime & death transfer* but deducted before any other Exemptions and reliefs.
- Business (sole trader, partnership or company) must be trading business for BPR.
- **Excepted Business:** Business dealing in securities, stocks and shares **OR** Dealing in land or buildings.
- BPR not available on **Excepted Assets** (assets held by business for non-trading or investment purpose) or if there is already a binding contract to transfer the asset.
- If individual transfer shares of a company and company have some business assets and some excepted assets (e.g. non business investments) then BPR upon shares will be restricted to proportion of business assets only. Similarly if an individual transfer's unincorporated business then BPR will be restricted to proportion of business assets only. BPR will be calculated as follows:
  BPR = Transfer of value X (value of total assets less value of excepted assets)/value of total assets
- **Relevant Business Property:**
  a) Un-incorporated business or interest in partnership.
  b) Unquoted securities which gave the transferor voting control of the company immediately before the transfer (control may be achieved by taking into account related property)
  c) Unquoted shares of any company
  d) Quoted shares and securities which gave the transferor voting control of the company immediately before the transfer (control may be achieved by taking into account related property)
  e) Any land or building, machinery or plant which, immediately before the transfer, was used wholly or mainly for Controlling company or partnership in which transferor is a partner.

BPR is available @ 100% for assets within (a), (b) or (c) above, and 50% for assets within Paragraph (d) or (e) above.

- **Minimum Period of Ownership:**
- Asset being transferred must be retained for a period of 2 years.
- If donor has inherited the asset on death of spouse, ***combined ownership period of both spouses*** should be ≥2 years.

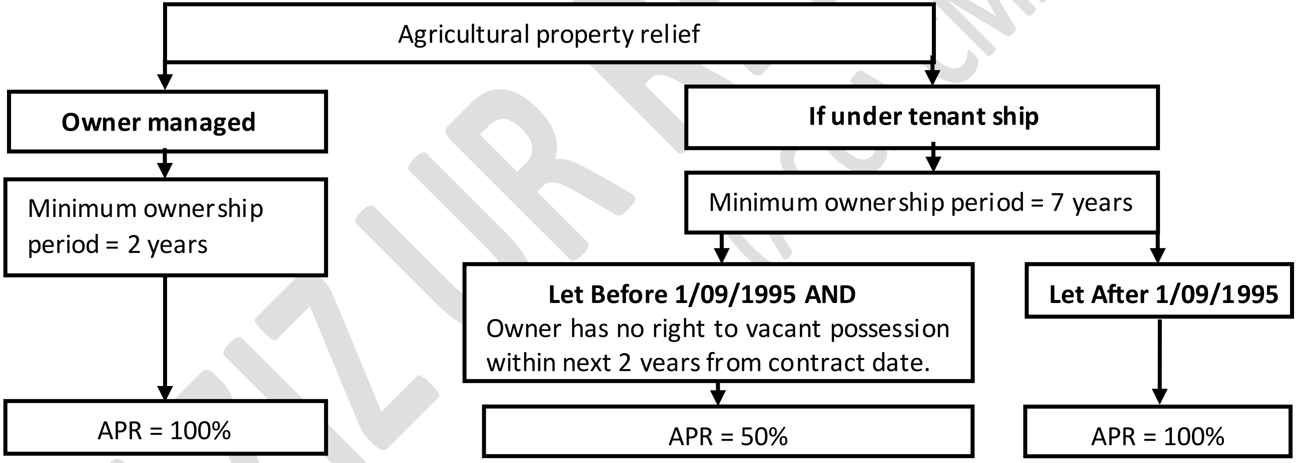
- If the existing business property is ***replaced*** by relevant business property then combined period of ownership should be at least ***2 year out of last 5 years***. BPR is given on ***lower of two property value.***
- BPR is still available if when current transferor acquired the property it was eligible for BPR and either the previous or this current transfer was made on death (no need to consider ownership period).

➢ **Withdraw of BPR**

- If a CLT on whom BPR has been claimed at gift date becomes chargeable on death then BPR will still be available if:
  - **a)** Asset is still a Relevant Business Property
  - **b)** Donee has still owns asset or replacement asset on death of donor
- If the above two conditions are not satisfied then BPR will be withdrawn and will be added back in the gross chargeable amount for death IHT calculation.

7 Agricultural Property Relief:

- It is *automatic relief* on *Property situated in the UK, EEA, channel islands or the isle of Man* can *reduce transfer of value of property by 50% or 100%*
- It is *available on both lifetime & death transfer* but deducted before any other Exemptions and reliefs.
- It is available upon agricultural value of agricultural property if it is held for minimum period of ownership.
  - **Agricultural Property**: It includes Farmland, farm building/farm houses, milking parlours / pastures, cottages.
  - **Agricultural Value:** The value of the property because of the agricultural capacity is called agricultural value.
  - **Minimum Period of Ownership:**


Agricultural property relief
Owner managed
If under tenant ship
Minimum ownership period = 2 years
Minimum ownership period = 7 years
Let Before 1/09/1995 AND
Owner has no right to vacant possession within next 2 years from contract date.
Let After 1/09/1995
APR = 100%
APR = 50%
APR = 100%

- If donor has inherited the Property on the death of spouse the combined period of ownership of both spouses should be greater than minimum ownership period.
- If the existing agricultural property has replaced the previous agricultural property then APR will be available if period of ownership of both the properties is at least *2 years out of last 5 year if property is owner managed* and *7 years out of 10 years if property is under tenant ship*.

➢ **APR in farming Company:**

- If individual has shares in farming company APR will be available if:
  - Individual has controlling interest in the company
  - The minimum period of ownership is satisfied
- APR will be available upon agricultural value of agricultural property held by the company.

➢ **Withdraw of APR**

- If a CLT on whom APR has claimed becomes chargeable on death then APR will still be available if:
  - The property is still Agricultural Property.
  - The Donee has still owns the same property or replacement property on the death of donor.
- If the above two conditions are not satisfied then APR will be withdrawn and will be added back in the gross chargeable amount for death IHT calculation.

Note: if both APR & BPR are available then APR should be deducted first and then BPR should be available on remaining value.

8 Death Estate Computation

Proforma Death Estate Computation

Freehold Property less any Repayment mortgage & interest only mortgages (Endowment mortgages is not deductable)	XX
Leasehold property	XX
Unincorporated business	XX
Shares plus Next dividend if quoted ex-dividend	XX
Securities plus Next interest if quoted ex-interest	XX
Personal chattels and Motor cars	XX

Interest and rental income accrued to the date of death		XX
Insurance policy proceeds, Cash at bank and on deposit, NISAs, Debts due to the deceased		XX
Foreign Property (translated @ lowest rate on death date If given in foreign currency.)	XX	
Less: valuation expenses (max 5% of property value)	(XX)	XX
Less: Allowable deductions:		
Funeral expenses, legally enforceable debts, Outstanding taxes (e.g. income tax, CGT, NICs)		(XX)
Less: Exempt legacies (e.g. to spouse or civil partner, charity, political party)		(XX)
Net free estate		**XX**
Gift with reservation (GWR)		XX
Settled Property (will be dealt with in trusts)		XX
Gross chargeable estate		**XX**
IHT Liability:		
Gross chargeable estate		XX
Less: Death unused NRB		(XX)
Taxable Estate		**XX**
IHT @ 40% or 36% Reduced Rate		XX
Less: Quick succession Relief		(XX)
		XA
Calculate average estate Rate(AER) = (XA /Gross chargeable estate) X 100		
Less: Double Tax Relief ; Lower of:		
a) Foreign tax suffered		
b) AER x foreign property value in estate		(XX)
IHT payable		XX

- No annual exemption available on death transfers but APR and BPR may be available if conditions are satisfied.
- Cost of administrating the estate by executor is not an allowable expense as it is incurred after the death.

➢ Life insurance Policies payment:

Life insurance Policies payment will be included in death estate by proceeds received if for deceased individual. If life insurance policy proceeds are received by a beneficiary (spouse or children) instead of deceased person then it will not be added in death estate computation of deceased person.

➢ Joint Property

If a property is owned jointly by two or more persons then it will be apportioned between owners at the death of any one owner as per agreed ratio. Maximum deduction for valuation is 10% of value of property.

➢ Settled Property:

If the deceased person is a beneficiary of a trust then any amount received from the trust on his death is called settled property. Death IHT of beneficiary which relates to settled property will be paid by trust.

➢ Reduced IHT Rate (36%) on death estate:

Reduced IHT Rate (36%) on death estate is applied instead of 40% if 10% or more of the baseline amount (taxable amount plus charity exemption) is left to charity.

➢ Single Gross up:

- 'Single grossing up' (SGU) is required if in the will of a deceased person; specific gift(s) of UK assets are left to a chargeable person(s), and the residue of the estate is left to an exempt person.
  IHT payable = (Net chargeable estate – NRB available) × 40/60
  Gross chargeable estate = (Net chargeable estate plus IHT payable)
- If the UK death estate is transferred to exempt recipient (e.g spouse or charity) and residue is left to chargeable persons then no grossing up is required. Foreign property need not to be gross up.

➢ Quick Succession Relief:

It arises when two death IHT arise within five years and available to 2nd deceased person. It is deducted from IHT liability and calculated as follows: ***QSR = IHT paid on first death X % age***

IHT paid on first death = (Total IHT paid on 1st death / Gross chargeable estate on 1st death) X value of gift

Years between Transfer and death of transferee	
1 year or less	100 %
More than 1 but less than 2	80 %
More than 2 but less than 3	60 %
More than 3 but less than 4	40%
More than 4 but less than 5	20%

Remember:

- *%ages are not given in exams.*
- *QSR is given before DTR.*

➢ Allocation of IHT payable:

- The IHT payable on the estate is apportioned between different elements of the estate at the AER (after QSR).
- The tax on settled property is payable by the trustees.
- The tax on a GWR is payable by the beneficiary receiving the GWR.
- The remaining tax on death is initially paid by the executors. The remainder of the tax relating to the UK assets is paid from the estate, and so is effectively borne by the person who inherits the residue of the assets after the specific legacies have been paid (known as the residuary legatee).

➢ Due Dates of Payment of Death IHT: IHT arising on death is payable by the Personal Representatives (PRs). The time limit for this is 6 months from the end of the month in which the death occurred.

➢ The instalment option

- IHT on certain property can be paid by ten equal annual installments on CLTs where tax is borne by the donee, or on the transfer of a person's death estate. The first instalment is due for payment on normal due date.
- Instalment option may be used for IHT payable due to death of donor within seven years of making a PET. In this case, donee must have kept the property (or replacement property) until donor's death (or his own, if earlier),
- The instalment option applies to:

a) Land and buildings
b) Shares or securities in a company controlled by the transferor immediately before the transfer
c) Other holdings in unquoted companies where the tax on them together with that on other instalment property represents at least 20% of the total liability on the estate on a death, or where the tax cannot all be paid at once without undue hardship
d) Shares in an unquoted company (including an AIM listed company) representing at least 10% of the nominal value of the issued share capital and valued for IHT purposes at not less than £20,000
e) A business or an interest in a business

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

➢ Gift with Reservation:

A 'gift with reservation of benefit' (GWR) is a lifetime gift in which the legal ownership of an asset is transferred, but the donor retains some benefit in the asset gifted. However if Donor pay commercial rent then it can be treated as normal transfer.

- **Examples of a GWR include:**
  - the gift of a house, but the donor continues to live in it
  - the gift of shares, but the donor retains the right to future dividends
  - the gift of assets into a discretionary trust, but the donor is a potential beneficiary of the trust fund.
- **The treatment of GWR**

Reservation still in place when donor dies	Reservation lifted before donor's death
(1) Original gift = GWR = PET or CLT @ MV of asset on date of gift	**(1) Original gift** = GWR = PET or CLT @ MV of asset on date of gift
(2) On death of donor: (donor still uses asset at date of death) = Asset included in donor's estate @ MV on date of death	**(2) When reservation lifted:** (donor no longer uses asset) = Deemed PET at that time @ MV of asset on date reservation lifted
A GWR therefore potentially gives rise to a double charge to IHT. However, HMRC have the right to charge: the **highest** tax liability arising from event (1) or (2) (known as double charges relief)	

➢ Pre-owned Assets: If the gift with reservation rules do not apply, **an income tax charge may apply if individuals have entered into tax planning to reduce their inheritance tax liability** without completely divesting themselves of the asset. The transferor may, however, elect that the asset should be treated as remaining within their estate under the gift with reservation rules so that an income tax charge does not arise

➢ Associated operations: *"Two or more transactions affecting the same property (directly or indirectly)"* All associated operations are treated as one disposition made at the time of the last one of associated operations.

9 Transfer of Unused Nil Rate Band

If any partner in the spouse dies with unused nil rate band then the other partner may claim to increase his/her nil rate band by the percentage of unused nil rate band of deceased partner.

10 Altering Dispositions Made On Death

Dispositions on death may be altered: by application to courts and by means of a voluntary variation or a disclaimer of a legacy. Application to the courts may be made if the family and dependents of the deceased feel that the will has not made adequate provision for them.

Within two years of a death the terms of a will can be changed in writing, either by a variation of the terms of the will made by the persons who benefit or would benefit under the dispositions, or by a disclaimer.

11 Overseas Aspects

- **Domicile**
  If individual is UK domiciled, or deemed UK domiciled, transfers of all assets, wherever situated, are subject to IHT
- **Deemed UK domicile:** A person is deemed to be domiciled in the UK for IHT purposes if:
  a) He is resident in UK for ≥17 out of 20 tax years ending with year in which any chargeable transfer is made.
  b) For 36 months after ceasing to be domiciled in the UK under general law.
  For individuals not domiciled in the UK, only transfers of UK assets are within the charge to IHT, and even some assets within the UK are excluded property. Non-UK assets of Non UK domiciled individual are not subject to IHT.
  Non UK domiciled individual with a UK domiciled spouse or civil partner can elect to be treated as domiciled in UK for IHT purposes.
- **The location of assets** For someone not domiciled in the UK, the location of assets is clearly important:
  - Land and buildings, freehold or leasehold, are in country in which they are physically situated.
  - A debt is in the country of residence of debtor
  - Life policies are in the country where the proceeds are payable.
  - Registered shares and securities are in country where they are registered.
  - Bearer securities are where the certificate of title is located at the time of transfer.
  - Bank accounts are at the branch where the account is kept.
  - An interest in a partnership is where the partnership business is carried on.
  - Goodwill is where business to which it is attached is carried on.
  - Tangible property is at its physical location.

CHAPTER 13
CORPORATION TAX

1 INTRODUCTION:

Companies resident in the UK are chargeable to corporation tax on worldwide income and gains. Company is UK resident if it is either incorporated in UK **or** incorporated overseas but centrally managed and controlled from UK.

- **Calculation of Corporation Tax Liability:**

X LTD; Corporation Tax Computation For the 12 months ended XX/XX/XX

	£
Trading Profits	XX
Interest Income	XX
Income From Foreign Sources	XX
Rental Income	XX
Chargeable Gains (profit on disposal of assets)	XX
Total profit	XX
Less: Charges on Income (Gift Aid Donation)	(XX)
Total Taxable Profit (TTP)	XX
Add: Franked Investment Income (FII)	XX
Augmented Profits	XX

- **Corporation tax Liability:**
  - Corporation tax liability is calculated as:
    Taxable Total Profits X corporation tax rate (20% for financial year FY15)

- **Financial Years (FY):** The tax rates to be used for corporation tax are set for Financial Years (FY). Financial starts on 1st April and ends on 31 march. FY 2015 = 1 April 2015 to 31 March 2016
- **Period of Account:** Duration for which company prepares it accounts. It is generally 12 months long, but can be longer or shorter than this.
- **Accounting Period:**
  - It is the period according to which corporation tax is paid. It can be ≤12 months but never >12 months.
  - **When accounting period start?**
    - When a company starts to trade
    - When the previous accounting period ends.
  - **When accounting period end?** It ends on earlier of:
    - 12 months after its start
    - The end of the company's periods of account
    - The company's ceasing to be resident in the UK
    - When a company ceases to trade, or when its profits being liable to corporation tax are ceased.

Long Periods of Accounts:

- If period of account >12 month, it will split into two Acc. periods, 1st of 12 months and 2nd of remaining months.
- The following rule applies in the allocation of profits and charges between the two chargeable accounting periods:

Income / Charges	**Method Of Allocation**
Trading Profit (before capital allowances)	Time apportioned
Capital allowances and balancing charges	Calculated for each period
Rental Income	Accruals Basis
Interest Receivable	Accruals Basis
Chargeable Gains	Allocated to accounting period
Charges On Income	Deducted in period in which paid
Franked Investment Income	Allocated to accounting period.

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2 TAXABLE TOTAL PROFITS

2.1 Trading Income:

Calculation Of Taxable Trading Profit
For the year ended xx/xx/xx

Profit From Financial Accounts	XX
Add: Disallowable Expenses	XX
Taxable Income (not included in the profit figure)	XX
Less: Allowable Expenses	(XX)
Disallowable Income (included but not taxable under trading profit)	(XX)
Taxable Trading Profit	XX

- No private element of expenses added back
- Interest payable on a loan taken for trading purpose is allowable deduction from trading profit while Interest payable on a loan taken for non-trading purpose is deducted from interest income.
- Dividend payable by company is not an allowable trading expense.

CAPITAL ALLOWANCES: Same as unincorporated business, but there is no private use asset column. If the accounting period is less than 12 months, WDA and AIA are proportionately reduced. If accounting period is >12 months there will be two chargeable accounting periods and capital allowances will be calculated separately for period.

Additional Aspects:

- Only one AIA (of £500,000) is available to *Related companies* (companies involved in same activities or share same premises) which are owned by the same individual and owner of companies can allocate it as he wants to.
- Unrelated companies owned by the same individual(s) will each be entitled to the full AIA.
- Only one AIA is available to Group of CO.s however, AIA can be shared between group CO.s in any way.
- WDA 8% in respect of integral features applies to both initial and replacement expenditure. *Replacement expenditure* occurs where more than 50% of an asset is replaced in a 12-month period. This prevents substantial repairs being treated as revenue expenditure for tax purposes.
- *Expenditure on energy saving or environmentally beneficial plant and machinery qualifies for a 100% first year allowance.* Where a company has made a loss, it may surrender that part of the loss that relates to such allowances in exchange for a payment from HMRC equal to 19% of the loss surrendered. But the maximum payment that a company can claim is higher of £250,000 and its total PAYE & NIC liabilities for relevant accounting period.

Basis periods: These rules are not relevant for companies.

2.2 Interest:

- Interest received or paid is dealt with on accruals basis.
- It is received *gross* by CO. so no grossing up is required.
- **Loan Relationship Rule:** Interest payable on loan taken for trade is deducted from trading profit while Interest on a loan taken for non-trading purpose is deducted from interest income.
- Interest received from HMRC is taxable and interest paid to HMRC is allowable trading expense.
- For individuals Interest from HMRC is not taxable and paid to HMRC is not an allowable trading expense.

2.4 Foreign Income:

Any foreign income must be included in TTP.
Foreign income is gross up by foreign tax suffered.

2.3 Dividend:

- Companies do not pay tax on Dividends received from other UK and non-UK companies.
- Gross dividends (Net Dividends x 100/90) are added to Taxable total profits to find Augmented profits to determine Corporation Tax Rate %
- Gross Dividend is also called Franked Investment Income.
- Dividend from associated CO. is not included in FII.

2.5 Property Income:

Same as individual except:

- Property income is calculated for the CAP
- Interest payable on a loan to buy a rental property is deductible from interest income not property income
- There is no rent a room relief for companies.

Property loss must be offset against total profits before gift aid of current period and any remaining loss is deducted from future total profits before gift aid.

2.6 Gift Aid Donations:

Gift aid donations are made gross by companies and deducted from trading profit if allowable (small local donation). Disallowed gift aid donations from trading profit should be added back in trading profit and instead included as a separate gift aid deduction on Corporation Tax computation.

If donations exceed total profit then unrelieved donations are wasted except 75% group relief is claimed (see later).

2.7 CHARGEABLE GAINS:

A company is liable to corporation tax on its total net chargeable gains in the CAP.

➢ **Calculating net chargeable gains of a company**

Capital gains arising on disposals in CAP	X
Less: Allowable losses arising on disposals in CAP	(X)
Less: Allowable losses b/f from previous CAPs	(X)
Net chargeable gains	X

➢ **Calculation of gains and losses for companies**

Disposal proceeds (or market value)	X
Less incidental costs of disposal	(X)
Net proceeds	X
Less allowable costs	(X)
Un-indexed gain	X
Less indexation allowance	(X)
Chargeable gain	X

Indexation allowance: Indexation allowance gives a company some allowance for the effect of inflation in calculating a gain. It is given from the date of expenditure to the date of disposal. IA cannot create nor increase a capital loss.

Indexation Allowance = Cost X Indexation Factor

$$\text{Indexation Factor} = \frac{\text{(RPI in month of disposal – RPI in month of expenditure)}}{\text{RPI in month of expenditure}}$$

➢ **DISPOSAL OF SHARES AND SECURITIES :**

All rules are same as individuals except

Matching Rule:

- Shares acquired on same day
- Shares acquired on previous 9 days
- Shares in share pool.

On disposal or acquisition of shares indexation allowance is added in cost.

Bonus Issues

- Bonus shares are added in share pool with no increase in cost.
- Not index the cost of original shares to the date of bonus

Rights Issues

- It increases the number of shares and cost of share pool.
- Pool is indexed to the date of the rights issue.

➢ **ROLLOVER RELIEF :**

Rollover relief is the only capital gains relief available to companies. It allows the deferral of the indexed gains arising on the disposal of **qualifying business assets**.

All rules for rollover relief are same as individuals except that the qualifying assets for companies are:

- Land and buildings used in business
- Fixed plant and machinery (unmovable)

Goodwill is not a qualifying asset for rollover relief for CO.

3 LOSSES – COMPANIES

TRADING LOSSES

➢ **Carry forward relief (Section 45):**

Trading loss will be carry forward and set off against 1st available future TATP from same trade. Loss can be carry forward indefinitely and partial claim is not allowed.

➢ **Terminal Loss Relief: (Section 39):**

If trading loss arises in last 12 months of trade then this loss can be set off against the total profit of previous three years on LIFO basis. Partial claim is not allowed.

➢ **Set Off Trading Loss Against Total Profit. (Section 37):**

Current year trading loss can be off set against:

a) The total profits before gift aid of the current year.
b) Having first relieved the trading loss against total profit of current year only then any remaining trading losses can be carried back against total profits before gift aid of the previous 12 months.
c) Partial claim is not allowed.

NON-TRADING LOSSES

➢ **Capital losses:**

Capital losses are relieved against:

a) Current year capital gains, then
b) Capital gains in future accounting periods.

➢ **Property Business losses:**

Property Business losses are relieved by

a) Setting them off against total profits before gift aid of the current period, then
b) Carry them forward against total profits before gift aid of future periods.

➢ **Choice of Loss Relief:**

a) Tax saving **b)** Cash flow **c)** Wastage of gift aid donations

Restriction on Loss Relief:

- It is applicable upon trading losses to prevent tax avoidance. If there is change in ownership means that more than one half of the ordinary share capital of the company and within 3 years from the date of change in ownership if there is change in nature or conduct of business then:
  - Losses before change in ownership cannot be deducted from profits which arise after change in ownership.
  - Losses after change in ownership cannot be deducted from profits which arise before change in ownership.
- Change in nature or conduct means major change in services provided, customers, outlets or markets.

Loan Relationship Deficits:

Non trading interest income	XX
Non trading interest expense	(XX)
	XX/(XX)

Net Interest Income	Non trading interest Expense			
	Option 1	**Option 2**	**Option 3**	**Option 4**
Put in Performa as interest income	Set off against total profit before GAD of current accounting period	Carry back against interest income of previous 12 months (or 36 months if current year is cessation year.)	Carry forward against any non-trading profits of future periods.	Group relief
	• Partial claim is allowed so company has the option to relieve loss as it wants. • Claim for current period & carry back must be made within 2 years from end of Acc. period of loss			

4 DISINCORPORATION RELIEF

A relief has been introduced to enable relatively small companies to transfer their business to sole trader or partnership by transferring assets to their shareholders without giving rise to taxable profits.

➢ **Conditions:** All of the following conditions must be satisfied in order for the relief to be available.

- The business must be transferred as a going concern.
- All of the assets of the business (apart from cash) must be transferred to the shareholders.
- The total market value of land and buildings and goodwill must not exceed £100,000.
- All of the shareholders to whom the business is transferred must be individuals who have held their shares in the company for the 12 months prior to the date of transfer.

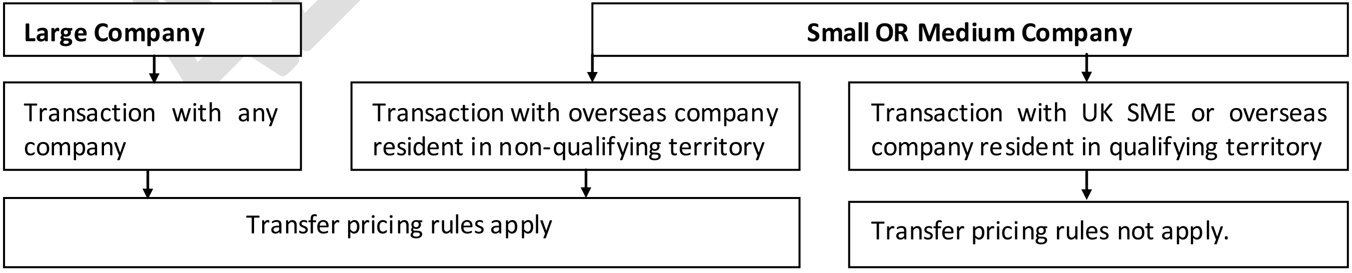
The relief must be claimed within two years of the date on which the business was transferred. The claim must be made jointly by the company and all of the shareholders to whom the business was transferred.

The relief operates by deeming the sales proceeds received by the company, and the amount paid by the shareholders, to be equal to:

- for land and buildings, the lower of cost and market value, and
- for goodwill, the lower of tax written down value and market value.

5 Transfer Pricing Legislation:

- It is applicable upon transactions between connected companies. Companies are connected if:
  - On company directly or indirectly participate in the management, control or capital of the other company, or
  - A third party directly or indirectly participates in the management, control or capital of both companies.



Large Company

Transaction with any company

Small OR Medium Company

Transaction with overseas company resident in non-qualifying territory

Transaction with UK SME or overseas company resident in qualifying territory

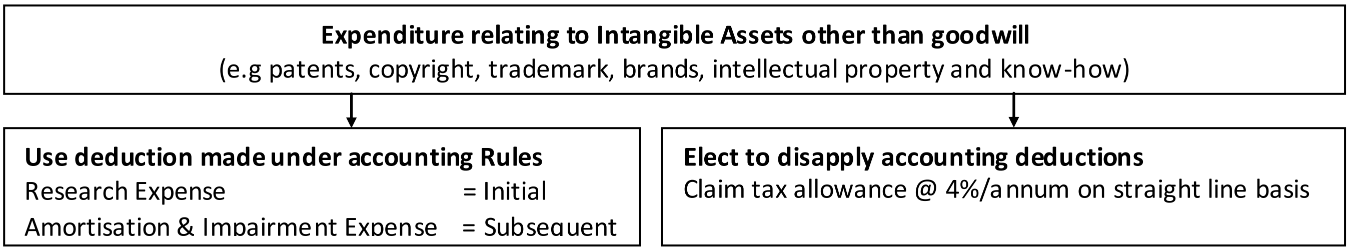
Transfer pricing rules apply

Transfer pricing rules not apply.

- If transfer pricing rules apply then the transaction between related parties are recorded at an arm's length price.
- Non-qualifying territory is one which is not in UK and has no DTR agreement with UK.

➢ **THIN CAPITALIZATION:** Interest expense on loan which is in excess of companies borrowing limit is disallowed. Gearing ratio and interest cover ratios are used to determine financial stability and borrowing limit.

6 Goodwill and intangible non-current assets



Expenditure relating to Intangible Assets other than goodwill
(e.g patents, copyright, trademark, brands, intellectual property and know-how)

Use deduction made under accounting Rules
Research Expense = Initial
Amortisation & Impairment Expense = Subsequent

Elect to disapply accounting deductions
Claim tax allowance @ 4%/annum on straight line basis

- Election for choice of treatment is irrevocable and should be made within 2 years from year of acquisition of asset
- If a company disposes off intangible assets then profit or loss (difference between the disposal proceeds and carrying value) will be treated as trading profit or trading loss. Company has the option to elect to rollover the trading profit upon disposal of intangible assets if disposal proceeds are reinvested within 1 year before or 3 year after disposal.

AZIZ UR REHMAN (ACCA, MA, CPA)

Tax treatment of goodwill

No amortisation or impairment on goodwill are allowable for tax purposes except on disposal. On a disposal of goodwill profit is taxable as trading income but a **loss is a non-trading loss** which can be**:**

- Set off against total profits of the current period
- Carry forward and deducted from non trading profit of next period.
- Transferred to a 75% group member as group relief.

6.1 PATENT ROYALTIES:

- Patent royalties are received gross from another company and net of basic rate tax from individuals.
- They are chargeable on an accrual basis, under trading profits calculation, if patents are held for trading purposes and are treated under the category of Other Income, if held for non-trading purposes.
- Patent royalties paid are treated as trading expense deductible (if related to trade).
- Patent royalties are paid net to an individual and gross to another company.

➢ **Patent box** A new scheme has been introduced in relation to patent profits in order to encourage companies to develop and exploit patents. Broad effect of the scheme is to tax profits arising in respect of patents at a lower rate of corporation tax. *Taxable amount of patent is calculated by deducting an amount from the net patent profit.*

For the year ending 31 March 2014, the *deduction* is calculated as follows:

Net patent profit x 80% x ((MR – 10%) / MR) Where MR is the main rate of corporation tax.

7 Substantial Shareholding Exemption

Substantial shareholding is, *holding of ≥10% shares in another CO. which are owned for ≥12 months in 2 year before disposal.*

- Gain on disposal of shares out of substantial shareholding is exempt and loss is not allowable if both investor & investee companies are trading co.
- This exemption is also available upon part disposal of shares which is made subsequently out of remainder holding provided it was part of substantial shareholding and has been owned at least 12 months out of last 2 years.
- In order to determine substantial shareholding the *shares held by connected companies will also be considered.*
- If there is a share for *share exchange then the combined period of ownership* of both the holdings will be considered to determine minimum period of ownership.

8 Research and development expenditure

R&D expenditure incurred by a company may be 100% allowable expenditure if it relates to company's trade.

R&D relief: SMEs ***(Question in exam will state whether or not the company is a SME.)***

- R&D relief for SMEs is given by allowing the company to claim *230% of the expenditure* as a deduction instead of the actual cost, in computing their taxable trading income.
- ***Qualifying Research & development expenditure*** includes: *Staff costs* (ie salaries but not benefits, pension contributions and employer's Class 1 NIC), *Software & consumable items* (fuel, power and water), and *Subcontracted expenditure of the same nature*. It excludes contributions to other bodies for independent research and expenditure covered by grant or subsidy.
- If *deduction creates trading loss*, it may create an immediate repayable tax credit of 14.5% of lower of:

  a) 230% of qualifying R&D expenditure **b)** Trading loss.

R&D relief: Large Companies

Where a large company incurs qualifying expenditure on R&D, it can claim:

- A tax deduction of 130% of the Research & Development costs incurred.
- A tax credit equal to 11% of the R&D expenditure instead of extra 30% deduction.

➢ **11% tax credit for large companies:** It has two effects:

a) 11% of R&D expenditure is included as taxable income and taxed at 21%.
b) 11% of R&D expenditure is deducted from corporation tax liability.

Any excess (b less a) can be paid to the company up to a maximum of the company's PAYE/NIC liability for R&D employees for the relevant accounting period.

9 BUSINESS FINANCIAL MANAGEMENT

➢ **Sources of Finance:**

	Equity Finance	**Debt Finance**
Amount	Company can issue shares up to maximum of authorized share capital.	There is no limit of debt finance which a company can raise through debt instruments and banks loan until investor is ready to invest.
Return	Company is required to pay dividend which is based on profits and this will not be treated as allowable expense.	Entity is required to pay mandatory interest which is regardless of profit and it is treated as allowable expense.

Investor	• If investor is a company any dividend received by company is exempt. • If investor is an individual and is a basic rate tax payer then no additional liability will arise in respect of dividend received by the individual. However if individual is high or additional rate tax payer then individual may has to pay additional tax.	• If investor is an individual interest will be received net of 20% tax. • If individual is a basic rate tax payer no additional tax liability will arise. However in case of high/additional rate tax payer additional tax liability may arise. • If investor is a company then interest will be received gross and it will liable to CT.

- **Differences between sole trader and company:**

Sole Trader	Company
Trading profits are liable to income tax on tax year basis.	Trading profits are liable to corporation tax for accounting period.
Application of basis period.	No application of basis period.
Capital allowances are available but with Private use adjustment.	Capital allowances are available but No Private use adjustment is required.
Personal Allowance is available	No personal allowance is available.
Class 2 and Class 4 NIC will become payable.	No payment of NIC is required for trade.
Six Loss relief options are available.	3 loss relief options are available Group relief is also available.
No tax implication at the time of withdrawal of profit after tax from business.	Profit after tax from company can be withdrawn in form of dividend or employment income.
Business may have VAT registered.	Company may have VAT registered.
Upon disposal of business it will be treated as chargeable disposal however entrepreneur relief, gift relief, and rollover relief is available.	Upon disposal of shares it will be treated as chargeable disposal however rollover relief is available.
If an individual has expected losses in initial years of trade then individual should preferably start business as sole trader to take advantage of tax saving at high rate.	If an individual has profit in initial years of trade and has no intention to withdraw funds in initial years then it is better to operate in form of company to take advantage of low corporation tax rates.

- **Extraction of Funds from a Company:**

Salary	Dividend
Income tax payable @ 20%, 40% or 45% by individual.	Income tax payable @ 10%, 32.5% or 37.5%.
Class 1 primary NIC payable by individual @ 12% or 2%.	NO NIC is payable by individual.
Company is liable to pay class 1 secondary	NO NIC is payable by company.
Salary and NIC paid to individual is treated as allowable expense for company.	Dividend is not an allowable for company.
Individual can make personal pension contribution in respect of salary received from the company.	Don't qualify as relevant earning for personal pension cont. because it is not a earned income.

- **Rental Income from company**
  - Individual should try to own the assets of the company instead of owning assets through the company in this way individual will be able to withdraw profits after tax from the company in the form of rental income although this will be liable to income tax as a property income but company will be able to claim allowable deduction in respect of rent paid for the property from trading profits.
  - If asset is being used in trade in such a manner as mentioned above individual can avoid double taxation at the time of disposal of asset. However BPR would be reduced to 50% for the IHT purpose.
- **Interest income from the company**
  - If an individual makes a loan to the company then any interest income received by individual will be taxed in the year of receipt of interest @20%, 40% or 45%.
  - Interest paid by company is an allowable expense from company trading profit on accrual basis.
- **Personal pension contribution**
  - Individual can withdraw funds from the company by making persona pension contribution for himself as an employee through other company however pension funds are not withdrawn up to the age of 55 years.
- **Purchase of Non-Current Assets**
  - If an asset is purchased capital allowances are available in normal way.(AIA, WDA)
  - If individual is VAT registered then Capita allowance will be claimed upon VAT exclusive amount.

- **Hire Purchase Agreement/Finance Lease.** Assets acquired under hire purchase agreement will be treated as outright purchase of the asset and capital allowance will be claimed in normal way upon cash equivalent value of asset. Any interest paid along with installment amount will be treated as allowable expense.
- **Operating Lease** Any rent paid for asset acquired under operating lease for trading purpose is allowable trading expense with the exception of high emission car (CO2 >130 gram/km) for which 15% of rent paid is disallowed.

10 Types of companies

10.1 Close Company:

Company which is controlled by maximum 5 shareholders or if there are more than all shareholders should be the directors of the company. Control means holding >50% of: ‘‘share capital or voting rights, or distributable profits or net assets on winding up”

- **Provision of benefits from Close Company to an individual who is shareholder and director:**
  - For directors it will be a taxable benefit liable to income tax calculated using the rules of employment income.
  - For company cost of providing benefit will be allowable expense from company’s trading profit.
- **Provision of benefits from Close Company to an individual who is just a shareholder:**
  - For individual it is assumed that individual has received net dividend equal to taxable value of benefit calculated using employment income rules.
  - For company it will be assumed that company has pay dividend equal to value of taxable benefit.
- **Provision of Loan from shareholder to Close Company:** If an individual takes loan and invest into close company for purchase of shares then it is called qualifying loan and any interest paid is deductible expense from his total income provided the company is personal trading company (owns ≥ 5% shares).

If close company is an investment company then it will be liable to UK corporation tax @ 21% regardless of profit.

- **Loan from close company to its shareholders only or shareholder plus employee.**
  Tax Charge: If a close company lends a loan to its shareholders then company has to pay a tax charge @25% upon the amount of loan.
- This tax charge is refundable into a situation:

a) When shareholder repay the loan to company.
b) When the company writes off the loan into its own books at this point of time individual is deemed to have been received a net dividend equal to the amount of loan. However for the company the written off loan will not be treated as allowable trading expense.

No tax charge will be due by company if individual repays loan before due date of payment of tax by company.

- **Exemption from tax charge:** No tax charge will arise if following three conditions are satisfied:

a) Amount of loan is ≤ £15,000. **b)** Individual is full time employee of CO. **c)** Individual owns <5% shares in CO.

- **Benefit in respect of the interest:** If the company lends the loan at less than official rate of interest (3%) then:
  - If individual is a shareholder it will deemed to have been received net of dividend equal to value of taxable benefit which will be calculated using employment income rules and
  - If individual is shareholder & director then it will be taxable benefit for related individual.

10.2 Companies with investment Business:

- Companies holding investments are called companies with investment business.
- Management expenses in respect of investments are allowed to be deducted from total profit before gift aid donations of current year and any unrelieved management expenses will carry forward against the total profit of future years **OR** Company can choose to transfer the unrelieved management expenses to 75% group member.
- Management expense includes remuneration of the employees, audit fee, bank interest, head office overheads, commissions, office rent and rates.
- Companies with investment Business are taxed in normal way but if the investment company is a close company then its profit will be taxed @ 21% irrespective of the level of profit.

10.3 Personal Service Company:

If an individual incorporates a company independently and starts providing services in his personal capacity this is called personal service company. If HMRC identifies that in the absence of incorporation individual is being providing services as an employee does, then whole receipts of the company will be treated as deemed salary for the individual from the related client.

The deemed salary will be calculated as follows:

Total receipt of the company	XX (A)
Less: statutory deduction @ 5% x A (flat rate)	(XX)
Less: salary paid by company	(XX)
Less: NIC paid by company for employee	(XX)
Less: Allowable employment expenses	(XX)
Deemed salary including NIC	XX (B)
Less: NIC upon deemed Salary: (B x 13.8%)/113.8%	(XX)
Net Deemed Salary liable to income tax	XX .

11 GROUP ASPECTS

11.1 Associated/Connected company Companies are associated with each other if:

- One controls the other or
- Both are under control of a same person/company

Control means holding >50% of: ''share capital or voting rights, or distributable profits or net assets on winding up"

- **Tax Implications:** If CO. becomes connected CO. during the accounting period it will be treated as connected CO. for whole of the accounting period. Overseas CO's are included but Dormant CO's are excluded. Dividend received from associated CO's is not included in FII. Upper & lower limits are divided by number of associated CO's. Only one AIA is available to a group of companies and group members can allocate it in any way across the group.

11.2 75% Loss Relief Group:

75% Loss Relief Group is formed when:

- One company is the 75% subsidiary of another, or
- Both companies are 75% subsidiaries of a third company

Company is 75% subsidiary of another if other company:

- own ≥75% of share capital, &
- Entitled to ≥75% of subsidiary's assets on winding up, &
- Entitled to ≥75% of subsidiary's distributable profits.

Sub-subsidiaries: Holding company must have an effective interest of ≥75% in sub-subsidiary.

- **Tax Implications:**
- Group can be formed without ultimate parent company and one company can be part of more than one group.
- Overseas Companies can become part of this group but relief is only available to UK resident companies unless overseas company is EEA and loss can't be utilized in any other way.
- Member of 75% loss relied group can transfer:
  - Unused Trading losses & property business loss
  - Unused Gift Aid Donation
  - Unused management expense (if investment CO.)
  - Unused non trading interest expense.
- Only current year and corresponding period losses are eligible for relief.
- Capital losses are not eligible for group relief.
- *Surrendering CO.* (CO. that surrenders its loss) may surrender as much of loss as it wants to & it is not necessary to relieve loss against its own income & gains 1st
- *Claimant CO.* (CO. to which loss is surrendered) can offsets loss against Taxable Total Profits of its corresponding Acc. Period but after offsetting its own b/f trading loss. Can't carry group relief forward or backwards.
- *Most beneficial order to surrender relief* is as follows:
  - To CO.s pay corp. tax @ marginal rate (effective 21.25%)
  - 2nd to CO.s subject to corporation tax @ 21%.
  - Finally to CO.s subject to corporation tax @ 20%.
- Claimant CO. may make payments to surrendering CO. for group relief. Any payment up to the amount of loss surrendered is ignored for corporation tax purposes.
- Losses which arise before joining the group or after leaving the group are not eligible for group relief.

11.3 75% Capital gains Group

75% capital gain Group is formed when:

- One company is the 75% subsidiary of another, or
- Both companies are 75% subsidiaries of a third company

Sub-subsidiaries: Holding CO. must have effective interest of ≥50% in sub-subsidiary.

Note: Group *cannot be formed without ultimate parent CO. and one CO. cannot be part of more than one group.*

- **Tax Implications:**
- Group CO.s can *transfer assets between themselves at no gain / no loss* & deemed to take place at cost plus Indexation Allowance.
- Group companies can *transfer only Current year capital gains or capital losses* to other group members. While b/f capital loss is not allowed to transfer. Election must be made in 2 years from end of accounting period of disposal
- Rollover relief is available on a group wide basis Where:
  - one company sells qualifying asset, and
  - Another company buys a qualifying asset within the rollover relief qualifying time period.

Gain can be rolled over against purchased asset of other CO.

- **De-grouping charge:** It *can arise if a 75% gain group member leaves the group and within previous 6 years it has received an asset from another 75% group member via no gain no loss transfer.* It will be calculated as:

M.V at date of original intra group transfer	XX
Less: original cost plus indexation allowance	(XX)
De-grouping Charge	XX .

- Charge is taxable to Transferor CO. however it will be exempt in case of substantial shareholding exemption.
- Transferor Company can choose to transfer de-grouping charge to the other 75% gain group members.
- SDLT is exempt on transfer between 75% gain group CO.s but exemption will be withdrawn if recipient CO. leaves the group within 3 years from date of intra-group transfer.

Pre Entry Capital Loss: When a CO. joins 75% gain group it capital losses before joining can be offset against gains:

- From disposal of assets before joining the group
- From disposal of assets which were owned before joining the group and sold after joining group.
- From disposal of assets which were acquired after joining the group and sold to third party.

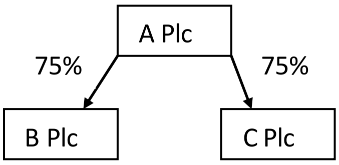
12 Consortium

When two or more companies (UK or overseas) mutually owns ≥75% shareholding in another company provided each company own at least 5% but up to maximum of 75%. This is called **consortium arrangement.**

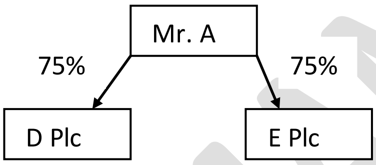
- Investor Company is called consortium member and Investee Company is called Consortium Company.
- A consortium company can transfer its loss upward to consortium member but up to maximum of the %age holding of a consortium member but for this purpose consortium company has to offset loss against its own total profit 1st.

- Consortium Member CO. can also transfer its loss downward to consortium CO. but up to maximum of its %age holding. There is no need to consortium member to offset the loss against its own total profit 1st.
- Losses cannot be transferred between consortium members. Overseas company can become part of consortium arrangement but it cannot take advantage of consortium features.

12.1 Transfer of trade within a group



Transfer of assets from B Plc to C Plc
Special rules apply and this is a gain group



Transfer of assets from D Plc to E Plc
Special rules apply but this is not a gain group (Same person must own ≥75% of trade at some time; within 1 year before transfer & at any time within two years after transfer.)

Transfer of trade and Assets without change in ownership			
Special Rules		**Capital Gain**	
Trade Losses	Capital Allowances	If gains group	If no gains group
Transferred with trade & set off against future profits of same trade.	• Assets will be transferred at WDV. • No BC/BA for transferor • No AIA or FYA for transferee	Assets transferred at no gain no loss	Capital gain/loss arises on chargeable assets sold.

If existing 75% gain group member transfer its trade to a newly incorporated subsidiary company controlled by the ultimate parent company then, the ultimate parent company can claim substantial shareholding exemption on disposal of the holding in newly incorporated subsidiary even if:

– Shares of newly incorporated subsidiary are not owned for 12 month out of previous 24 months **BUT**
– New subsidiary owned the trade for 12 month out of previous 24 months.

13 Overseas Aspects

- Companies incorporated in the UK, or incorporated overseas but centrally managed and controlled in the UK are called UK resident companies.
- All UK resident Companies are chargeable to corporation tax on their worldwide income and chargeable gains.

Permanent establishment:
Means having a place of management or a branch or an office or a factory or any work related area.

13.1 Overseas Branch

- An overseas branch of a UK company is effectively an extension of the UK trade, and 100% of the branch profits will be assessed to UK corporation tax.
- An overseas branch profits are treated as UK profits and will be calculated in same way.
- UK capital allowances are available on oversees plant and machinery purchased.
- Overseas branch profit is placed in a separate column after grossing up for the overseas tax suffered, in the UK corporation tax Performa.
- Trading losses of an overseas branch are available for set off, against the profits of other companies in the group.
- Corporation tax limits are not divided.
- As profits are subject to both UK corporation tax and overseas tax within the country in which it trades, double taxation will therefore occur. Double Taxation Relief (DTR) will be given for the overseas tax suffered which results in reduction of UK corporation Tax liability.
- *UK Company having overseas branch has the option to make an irrevocable election for the exemption of overseas branch profit from UK tax. In this case branch profit and gains are exempt from UK CT, no loss relief available, no capital allowance is available. If election is made it will be irrevocable and will be applicable to all overseas branches.*

➢ **Double Tax Relief (DTR)**

Income from overseas branch may be subject to both overseas tax and UK corporation tax, so double taxation relief is given for this double taxation which is deducted from UK corporation tax liability.

Try to deduct gift aid donations from UK income for maximum tax saving.

DTR is lower of:

(i) Overseas tax on overseas income.

UK corporation tax on overseas income.

13.2 Overseas Subsidiary

- Will be classed as an associated company (reduces the limits) if ownership is > 50%
- Profits will be subject to overseas Corporate Tax but are not charged to UK corporation tax
- Dividend is exempt from UK Corp. tax & not added in FII.

- UK capital allowances are not available
- Intra-group transactions between overseas subsidiary and a UK resident group member will be subject to the Transfer Pricing rules.
- No group relief is available for trading losses of an overseas subsidiary
- If dividend is received from overseas company in which UK parent owns more than 50% of voting power it will be ignored in computing FII to determine augmented profits. If a UK Company receives a dividend from a non-subsidiary overseas company this will be grossed up by 100/90 and included within FII figure in the normal way.

13.3 CONTROLLED FOREIGN COMPANY (CFC):

A controlled foreign company is a:

a) non UK resident company and
b) controlled by UK resident companies and/or individuals, and
c) that has artificially diverted profits from the UK

CFC Charge:

Individuals control (E.g. Mr A, & Mr. B)

UK Resident companies

CFC

UK Resident company control Owns CFC (can be controlled by more than 1 UK resident co. in which case each co. must own at least 25% interest in CFC)	
CFC Charge will arise on UK Resident Companies	No CFC Charge

CFC Charge:

	£
(Amount of CFC **chargeable profit** caught by CFC Legislation X % shareholding of UK company X main rate of corporation tax)	X
Less: DTR	(X)
Less: UK corporation tax on income of CFC (if any)	(X)
Less: Income tax suffered by the CFC on its income which it distributed to UK controlling CO.	(X)
CFC charge	X

Chargeable Profits

- Income of CFC (but not chargeable gains) that are artificially diverted from the UK, calculated as per UK tax rules is called chargeable profit
- CFCs will have **no chargeable profits** (so no CFC charge) if any of the following conditions are satisfied:
  - the CFC does not hold any assets or bear any risks intended to reduce UK tax
  - the CFC does not hold any assets or bear any risks that are managed in the UK
  - the CFC would continue in business if the UK management of its assets and risks were to cease

Exemptions to CFC charge

The CFC charge is not applied if any one of the following exemptions applies (even if CFC has chargeable profit) :

Exempt period exemption	No CFC charge will arise in first year (first 12 months) if it will be CFC in the second accounting period and no CFC charge in second year.
Excluded territories	CFC is resident in an excluded territory *(Territory approved by HMRC where rate of corp tax is higher than UK)* than no CFC charge arises.
Low profits	The CFC's TTP ≤£500,000 of which non-trading profits is ≤£50,000.
Low profit margin	CFC's accounting profit is ≤10% of relevant operating expenditure.
Tax exemption	The tax paid in the overseas country is at least 75% of the UK corporation tax which would be due if the CFC were a UK resident company

14 Re-Construction & Re-Organization

Share for share exchange:

- Claim substantial shareholding exemption if available.
- Transfer the gain to 75% Group Company.
- If substantial shareholding exemption is not available
  - Claim share for share exchange rule.
  - No Gain NO loss arise
  - Cost of old shares will become cost of new shares.

Consequences of Disposal of Shares:

- Substantial shareholding exemption can be available.
- Stamp duty @ 0.5% will be payable.
- The company being disposed off will be treated associated company for whole accounting period
- There may be de-grouping charge.
- Transfer of trade special rules might be applicable.

15 Methods of Withdrawal of investment from company

➢ **Purchase of its own shares by company (Buy Back)**

Proceeds received by individual may be taken as income distribution (dividend) or a capital payment.

a) Capital Repayment: If all of the *following conditions are satisfied then proceeds received by individual will be treated as capital receipts and calculate gain or loss.*

Capital gain/loss = Disposal Proceeds – purchase price

- Company must be an unquoted trading CO. and Buy back of shares by CO. must be for benefit of trade.
- Shares must have been owned for at least five years if purchased and it will be 3 years if inherited.
- The shareholder is resident in UK and must have sold either entire shareholding or substantial shareholding (≥75% from his shareholding)
- Shareholder must not own ≥30% holding after sale.

Note: *If Co. buy back its shares from another CO. HMRC will always treat the event as capital disposal.*

b) Income Distribution: If any of the above conditions is not satisfied then proceeds received by individual will be treated as net dividend and calculated as follows:

Net Dividend = Proceeds received less Original subscription price(issue price)

➢ **Sale of shares:**

- If an individual disposes off shares in a company then it will be taken as normal chargeable disposal.
- If individual disposes off the shares after the receipt of dividend the dividend income will be liable to income tax and disposal of shares will be a chargeable disposal.
- If there is no Entrepreneur relief is available upon disposal of shares & individual is high rate tax payer then it will be beneficial for the individual to receive dividend before disposal of shares as dividend is liable to low tax rate then capital gain.

➢ **Liquidation**

At the time of liquidation, liquidator is appointed, assets of the company are realized, any obligations of the company are paid and finally the surplus amount is distributed to shareholders.

Payment received by shareholder before appointment of liquidator is treated as dividend while proceeds received after appointment of liquidator will be treated as capital receipt and gain will be liable to capital gain tax.

CHAPTER 14
VALUE ADDED TAX (VAT)

INTRODUCTION:

- VAT is an **indirect tax** charged on most goods and services, supplied within the UK and is **borne by final consumer**.
- VAT is charged on taxable supplies of goods and services in the UK by taxable persons in the course of their business. It is collected by VAT registered person and paid to HMRC.
- VAT on sales is called **output VAT** and it is calculated on sales after maximum prompt payment discount if availed by customers. VAT registered person charge VAT on sales and payable to HMRC.
- VAT on purchases is called **input VAT**. Input VAT is reclaimed from HMRC.

1 Types of supply.

VAT rates are:

Standard Rated	20%	On most goods and Services supplied
Zero rated	0%	Non luxury food (except in business e.g restaurants), Books, newspaper, Sewerage and water services, Children's clothes and footwear, Medicine, Exports outside the EU. Transport (not taxes), gift to charity
Exempt		Financial service, Insurance, Postal service, education, health, sports and land (Not buildings).
Low Rated	5%	Fuel for domestic purpose, energy saving materials

- **Zero Rated:** No VAT is charged but considered as taxable supply for determination of registration limit.
- *Some supplies are outside the scope of VAT which includes wages, dividends, other taxes, transfer of business as a going concern and sales between companies in a VAT group.*

➢ **Basic Computation**

OUT PUT VAT (VAT Charged to customers on sales)	XX
INPUT VAT (VAT paid an purchases)	(XX)
Net VAT Payable / (Recoverable)	XX/(XX)

➢ **Tax Point:** Tax point or time of supply determines when output VAT will be due.

- The basic tax point is the date goods are made available to the customer or service completed.
- If an invoice is issued or payment received before the basic tax point, then this becomes the actual tax point.
- If an invoice is issued within 14 days of the basic tax point, the invoice date will becomes the actual tax point.

Exception:

Goods supplied on sale or return are treated as supplied on the earlier of adoption by the customer or 12 months after dispatch.

Continuous supplies of services paid for periodically normally have tax points on the earlier of the receipt of each payment and the issue of each VAT invoice, unless one invoice covering several payments is issued in advance for up to a year. The tax point is then the earlier of each due date or date of actual payment. However, for connected businesses the tax point will be created periodically, in most cases based on 12 month periods.

➢ **VAT Periods:** VAT period (also known as Tax Period) is the period covered by a VAT return. It is usually three months (quarterly returns). VAT return must be submitted and VAT must be paid within one month after the period. A registered person can elect for monthly VAT returns if his input tax regularly exceeds his output tax.

2 REGISTRATION

2.1 Compulsory Registration (Historical Test)

- Registration is compulsory if at the end of any month accumulated taxable supplies of previous 12 months exceed £81,000. These figures are exclusive of VAT
- HMRC must be informed within 30 days after the end of the month in which taxable supplies exceed £82,000 by completing form VAT1 or using HMRC's online services.
- The trader will be registered for VAT from next day of 30 days notification period.
- VAT registration is not required if taxable supplies in the following 12 months will not exceed £80,000.

2.2 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 of just following 30 days will exceed £82,000 (Exclusive of VAT). Then individual is required to inform HMRC before end of those 30 days by completing form VAT1 or using HMRC's online services. Individual will be registered for VAT from beginning of those 30 days.

2.3 Voluntary Registration

A person making taxable supplies may apply for VAT registration on voluntary basis by writing an application to HMRC even if taxable supplies are below £82,000. It will be considered VAT registered from date of application. It is beneficial if beneficial is making zero-rated supplies or supplies to VAT registered customer. However it is not beneficial when business is making supplies to non-VAT registered customer.

Advantages	Disadvantages
• Avoids penalties for late registration. • Can recover input VAT • Can disguise the small size of business	• Must follow VAT administration rules • Makes product prices more expensive (vat inclusive prices)

Consequences of Registration: Output and input VAT will be calculated. Trader is assigned a VAT registration number and allocated a period for filling return (which is normally 3 months).

2.4 VAT Group registration: Companies under common control may apply for group registration. Group appoints a representative member who calculates all input VAT and output VAT for the group.

Advantages of group registration:

- No VAT implication on intra-group transactions between members of VAT group.
- Group members will file single VAT return on group basis which will save administration costs.
- An application to create, terminate, add or remove a CO. from a VAT group may be made at any time and there is no compulsion to include every member into VAT group.

Disadvantages of group registration:

- All VAT group members are jointly and severely responsible for group VAT liability.
- Administrative difficulties for making single VAT return.

2.5 Output VAT:

- **Goods for own use:** Where the trader withdraws goods from the business for own use, output VAT must be accounted for on the replacement value of the supplies.
- **Gifts of inventory or non-current assets** are treated as taxable supplies at replacement cost, except gifts of:
  - goods to the same person which cost the trader £50 or less in a 12-month period
  - Business samples, regardless of the number of same samples given to the recipient
- **Gifts of services,** whether to employees or customers, are not taxable supplies.

2.6 Recovery of Input VAT:

Input VAT is recoverable by taxable persons on goods and services which are supplied to them for business purposes. A VAT invoice is needed to support the claim.

➢ **Recovery of Pre-Registration Input VAT on Goods:** It will be recoverable if Goods were acquired in previous 4 years from date of registration for business purpose and are still on hand upon the date of registration.

- **Recovery of Pre-Registration Input VAT on Services:** It will be recoverable if Services were acquired in previous 6 months from date of registration for business purpose.
- **Recovery of Normal Input VAT:**

- **Capital vs revenue expenditure:** There is no distinction between capital and revenue expenditure for VAT. Output VAT and input VAT is calculated as normal if these expenditures are incurred for trade.
- **Business entertaining:** Input VAT on entertainment expenses incurred for employees and overseas customers is recoverable. However Input VAT on entertainment expenses incurred for suppliers and UK customers is irrecoverable.
- **Private Use:** input VAT cannot be claimed for goods or services that are not used for business purpose except for the treatment of cars which is given below.
- **Motor cars:** Input VAT upon purchase of car is irrecoverable unless there is 100% business use (Pool Car) in which case 100% recovery available. In case of leased car 50% of input VAT is recoverable where the car has some private use.
  Note that if input VAT cannot be recovered on purchase of a motor car, no output VAT will be due on its disposal.
- **Motor Expenses:** Input VAT upon fuel cost and repair & maintenance incurred for employees is recoverable even if there is private use of car by employee. If employee reimburses full fuel cost then output VAT will be payable upon reimbursed expenses. However If employee reimburses partial fuel cost or don't reimburse then output VAT will be payable but as per HMRC scale charge. Note that VAT is not charged on the insurance and road fund licence
- **Relief for Bad Debts:** Input VAT on bad debts is recoverable if:
  a) ≥6 months elapsed from due date of payment and
  b) Amount written off as bad debts in the seller's books.
  Relief is obtained by adding the VAT element of the impaired debt to the input tax claimed.
  Claims for relief for impaired debts must be made within four years and six months of the payment being due.
- **Business and non-business expenses:** Input VAT on business expenses is recoverable. VAT on non- business items passed through the business accounts is irrecoverable.

Important Note: For propose of Income Tax, Capital Gain Tax, Corporation Tax, If VAT is recoverable than the cost must be VAT exclusive (e.g. Plant & machinery cost for capital allowances) and If the VAT is irrecoverable than the cost must be VAT inclusive (e.g. Car with private use for capital allowances).

3 VAT on sale of a business

Normal Disposal of business : The business should charge VAT on asset transferred.

Transfer of business as a going concern:

If the following conditions are satisfied, then the sale/transfer:

- Will not be treated as a taxable supply
- No output tax will therefore be charged on the assets transferred by the seller, and
- No input tax is recoverable by the purchaser.

- **Conditions:**

- The business is transferred as a going concern.
- There is no significant break in the trading.
- The same type of trade is carried on after the transfer.
- The new owner is or is liable to be registered for VAT, immediately after the transfer.

Note that all these conditions must be met.

- **Transfer of registration:**

On the sale of a business it is normally compulsory to deregister. However, instead of doing so, both the transferor and the transferee may make a joint election, for the transferor's registration to be transferred to the transferee. Where this is done, the transferee assumes all rights and obligations in respect of the registration, including the liability to pay any outstanding VAT. Therefore, this may not be a good commercial decision.

4 Deregistration

Compulsory Deregistration:

If an individual ceases to make taxable supplies or ceases to trade then individual should inform HMRC within 30 days and individual would be considered as VAT deregister right from date of cessation.

Voluntary Deregistration:

If individual identifies that his taxable supplies will not exceed £80,000 in the following 12 month then individual can apply for VAT deregistration on voluntary

Consequences of Deregistration:

On deregistration date individual is required to calculate output VAT upon all current and non-current assets according to their market value and this has to be payable to HMRC and if it has less than £1000 it will be waived off.

basis by writing an application to HMRC. Individual will be considered VAT deregistered from date of application.

5 SPECIAL SCHEMES

5.1 Cash Accounting Scheme: VAT is accounted for on the basis of cash receipts and payments, rather than on the basis of invoices issued and received (therefore *automatic relief for bad debts*).

***Conditions to be satisfied to join the scheme*:**

- Taxable turnover (exclusive of VAT) not exceeding £1,350,000 per annum.
- VAT returns must be up-to-date and no convictions for VAT offences or penalties in past.
- If taxable turnover exceeds £1,600,000 trader will have to exit the scheme.

Advantages:

- Businesses selling on credit do not have to pay output VAT to HMRC until they receive it from customers.
- This gives automatic relief for impaired debts.

Disadvantages:

- Input tax cannot be claimed until the invoice is paid. This delays recovery of input VAT.
- Not suitable for businesses with a lot of cash sales or zero-rated supplies which would simply suffer a delay in the recovery of input VAT.

5.2 ANNUAL ACCOUNTING SCHEME

A single VAT return for a 12 month period (Normally accounting period of the business) is filed within two months from end of the period.

VAT is paid in nine equal installments each will be 10% of previous year's VAT liability and one balancing payment. Installments are payable at the end of month 4 to 12 of accounting period. Balancing payment (or repayment) is made when the return is filed.

Conditions to join the scheme are same as cash accounting scheme.

Advantage: Only one VAT return each year so less occasions for VAT penalty and batter management of Cash flows.

Disadvantage: Have to ensure that supplies does not exceed turnover limit and Timings of VAT payments may create problem for business.

5.3 FLAT RATE SCHEME

VAT = Sale (VAT inclusive) X Flat rate %

- This scheme is available to small businesses. Under this scheme VAT liability is calculated by simply applying a flat rate percentage to total turnover including zero rate & exempt supplies. *(Flat rate % will be given in exam).*
- No input VAT is recoverable with the exception of non-current assets having cost more than £2,000.

***Conditions to join the scheme*:**

- Taxable turnover (exclusive of VAT) not exceeding £150,000 per annum.
- VAT returns must be up-to-date and no convictions for VAT offences or penalties in past.
- If the taxable turnover exceeds £230,000 the trader will have to exit the scheme.

DISAGGREGATION

If HMRC finds that a person split its business into parts to avoid vat registration then HMRC will issue a direction and sales revenue from all parts will be taken into account to determine VAT registration limit. However direction cannot have retrospective effect.

6 Land and Buildings

Type of supply:

- Sale of new commercial building are *standard rated.* ('New' means < 3 years old)
- Sale/lease (> 21 years) of residential or charitable property are *zero-rated*.
- All other supplies of land and building taxpayer has 2 options. ***Option 1 exempt, Option 2 option to tax.***

Option to Tax: A VAT registered seller can opt to waive exemption and elect to opt for VAT.

- **Conditions:** An election must be made within 30 days from date of contract. However it could be withdrawn within 1st 6 months or after 20 years otherwise it is irrevocable. A separate election should be made for each building (election can't be made for part of building).
- **Tax Implication:**

- Supply of Land & Building will become taxable for VAT.
- Rent received from that building (if rented) will become liable to VAT @ standard rate (20%).
- Landlord can recover any input tax on the purchase and running costs of the building
- The new owner (purchaser) has once again has both options exempt and option to tax.

7 Partially Exempt Business

Businesses which are engaged in both taxable and exempt supplies are called partially exempt business. Partially exempt business can recover input VAT in the following manner:

a) Input VAT related to taxable supplies & expenses is *fully recoverable*.

b) Input VAT related to exempt supplies is *not recoverable*.

c) Input VAT, Non-attributable or related to overheads is Recoverable in "*proportion of taxable supplies*"

$$\text{Recoverable VAT} = \text{Non-attributed input VAT} \times \frac{\text{Taxable supplies}}{\text{Total Supplies}}$$

Taxable supplies and total supplies will be taken excluding VAT. Supplies of capital goods are excluded when calculating this proportion.

- Individual is required to use the %age of the last year for the recovery of input VAT in respect of overheads.
- Individual can use quarterly %age instead of previous year with an annual adjustment at year end.

➢ **De Minimis limits**

Whole irrecoverable input VAT will become recoverable if business is below the *following De Minimis limits*:

- Total input VAT ≤ £625/month and exempt supplies are less than 50% of total supplies.
- Total input VAT less input VAT related to taxable supplies is ≤ £625/month and exempt supplies are less than 50% of total supplies.
- Input VAT related to exempt supplies ≤ £625/month and input VAT relating to exempt supplies is ≤50% of total input VAT.

Annual Adjustment:

Input VAT is calculated for each VAT return period separately (i.e. usually for each quarterly return, or based on the previous year). At the end of the accounting period, an annual adjustment calculation must be performed to make adjustment for over/under declaration.

8 Capital Goods Scheme

This scheme is available to partially exempt businesses only and applicable upon:

(i) *Purchase of land and building having value £250,000 or more*. The related adjustment period is 10 years however it will be 5 years if the land and building is acquired under lease agreement.

(ii) P*urchase of computers equipment's having value £50,000 or more* and the related adjustment period is 5 years.

If the scheme applies, the initial deduction of input VAT is made in ordinary way and then reviewed over the adjustment period. Adjustments are made over the adjustment period if proportion of the exempt supplies changes and is calculated as follows:

$$\text{Annual adjustment} = \frac{\text{Total input VAT}}{\text{Adjustment period}} \times (\text{\% of taxable supplies now} - \text{\% of taxable supplies in year of purchase})$$

➢ ***Adjustments for sale***

On the disposal of an asset under the capital goods scheme during the adjustment period:

- The annual adjustment is made as normal in the year of disposal (as if the asset had been used for the full year).
- A further adjustment must be made to cover the remaining intervals.

The adjustment for sale is as follows:

- If the disposal was taxable (e.g. option to tax exists), we assume 100% taxable use for the remainder of the adjustment period, although note that the VAT recovery cannot exceed the VAT charged on the sale of the asset.
- If the disposal was exempt (e.g. no option to tax exists), we assume 0% taxable use for the remainder of the adjustment period.

9 IMPORTS, EXPORTS, ACQUISITIONS, DESPATCHES

Trading with Non-European Countries:

➢ **EXPORTS** (sales to countries outside the EU.)

- Supply will treated as zero rated

➢ **IMPORTS** (Purchases from countries outside the EU.)

- These are taxed at Standard Rate or Zero Rate as it would have been taxed as UK supplies.
- Supply of services from non-European countries is treated as above. BUT input VAT is not paid to HMRC at point of entry into the UK (Not goods), the UK customer will account for UK VAT when the service is performed.

Trading with European Countries:

➢ **Exports (Dispatches)** (Sales to countries in the EU.)

- The supply will be treated as zero rated if purchaser is registered for VAT and standard rate if the purchaser is not VAT registered.

➢ **Imports (Acquisitions)** (Purchases from countries in EU)

- These are taxed at Standard Rate or Zero Rate as it would have been taxed as UK supplies.

Imports from outside the EU

Goods

VAT is charged on goods imported from outside the EU as if it were a customs duty. It is normally collected direct from the importer at the place of importation, such as a port or airport.

- If the imported goods are immediately placed in a bonded warehouse or free zone, then VAT is postponed until the goods are removed from the warehouse or zone.
- Approved traders can pay all their VAT on imports through the Duty deferment system. In order to set up an account with HMRC the trader will need to arrange a bank guarantee. This allows all VAT on imports to be paid on the 15th of the month following the month of importation.
- This assists the trader's cash flow and is more convenient than having to be paid at the point of import.
- VAT can then be reclaimed as input VAT on the VAT return for the period during which the goods were imported.
- The net effect of importing goods is therefore the same as if the goods were bought within the UK.

Services

The treatment of services purchased from outside the EU is generally the same as the treatment of services purchased from within the EU, and is discussed later in this section.

Exports outside the EU

Goods: The export of goods outside the EU is a zero-rated supply. This is a favourable treatment for the exporter as it allows them to recover input tax. It also means the customer is not charged VAT.

Services: The supply of services outside the EU is outside the scope of VAT.

Transactions within the EU

Goods

The following table summarises the two situations which can occur when trading goods between EU countries.

	Transactions	Accounting for VAT
Supplier and customer registered (the destination system).	Zero-rated in country of origin. Chargeable at the appropriate rate in force in country of destination.	**(a)** Supplier does not account for output VAT – supply zero-rated. **(b)** Customer must account for output VAT on their VAT return at rate in force in customer's country. **(c)** VAT suffered by customer may be reclaimed by them as input VAT in the appropriate quarter
Supplier registered but not customer (the origin system).	Chargeable at the appropriate rate in force in the country of origin.	(a) Supplier accounts for output VAT. (b) No input VAT recoverable by the customer (as not VAT registered).

The output VAT on purchases from the EU must be accounted for by the customer in their VAT return for the date of acquisition.

The date of acquisition is the date of the VAT invoice, which must be issued by the 15th day of the month following the month in which the goods came into the UK.

Both the output VAT and input VAT are therefore likely to be on the same. VAT return and will cancel out, unless the business makes exempt supplies and therefore cannot reclaim input VAT. VAT on purchases from within the EU and outside the EU is collected via different systems, however, both leave the UK business in the same overall financial position.

Services

The rules governing VAT on the supply of services are complex. These notes just cover the basic principles needed for the F6 examination.

For services, VAT is generally charged in the place of supply.

The place of supply varies depending on whether the customer is a business or non-business customer.

Supply of service to	**Place of supply**
Business customer	Where the customer is established
Non-business customer	Where the supplier is established

These rules can be applied to a UK business as follows:

UK business		
Supplies services to	Overseas business customer	• Place of supply is overseas • Outside the scope of UK VAT
Receives services from	Overseas business	• Place of supply is UK • Reverse charge procedure: UK business accounts for 'output VAT' at standard UK rate on VAT return. This VAT can then be reclaimed as input VAT.

Time of supply for cross border supplies of services

The rules are governed primarily by when a service is performed and a distinction is made between single and continuous supplies.

- For single supplies, the tax point will occur when the service is completed or when it is paid for if this is earlier.
- In the case of continuous supplies, the tax point will be the end of each billing or payment period.

10 ADMINISTRATION OF VAT

VAT return and payment procedures

Normal VAT accounting

- VAT return periods are normally three months long, but traders who regularly receive repayments, can opt to have monthly return periods to receive their repayments earlier.
- VAT returns show total output VAT and total input VAT for the period.
- All businesses must file their VAT return and pay VAT electronically.
- The deadline for filing and payment online is One month and seven days after the end of the quarter.

VAT refunds

- VAT refunds are normally made within 21 days.
- Where it is discovered that VAT has been overpaid in the past, the time limit for claiming a refund is four years from the date by which the return for the accounting period was due

Normal VAT invoices

The original VAT invoice is sent to the customer and forms their evidence for reclaiming input VAT, and a copy must be kept by the supplier to support the calculation of output VAT.

- A VAT invoice must be issued when a standard rated supply is made to a VAT registered business.
- The invoice can be sent electronically provided the customer agrees.
- No invoice is required if the supply is exempt, zero-rated or to a non- VAT registered customer

A VAT invoice should be issued within 30 days of the date that the taxable supply is treated as being made. VAT invoice must include following detail:

a) The supplier's name, address and registration number
b) The date of issue, the tax point and an invoice number
c) The name and address of the customer
d) A description of the goods or services supplied, giving for each description the quantity, the unit price, the rate of VAT and the VAT exclusive amount
e) The rate of any cash discount
f) The total invoice price excluding VAT (with separate totals for zero-rated and exempt supplies)
g) Each VAT rate applicable and the total amount of VAT

If an invoice is issued, and a change in price then alters the VAT due, a credit note or debit note to adjust the VAT must be issued.

Less Detailed VAT invoices

A **less detailed VAT invoice** may be issued by a taxable person where the invoice is for a total including VAT of up to £250. Such an invoice must show:

a) The supplier's name, address and registration number
b) The date of the supply
c) A description of the goods or services supplied
d) The rate of VAT chargeable
e) The total amount chargeable including VAT

Zero-rated and exempt supplies must not be included in less detailed invoices.

VAT invoices are not required for payments of up to £25 including VAT which are for telephone calls, or car park fees, or made through cash operated machines. In such cases, input tax can be claimed without a VAT invoice.

VAT Surcharge:

If a taxable person submits a late VAT return, or submits a return on time but makes late payment of VAT due, then the HMRC may issue a 'surcharge Notice' which would specify the 'surcharge period' - which lasts for next 12 months and no penalty arise. If within 'surcharge 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.

Default in the surcharge period	Surcharge as a % of outstanding VAT @ due date
1st default	2%
2nd default	5%
3rd default	10%
4lh or more default	15%

Note: Surcharges at 2% and 5% rates are not normally demanded unless the amount due would be at least £400 BUT for surcharges calculated using the 10% or 15% rates there is a minimum amount £30 payable.

Surcharge period can only be eliminated if individual has 4 consecutive VAT returns on time.

VAT Records:

The business should retain all record for 6 years. Record should include record of all outputs, inputs, invoices, vat account and any supporting documents for claim of recovery of input VAT.

PENALTIES AND INTEREST

➢ **Failure To Notify HMRC About Registration:**

If a person who is exempted from registration, fails to notify liability for registration or change in nature of supplies there will be a standard penalty based on a percentage of the VAT lost during the period from when the notification should have been made until it is actually made. Actual penalty payable is linked to the taxpayer's behaviour.

- ***No penalty*** if reasonable excuse for failure to notify
- ***30% unpaid tax*** if non-deliberate failure to notify
- ***70% unpaid tax*** if deliberate failure to notify
- ***100% unpaid tax*** if deliberate failure to notify with concealment.

Note: Penalty will be reduced where a taxpayer make a disclosure, especially when this is unprompted by HMRC.

Errors in a VAT return:

Error	Disclosure	Correction	Penalty	Interest charged
< De-minimis	Voluntarily	entering Errors in next VAT return	Possible	No
> De-minimis	By application	Voluntarily by application	Possible	@ 3%
Discovered by control visit			Apply	@ 3%

De-minimis level is the greater of: £10,000 and 1% × turnover (subject to on upper limit of £50,000)

➢ **Interest on Unpaid VAT:** Interest @ 3% is charged on VAT paid after due date & runs from due date till payment date

➢ **Penalties for Errors in VAT Return:** 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:

Maximum Penalty:

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

Minimum Penalties: Unprompted disclosure is one made at a time when HMRC has not discovered, or is not about to discover error.

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

CHAPTER 15
SELF ASSESSMENT FOR INDIVIDUALS

1 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 received 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 2015 for 2014/15. However notification is not necessary if there is no actual tax liability.

Electronic Return	Non-Electronic Return
Later of: **(a)** 31 January after end of tax year **(b)** 3 months after the issue of notice to file a return **NOTE:** In case of electronic return income tax liability is calculated automatically through online process.	**Later of:** **(a)** 31 October after end of tax year **(b)** 3 months after the issue of notice to file a return **NOTE:** In case of paper return HMRC will calculate income tax liability on taxpayer's behalf if return is submitted by the 31 October deadline which is called self-assessment.

2 AMMENDMENTS IN TAX RETURN:

A return may be amended by HMRC to correct any obvious error or omission within 9 months after the day on which the return was actually filed.

The taxpayer may amend his return (including the tax calculation) within twelve months after the 31 January filing date. E.g. 31 January 2017 for 2014/15.

3 DETERMINATIONS OF TAX DUE IF NO RETURN IS FILED:

if tax return is not submitted by due filings date even If notice has received from HMRC. An officer of HMRC may make a determination of the amounts liable to income tax and CGT tax and there is no appeal against it. Such a determination can be made within 3 years of filling date and can be replaced with actual self-assessment.

4 PAYMENT OF INCOME TAX AND CAPITAL GAINS TAX

Normal due Date: the due date to pay tax liabilities (income tax, class 4 NIC and CGT) are 31 January after the end of the tax year. E.g 31 January 2016 for 2014/15.

Payment on Account: Payment on account is required if income tax liability of previous year exceeds the tax deducted at source of previous year.

However POA is not required:

- If relevant amount of previous year is less than £1000 or
- Tax deducted at source of previous year is ≥80% of previous year income tax liability.

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

Payment on Account = Relevant Amount X 50%

Relevant Amount = Previous year Income Tax + Previous year Class 4 NIC — Previous year tax at source

Final Balancing Amount: Current year Income Tax payable (current year income tax+ Current year Class 4 NIC + Current year CGT - Current year tax at source - Both Payment on Accounts.

5 PENALTIES ON LATE BALANCING PAYMENT OF TAX

PAID	Penalty
More than 30 days but Within 6 months after the due date	5%
More than 6 months but not more than 12 months after the due date	10%
More than 12 months after the due date	15%

6 INTEREST ON LATE PAID TAX: Interest is chargeable on late payment @3% of both payments on account and balancing payments. Interest runs from due date till actual date of payment. (Interest Rate will be given in exam)

7 REPAYMENT INTEREST:

Interest may be paid by HMRC @ 0.5% p.a on any overpayment of tax:

(i) It runs from due date of tax or the date HMRC actually received the tax till

(ii) The date of repayment.

8 KEEPING OF RECORDS:

All records must be retained until 5 years after the 31 January following the tax year where **taxpayer is in business** (eg. a sole trader or partner or letting property).

For all other taxpayers (e.g. employees) records must be retained until later of:

a) 1 year after the 31 January following tax year.

b) Date of completion of compliance check

c) The date on which start of compliance check becomes impossible.

Maximum penalty to each failure to retain records is £3,000 per tax year.

9 CLAIMS: All claims and elections must be made in a tax return. *Time limit for making a claim for Current year trading loss relief, carry back trading loss relief, early year trading loss relief and rent a room relief is by 31 January which is approximately 22 months after end of tax year. For all other claims time limit is 4 years after end of tax year.*

10 TAX EVASION and TAX AVOIDANCE: Tax evasion is illegal and Tax avoidance is legal way to reduce tax liability

11 DISCOVERY ASSESSMENTS: If an officer of HMRC discovers an error 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 6 years in case of careless error and 20 years where tax is lost due to deliberate understatement.

Discovery assessment may be appealed against.

12 PENALTIES FOR ERRORS:

Maximum Penalty:

Types of error	Penalty (% of PLR)
Careless	30%
Deliberate not concealed	70%
Deliberate & concealed	100%

Minimum Penalties: Unprompted disclosure is one made at a time when HMRC has not discovered, or is not about to discover error.

Types of error	Unprompted	Prompted
Careless	0%	15%
Deliberate not concealed	20%	35%
Deliberate and concealed	30%	50%

13 PENALTIES FOR LATE NOTIFICATION: There is a common penalty regime for submission of incorrect returns (of any tax) late notifications of chargeability of tax or register for tax, including income tax, NICs, CGT, corporation tax and VAT. Penalties may be reduced if a taxpayer makes unprompted or prompted disclosure.

	Maximum Penalty	*Minimum Penalties:*	
Types of error	(% of PLR)	Unprompted (% of PLR)	Prompted (% of PLR)
Careless	30%	0%	10% or 20%
Deliberate not concealed	70%	20%	35%
Deliberate and concealed	100%	30%	50%

Unprompted disclosure is one made at a time when HMRC has not discovered. or is not about to discover error.

14 PENALTIES FOR LATE FILING OF TAX RETURN

- **Tax return Late upto 3 Months**: Penalty is £ 100
- **Tax return Late by more than 3 Months but upto 6:** £100 + (£ 10 per day between 3 months to 6 months)
- **Tax return late by more than 6 months but upto 12 months:** Penalty is greater of: *5% of Tax Liability and £300*
- **Tax return late by more than 12 months**

Type of conduct	Careless	Deliberate not concealed	Deliberate and Concealed
PENALTY	Greater of: • 5% of Tax Liability • £300	Greater of: • 70% of Tax Liability • £300	Greater of: • 100% of Tax Liability • £300

15 Compliance check enquiries

- **Starting compliance check enquiry:**

HMRC have the right to enquire into the completeness and accuracy of any self-assessment tax return under their compliance check powers. HMRC do not have to state a reason for the enquiry and an enquiry can be made even if HMRC calculated the taxpayer's tax liability.

- HMRC must give written notice before commencing an enquiry.
- The written notice must be issued within 12 months of the date the return is filed with HMRC.

Compliance check can be started as a result of any of the following.

- A suspicion that income is undelared
- Deductions being incorrectly claimed
- Other information in HMRC's possession
- Being part of a random review process.

- **During the compliance check enquiry:**

HMRC can demand taxpayer to produce Documents, Accounts or any other information required.
The information requested by HMRC should be limited to that connected with the return.
An appeal can be made against the request.

- **Completion of compliance check enquiry:**

The enquiry ends when HMRC gives written notice that it has been completed. The notice will state the outcome of the enquiry. The closure notice must include either:

- Confirmation that no amendments are required
- HMRC's amendments to the self-assessment.

The taxpayer has 30 days to appeal against any amendments by HMRC. The appeal must be in writing.

16 Disputes and appeals

Disputes between taxpayers and HMRC can be dealt with by an HMRC internal review or by a Tribunal hearing.

- **Internal reviews**

For direct taxes, appeals must first be made to HMRC, which will assign a 'caseworker'.
For indirect taxes, appeals must be sent directly to the Tax Tribunal, although the taxpayer can continue to correspond with his caseworker where, for example, there is new information.
At this stage the taxpayer may be offered, or may ask for, an **'internal review'**, which will be made by an objective HMRC review officer not previously connected with the case. This is a less costly & effective way to resolve disputes informally, without need for Tribunal hearing. An appeal to Tax Tribunal cannot be made until any review has ended.
The taxpayer must either accept the review offer, or notify an appeal to the Tax Tribunal within 30 days of being offered the review; otherwise the appeal will be treated as settled.
HMRC must usually carry out the review within 45 days, or any longer time as agreed with the taxpayer.
The review officer may decide to uphold, vary or withdraw decisions.
After the review conclusion is notified, **the taxpayer has 30 days to appeal to the Tax Tribunal.**

- **Tribunal hearings:**

If there is no internal review, or the taxpayer is unhappy with the result of an internal review, the case may be heard by the Tax Tribunal. The person wishing to make an appeal (the appellant) must send a notice of appeal to the Tax Tribunal. The Tax Tribunal must then give notice of the appeal to the respondent (normally HMRC).
The Tax Tribunal is made up of two 'tiers':

a) A First Tier Tribunal
b) An Upper Tribunal

The case will be allocated to one of four **case 'tracks':**

(a) Complex cases, which the Tribunal considers will require lengthy or complex evidence or a lengthy hearing, or involve a complex or important principle or issue, or involves a large amount of money.
Such cases will usually be heard by the Upper Tribunal

(b) Standard cases, heard by the First Tier Tribunal, which have detailed case management and are subject to a more formal procedure than basic cases

(c) Basic cases, also heard by the First Tier Tribunal, which will usually be disposed of after a hearing, with minimal exchange of documents before the hearing

(d) Paper cases, dealt with by the First Tier Tribunal, which applies to straightforward matters such as fixed filing penalties and will usually be dealt with in writing, without a hearing

A decision of the First Tier Tribunal may be appealed to the Upper Tribunal.
Decisions of the Upper Tribunal are binding on the Tribunals and any affected public authorities. A decision of the Upper Tribunal may be appealed to the Court of Appeal.

SELF ASSESSMENT FOR COMPANIES

1 Notification of chargeability:

A company falling within the scope of corporation tax for the first time must notify HMRC within 3 months of start of the accounting period. Failure to notify chargeability to tax within 12 months of the end of the accounting period will lead to a standard penalty based on a percentage of the tax unpaid 12 months after end of the accounting period.

2 Payment of tax:

- **Normal:** corporation tax is payable 9 months and one day after the end of each accounting period.
- **Quarterly Installments:** Available to large companies. Large company is one paying corporation tax at main rate. Four quarterly installments will be made on 14th of months 7, 10, 13 and 16 following the start of the accounting period. Installments are based on the estimated current year's liability.

Quarterly payments are not required if current profits ≤£10 million and the company was not large in previous year.

3 Corporation tax return:

- **Notification of chargeability:** CO. receives a notice of chargeability to corporation tax after end of Acc. Period and must notify HMRC within 12months from end of accounting period if does not receive a notice.
- **Return:** Company's tax return is filed electronically and must include self-assessment of tax with their accounts.
  The return is due for filling on/or before the later of:
  - 12 months after the end of the period to which return relates
  - 3 months after the date on which the notice to file the return is received

Failure to submit the return on time will result in penalty as follows:

Return late by	**Penalty (1st & 2nd consecutive failure)**	**Penalty (3nd & consecutive failure)**
Upto 3 months	£100	£500
More than 3 upto 6 months	£200	£1000
More than 6 upto 12 months	£200 + 10% of tax	£1000 + 10% of tax
More than 12 months	£200 + 20% of tax	£1000 + 20% of tax

4 Claims:

If a company believes it has made an error in a return, an error or mistake claim may be made within four years from the end of the accounting period. Other claims must be made within four years of the end of the accounting period unless a different time limit specified.

5 Records:

Companies must keep records until the latest of:

- **Six years** from the end of accounting period
- Date any enquiries are completed
- Date after which enquiries may not be commenced

Failure to keep records can lead to a penalty or up to £3,000 for each accounting period.

6 Determinations and Discovery assessments:

If a return is not delivered by the filing date, HMRC may issue a determination of the tax payable within 3 years of the filing date. There is no appeal against it.

Discovery assessment: HMRC can raise an assessment within 4 years from the end of the accounting period; this is extended to 6 years if there is a careless error or 20 years if there is a deliberate error or failure to notify chargeability to tax.

7 Appeals and Disputes

The company can appeal against amendments to the corporation tax return. The appeal must be normally be made within 30 days of the amendment and must state the grounds for appeal. The appeals procedure is as per VAT.

8 Penalties for incorrect returns

- No penalty where a taxpayer simply makes a mistake
- 30% unpaid tax where a tax payer fails to take reasonable care.
- 70% unpaid tax if error is deliberate.
- 100% unpaid tax if deliberate failure with concealment.

Note: Penalty will be reduced where a taxpayer make a disclosure, especially when this is unprompted by HMRC.

ABOUT THE AUTHOR

Mr. Aziz Ur Rehman is an ACCA and well-known educationalist having more than 8 years of teaching experience in subjects of F3, F6, F7, P3 & P6 of ACCA along with subjects of Business Strategy, Business analysis & Advanced Taxation of ICAEW.

Apart from the aforesaid, Mr. Aziz-Ur-Rehman is also involved in preparation of books, notes and other helping material for different subjects of professional qualifications.

He invites feedback from students, visitors and teachers to help make this publication and others even better.

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