ACCA P6

Advance Taxation

SMART COMPENDIUM NOTES

For Exams in June & December 2015

Syllabus Coverage 100%

Marks Oriented (Exam Focused)

Authenticity (Reviewed by top tutors)

Relevant (ICAEW, ACCA F6&P6)

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40

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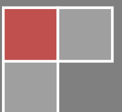
AZIZ UR REHMAN (ACCA)

Contact:

Mob: +923327670806

Emaiil: azizurrehman89@hotmail.com



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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 14 to 5th April 15.
Individual: *Non UK Residents* Pay UK Income tax on their UK Income only while *UK residents* Pay UK income tax on their worldwide income.

TAXABLE PERSON:

➢ ***Non UK Resident:*** Non UK resident persons Pay UK Income tax on his UK Income only.

Automatically treated as 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.

➢ ***A UK resident person:*** Pay UK income tax on his worldwide income.

Automatically treated as UK Resident:
- 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.

Not Automatically treated as UK Resident:

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.
- Having a house in the UK which is made use of during the tax year.
- Doing substantive work in the UK where 40 days or more is regarded as substantive.
- Being in the UK for more than 90 days during either of the two previous tax years.
- Spending more time in the UK than in any other country in the tax year.

Days in UK	Not UK Resident in any of the previous three tax years	UK Resident in any of the previous three tax years
Upto 15	Automatically non resident	Automatically not resident
16 to 45	Automatically non resident	Resident if 4 UK ties (or more)
46 to 90	Resident if 4 UK ties	Resident if 3 UK ties (or more)
91 to 120	Resident if 3 UK ties (or more)	Resident if 2 UK ties (or more)
121 to 182	Resident if 2 UK ties (or more)	Resident if 1 UK tie (or more)

1 TYPES OF INCOME

Exempt Income:
- Interest from national savings and investments certificates
- Gaming winning, Batting, lottery and premium bonds winnings
- Income received from an individual saving account (ISA)
- Scholarship income and state benefits paid in the event of accident, sickness or disability.

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.
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*
• Individual saving account (ISA)	• National saving and investment bank A/c
• National saving and investment certificates	• Government securities and Debentures of listed companies

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

2 INCOME TAX PERFORMA

Mr. A Income Tax computation 2014/15

		OTHER INCOME	SAVING	DIVIDENDS
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 100/50	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		
Tax Liability		XX		
Less: Tax Reducer	(See later in this chapter)	(XX)		
Less: Tax Deducted At Source				
Interest Income @ 20 %		(XX)		
Dividend Income @ 10%		(XX)		
PAYE		(XX)		
Trust (10%, 20%, 50%)		(XX)		
Income Tax Payable		XX		

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 company.
- To invest in partnership
- To purchase shares in close trading company. (company having shareholders ≤ 5)

NOTE 2: PERSONAL ALLOWANCE

Date of Birth	Personal Allowance	Adjusted net Income
Born on or after 6 April 1948	£10,000	£100,000
Born between 6 April 1938 and 5 April 1948	£10,500	£27,000
Born before 6 April 1938	£10,660	£27,000

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

NOTE 3: Calculation of Income Tax Liability:

Starting Band Rate			
£1------------- £2,880	20%	10%	10%
Basic Rate Band			
£2881-------------£31,865 (£28,985)	20%	20%	10%
Higher Rate Band			
££31,865------------ £150,000 (£118,135)	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)

3 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.

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

Discretionary trusts:

It is an arrangement whereby:

- Settlor transfers legal ownership of property to a trust for the benefit of person/persons (known as beneficiaries').
- During the life of trust, the beneficiaries have no legal right to receive any income or capital from the trust fund.
- Any payment of income or capital out of the trust fund is at the discretion of the trustees, and subject only to the powers and duties specified in the trust deed.

Interest in possession trusts:

in this trust

- The trustees have no discretion over the payment of either income or capital assets transferred to trust.
- Income will be managed as per instructions of settler.
- Normally the income will be given to the settler during his life time and the capital will be distributed to the beneficiary after death of the settler.

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 @50% from discretionary trust. So income is gross up for income tax computation. Tax credit is given @ 10%, 20% or 50% by deducting it from income tax liability.

Income from discretionary trust

Gross income= Net income X 100/50

Income from interest in possession trust:

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

IHT and CGT implication of trust is not examinable.

4 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.

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.

5 CHILD BENEFIT INCOME TAX CHARGE

An income tax charge has been introduced where a person's adjusted net income exceeds £50,000 and they receive child benefit. Child benefit is a tax-free payment that can be claimed in respect of children, and the tax charge in effect removes the benefit for those on higher incomes.

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, the amount of the income tax charge is equivalent to the amount of child benefit received.

6 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 and not in financial difficulty.	Unquoted and not in financial difficulty.	*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 raised by share issues	Used by company or its 90% subsidiary in qualifying trade (See Note) within 2 years of share issue.	Used by company or its 90% subsidiary in qualifying trade (See Note) within 2 years of share issue.	
Employees	Less than 250 full-time employees	Less than 25 full-time employees	
Gross Assets	≤£15m prior to and ≤£16m after share issue.	≤£200,000 before share issue.	
annual funds	Company must not have raised more than £5m from schemes (EIS, VCT and SEIS) in previous 12 months from date of the investment.	Company must not have raised more than £150,000 from SEIS investments in previous 12 months from date of the investment.	Company must not have raised more than **£5m** from schemes (EIS, VCT and SEIS) in previous 12 months from date of investment
Investor			
Investment & investor	• Investor must subscribe for ordinary shares wholly in cash and • Must not be connected. (Not employee nor own >30% shares by himself or associates ie spouse/civil partner or child, but not a brother or sister).	• 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)	
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 up to previous year unused annual limit.	If an individual wants to invest more than annual limit then he can invest in previous year but up to previous year unused annual limit.	
Dividend	Taxable.	Taxable.	Exempt.
BPR	Available if shares are owned for ≥ 2 years.	Available if shares are owned for ≥ 2 years.	Not Available
Deferral relief	EIS deferral relief is available.		
IT Reducer	30% of investments.	50% of investments.	30% of investments.

Withdrawal of Relief	• If shares are sold after 3 years full income tax reducer is available & capital gain is exempt. • If shares are sold before 3 years than: –Any resulting capital gain will be taxable, –Capital losses will be allowable however election can be made to treat capital loss as trading loss, –Income tax reducer will have to be repaid.	• If shares are sold after 3 years full income tax reducer is available & capital gain is exempt. • If shares are sold before 3 years than: –Any resulting capital gain will be taxable, –Capital losses will be allowable however election can be made to treat it as trading loss –Full IT reducer will be repaid if not sold at arm's length & 50% of amount received if sold at arm's length.	• If shares are sold after 5 years full income tax reducer is available. • Capital gain on disposal of shares is exempt whether sold before or after 5 years.

- **Qualifying Trade:** Qualifying trades include all trades except dealing in land, financial activities, legal, accountancy services and properties.
- Tax Reducer can reduce income tax liability up to Nil.

PENSION

OCCUPATIONAL PENSION SCHEME (OPC)	PERSONAL PENSION SCHEME (PPC):
• 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.	• PPC is managed by private financial institutions.(eg banks) • Anyone may contribute in a personal pension scheme. • Contribution in PPC is gross up by 100/80 and basic and higher rate bands will be extended by this gross amount.

- **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. 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 Allowance Charge:** Contribution 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.

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

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	
		(XX)
Property Business Profit/Loss		**XX**

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

- Limit of £4,250 will be reduced if another person also receives income.

5 Furnished Holiday Letting (FHL)

Conditions to qualify as FHL:
- Situated in UK, furnished and let commercially.
- Available for letting for ≥210 days in a tax year.
- Actually let for ≥105 days in a tax year.
- Available for short term letting (≤31 regular days). If let on long-term then total of such letting should ≤155 days.

Benefits of FHL:
- Loss of FHA is set off from income of same FHA
- FHA income Qualifies for personal pension scheme.
- CGT roll-over & entrepreneur relief is available.
- Capital allowances available on plant and machinery including furniture and furnishings.

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 so the price of debenture is apportioned between interest & capital element.

8 Individual Saving account

ISA can be opened by individual aged ≥18 (16 for cash ISA) and resident or ordinary 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.

- **Maximum investment limit:** For the tax year 2014-15 a person can invest up to £15,000 in NISA. The £15,000 limit is completely flexible, so a person can invest £15,000 in a cash NISA, or they can invest £15,000 in a stocks and shares NISA, or in any combination of the two.

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:

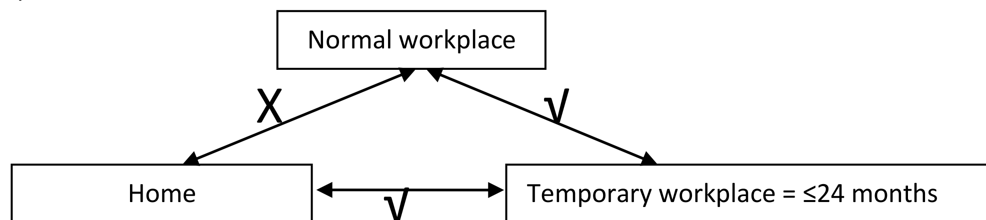
Employment income is calculated for a tax year (6April—5April) on receipt basis rule.

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) Employer Year end date if earnings are determined before year end
e) Determination date if earnings are determined after year end.

➢ ALLOWABLE DEDUCIONS

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



3 EXEMPT BENEFITS

- Free or subsidized meals if available to all employees.
- Provision of parking space at or near place of work.
- Workplace childcare, sports or recreation facilities.
- Payment to approved child career is exempt upto £55 for basic, £28 for higher and £25 for additional rate taxpayer.
- The provision of one mobile phone.
- 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.
- The cost of work-related training course.
- 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.
- 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.
- Premium paid by employer for employee's Permanent Health Insurance.
- 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.

4 TAXABLE BENIFITS

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

4.2 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 3.25%

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.

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.

4.3 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 by 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:

Upto ----------- 75g/km	5%
76g/km ----------- 94g/km	11%
95 g/km	12%

If CO2 emission >95g/km then 1% increase for each complete additional 5 grams of CO2 emission.
Add 3% for diesel Car but max percentage is 35%

No extra benefit will arise for cost of insurance, repair & maintenance and running cost because it is included in car benefit.

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

Fuel benefit = £21,700 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.

4.5 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	45pence/mile	25pence/mile
Motor-cycle	24pence/mile	24pence/mile
Pedal-cycle	20pence/mile	20pence/mile

4.6 Van Benefit: If van is provided to employee for private use then taxable benefit of ***£3,090 p.a.*** will arise. If employer also provides fuel for the van then additional taxable benefit of ***£581 p.a.*** will arise.

4.7 Beneficial Loans: A beneficial loan is one made to an employee below the official rate of interest of 3.25%. 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 3.25% (official rate %)	Balance of Loan outstanding in months X months/12 X 3.25%

- 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.

4.8 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)

4.9 Gift Of Asset:

- **Gifted New Asset To Employee:** Taxable benefit will be equal to ***cost to employer.***
- **1st Asset Is Provided For Use Then Subsequently Gifted To Employee:** Taxable benefit will be higher of:

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

5 Approved and Unapproved Share option Schemes:

	Grant of option	Exercise of option	Disposal of Shares
Approved	No tax	No tax	**Capital gain arises.** Sale proceed X Cost of option (X) Cost of shares (X) Capital Gain/Loss X
Unapproved	No tax	**Income tax charge:** MV @ exercise date X Cost of option (X) Cost of shares (X) Employment income X NIC payable if shares are quoted.	**Capital gain arises.** Sale proceed X MV @ exercise date (X) Capital Gain/Loss X

5.1 Approved Share Option Scheme

Schedule 3 SAYE option scheme (SAYE):

- Under this scheme companies provides small no of share options to their employees.
- Employees are required to contribute between £5 to £500/month for a period of 3, 5, 7 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.
- Exercise price of the option must be fixed at grant date of option and should not be less than 80% of the market value of shares at grant date.
- The cost of setting up the scheme is an allowable trading expense of company.

Tax implication: As an approved scheme no tax implication will arise either at grant date or at exercise date but CGT may arise on subsequent disposal of shares.

Schedule 4 company share option plan (CSOP):

- Under this scheme company allocates share options to selected employees (as per company discretion) and no contribution from employees is required.

Conditions to set up scheme:

- All employees (part time or full time) are eligible to participate but directors should be full time working director. Share options are allocated to selected employees. 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 of the option must be fixed at grant date of option and should not be less than 80% of the market value of shares at grant date.
- Employees having ≥ 30% shares of CO. are not eligible.
- Cost of setting up scheme is an allowable trading expense of company.

Tax implication: As an approved scheme no tax implication will arise either at grant date or at exercise date but CGT may arise on subsequent disposal of shares.

Enterprise Management Incentive (EMI): Under this scheme company allocates share options to selected employees (as per company 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:

- As an approved scheme no tax implication will arise either at grant date or at exercise date but CGT may arise on subsequent disposal of shares.
- A taxable benefit may arise at exercise date if exercise price is less then market value of shares at grant date. Taxable benefit will be market price at grant date less option exercise price.

5.2 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

Class 1 primary NIC may arise if shares are quoted and class 1A NIC 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 as 1 for 2 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.
- For the tax free advantage shares in plan must be retained for a period of 5 years.

Conditions to set up scheme:

- All the employees can participate in the scheme.
- Plan should not have any arrangement for loan to employees.
- If shares in plan are retained for a period of 5 years then No income tax or NIC arise.
- If shares are withdrawn after 3 years but before 5 years, there is charge to income tax and NIC based on lower of the value of the shares at the time of purchase of the shares and their value at the date of withdrawal.
- If shares are withdrawn before 3 years, there is charge to income tax and NIC on market value of the shares at the date of withdrawal.

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 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. If a loss arises on a disposal of employee shareholder shares, that loss will not be an allowable loss if the gain would have been exempt due to the operation of the above rule. Shares are not treated as exempt assets if the employee holds at least 25% of the voting rights in the company.

6 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).

7 Dispensation

It is an arrangement under which employer commits HMRC not to report certain benefits provided to employee to reduce certain administration burden.

CHAPTER 4
NATIONAL INSURANCE CONTRIBUTIONS

- **Class 1 Primary:** Payable by employees above 16 years on cash employment income which includes: Wages, salary, overtime pay, Sick pay, Commission, Bonus, Remunerations & gratuities, Quoted shares.
- Contribution by employee is calculated as follows.

Cash Earnings	Contribution Rates
£.1 - £7,957 per year	Nil
£7,958 - £41,865 per year	12%
Above £41,865	2%

- Contribution is not allowable deductions for employee.
- Contributions are payable by 19th of each month.
- **Class 1 Secondary:**
- It is payable by employer for employee on same cash earnings calculated for class 1 primary contribution.
- Class 1 secondary contribution is calculated as follows:

Cash Earnings	Contribution Rates
£.1 - £7,956 per year	Nil
£ above £7,956 per year	13.8%

- Allowable deduction for employer & exempt benefit for employee
- Contributions are payable by 19th of each month.

- **Class 1A:**
- It is payable by employer on **non-cash benefits** (e.g. living accommodation benefit, car benefit, fuel benefit, beneficial loan, use of asset, gift of asset etc.) provided to 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.

- **Class 2:**
- Payable by self-employed @£2.75/week if trading profit exceeds £5,885.
- It is not allowable deduction from trading profit.
- **Class 4:** Payable by self-employed on tax adjusted trading profits as follows:

Cash Earnings	Contribution Rates
£.1 - £7,957 per year	Nil
£7,958 - £41,865 per year	9%
Above £41,865	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:	Disallowed expenses if deducted from accounting profit	X
ADD BACK:	Income not included but taxable under trading profit	X
LESS:	Allowable expenses if not deducted from accounting profit	(X)
LESS:	Income included but not taxable under trading profit	(X)
	Tax adjusted trading profit	X

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

- **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.

- **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.

- **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.

- **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 paid on grant of short lease is allowable and is calculated as follows:

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

n = no of years of lease.

- **Bad Debts/Allowance For Receivables**
- Bad debts and allowance for receivables relevant to trade are allowable e.g. bad debts on credit sales.
- General provisions for bad debts are disallowed and specific provisions are allowable.
- Non-trade bad debts are disallowed. (E.g. bad debt on loan given to employees, customers and suppliers.)
- Recovery of bad debts is taxable.

- **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.
- Eligible interest is disallowed.
- Fines, penalties and payment of damages are all disallowed unless car parking fine paid on behalf of an employee.
- 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 and amortisation is disallowed.
- Expenditure relating to proprietors car, telephone ------ etc is disallowed.
- Redundancy, loss of office and Removal expenses for employees
- Contributions to pension scheme
- Insurance expense and Patent Royalties are allowable.
- Payment of Class 1 (employer) NIC , Class 1A NIC
- The general rule is that expenditure not wholly and exclusively for the purpose of the trade is not allowable.
- Payment of class 1 (employee) NIC, Class 2 NIC, Class 4 NIC are disallowed.
- Payment of class 1 (employer) NIC, and Class 1A NIC are allowable.
- Employer contribution to pension scheme for employee.
- Loss on sale of assets (capital losses) are disallowed.
- Capital allowances are allowable.

CHAPTER 6
CAPITAL ALLOWANCES

Capital allowances are available for expenditure on plant and machinery. Plant and machinery is something with which a trade is carried on except doors, walls, windows, ceiling and floors. Capital allowances are deducted in arriving at the tax adjusted trading profit

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.
- Cars having co2 emission between 96g/km–130g/km are included in main pool.
- Addition increases the amount of pool and disposal reduces the amount of pool.

SPECIAL RATE POOL

Following P&M become part of special rate pool:

- **Long-life assets:** it includes P&M with a working life of ≥ 25 years or more and annual running cost of ≥£100,000.
- **'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 with co2 emissions > 130g/km**
- **Thermal insulation of building.**

SHORT-LIFE ASSETS (SLA)

- P&M except cars which individual wishes to sell within 8 years after Acc. period of purchase are called short-life assets. Every short life asset is kept in separate pool.
- Balancing allowance or charge arises on disposal within 8 years after the accounting period of purchase.
- 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.

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 where a period of account is ≤ 12 months.
- 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

WRITTEN DOWN ALLOWANCE (WDA)

- WDA of 18 % on reducing balance method is given each year on "Main Pool".
- WDA of 8% on reducing balance method is given each year on "Special Rate Pool".
- 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 on Purchase of low emission cars. (95 g/Km co2 or less) and Purchase of energy saving equipments
- FYA is not time apportioned if accounting period is short or long than 12 months.

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.

CARS

- Cars emitting ≤ 95 g/km co2 (low emission Cars) are eligible for FYA of 100%.
- Second hand motor cars emitting 95 g/km co2 or less are included in main pool.
- Cars emitting between 95 g/km Co2 160 g/km co2 are included in main pool.
- Cars emitting 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.

Note: Such cars must be kept separate from other assets.

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 ≤ 95 g/Km	X							
FYA @ 100%	(X)							X
Purchase of CAR which don't Qualify AIA								
Cars CO2 emission 95 – 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 & subsequent year Rule</td><td colspan="3">3rd & subsequent 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 overlap profits. 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>

<table>
<tr><td colspan="4">Basis Period for the tax year in which accounting date changes</td></tr>
<tr><td>Short period of account and one closing date end in a tax year.</td><td>Short period of account and two closing dates end in a tax year.</td><td>Long period of account and closing date end in a tax year.</td><td>Long period of account and no closing date end in a tax year.</td></tr>
</table>

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

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

- 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 2018 for losses arising in 2013/14.

➢ 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 total income less gross personal pension cont.
- *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.

➢ 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.
- In order to set off trading loss against capital gains the total income of that year first must be reduced to nill.
- 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.

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

- 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.

➢ Terminal loss relief:

Terminal loss relief: If trade ceases then Loss of last 12 month of trade may be set off from 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 2018 for losses arising in 2013/14.

➢ **Business transferred to a company:** Relief is available for trading losses on incorporation of an unincorporated trade. Trading losses are carried forward by the individual and set against first available income derived 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.

➢ 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.

- **CASH BASIS FOR SMALL BUSINESSES**

- It is available to business (except companies) whose revenue is initially below the VAT registration threshold of £81,000. It is available until its revenue is twice the VAT registration threshold – that is £162,000.
- With the cash basis, receivables, payables and inventory are ignored, and tax deductible capital and revenue expenditure will be treated the same – purchases of equipment are simply deducted as an expense, whilst the proceeds from any disposals are included with receipts.
- A business using the cash basis can use the approved mileage allowances to calculate the deduction for business mileage. The rate is 45p per mile for the first 10,000 miles, with a rate of 25p per mile thereafter. The actual running and capital costs of owning a motor car are ignored.
- Where the use of the cash basis results in a trading loss, the only relief available is to carry the loss forward against future trading profits. There is no relief against total income.
- Trading profit (or loss) under the cash basis is therefore calculated as follows:

Receipts (including sale of equipment)	xx
Expense payments (including the purchase of equipment)	xx
Trading profit (or loss)	xx

- **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:** – Calculate gains as normal – Allocate the gain between partners • **Distribution to 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.

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	No CGT implication

- **Chargeable Assets:** All assets are chargeable unless specifically exempt. Exempt assets include:
  - Motor vehicles
  - National Savings & Investment certificates
  - Cash, Debtors and trading inventory
  - Decorations awarded for bravery
  - Damages for personal injury
  - Shares in VCT
  - Works of art given for national use
  - Gilt edged securities
  - Qualifying Corporate Bonds
  - Some Chattels
  - Investments held in an ISA
  - Prizes and betting winning
- **Chargeable Person:** An individual who is either resident or ordinarily 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
  - Capital expenditure on enhancing the value of the asset
- **Incidental costs:**
  - Fee & commission of agent, legal fee, advertising cost, auctioneers fee, agency fee

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	(11,000)
Taxable Gains	X

- **Annual exemption:** Every individual has an exempt amount for each tax year. For 2014/15 it is £11,000
- **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 £31,865. 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 on 31 January following the tax year (2014/15 by 31 January 2016)

  Payment by installments: CGT can be paid by installments if consideration on disposal is received over a period of more than 18 months. In such cases 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.

2 Transfer of Assets between Husband and Wife or Between Civil Partners

The transfer of assets is at Nil gain/ Nil loss.

- **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.

3 Capital Losses

a) 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) Still any unrelieved capital loss will be carried forward and deducted from capital gains of future years.

NOTE: 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 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 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 deffered by deducting the Small Part Disposal proceed from original cost of land and building.

4.2 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 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 X $\frac{\text{Remaining life at disposal}}{\text{Total useful life}}$	(X)
Chargeable Gain/Loss	X

4.3 Asset Lost or Destroyed

Asset Lost or Destroyed

No Insurance Proceed	**Insurance Proceed Received**		
	No Replacement of Asset	**Replacement of Asset within 12 Months**	
Disposal Proceed Nil Allowable cost (X) Capital Loss ...X....	Normal CGT calculation.	**Full Reinvestment:** No gain/no Loss 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...	**Partial Reinvestment:** 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

4.4 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 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 A/(A+B) (X) Gain/ Loss X A= insurance proceed – restoration cost B= M.V of asset after restoration

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 % of remaining life of lease / % 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 shares for CGT will be lower of:
  a) Lower quoted price + 1/4 (higher quoted price – lower quoted price)
  b) (Highest marked bargain + Lowest marked bargain)/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

- **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:

shares.

Disposal Proceed (cash)	X
Less: Allowable cost	
Cost of original shares X Cash Received / (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.

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 X $\frac{\text{Period of occupation}}{\text{Period of ownership}}$	(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. However last 36 months still applies to that part unless the business part was at some time used as main residence.
- **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) Part of the remaining gain (after PPR relief) which relates to a period of letting

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 2014/15 by 31 January 2016.

- **Qualifying Business Disposals:**

- Disposal of the whole or part of a business runs as an unincorporated business.
- Disposal of assets of unincorporated trading business within three 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.

➢ **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 disposal.

➢ **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 roll-over relief is available on full gain. If there is partial reinvestment of 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.** 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 → Gift → **DONEE**

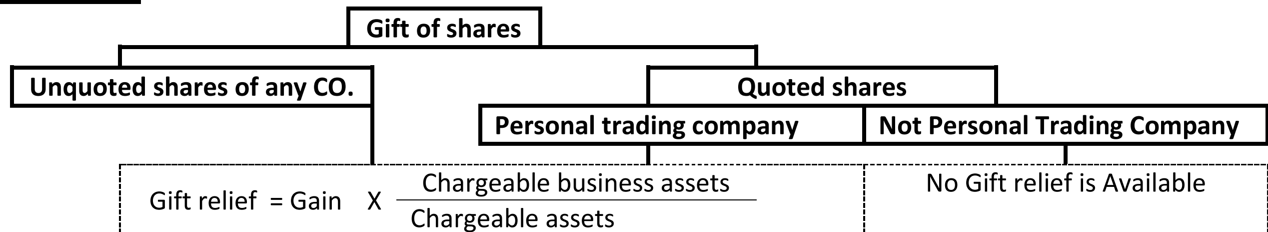
DONOR		DONEE	
Proceed	MV	Cost	MV
Less: Cost	(X)	Less: gain deferred	(X)
Gain	X		X
Less: Gain held over	(X)		
	Nil		

➢ **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 2013/14 the claim must be made by 5 April 2017.

➢ **Qualifying assets:** Gift relief may be claimed on the gift of the following assets:

- Assets used in the trade of Donor (Sole trader or partner in partnership) or Donor's personal trading company
- Unquoted shares and securities of any trading company.
- 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.)
- Agricultural property provided the conditions for inheritance tax agricultural property relief are satisfied
- 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)

- **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:**



- **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.

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 cost 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: Capital Gain X $\frac{\text{Value of shares issued}}{\text{Total consideration}}$

- **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:

An individual may defer a gain arising on disposal of any 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 disposal of EIS shares however gain on EIS is exempt if shares are held for 3 years.

- 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) The amount specified by the investor in the claim. This can take into account the annual exempt amount.
- 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 or ordinarily resident at time the claim to defer the gain was made and at the time the investment was made in the shares.
- 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 within four years after the end of the tax year in which the gain to be deferred arose ie by 5 April 2018 for a disposal in 2013/14.

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.

  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	1%	£150,001– £250,000	1%
£250,001 – £500,000	3%	£250,001 – £500,000	3%
£500,001 - £1,000,000	4%	£500,001 - £1,000,000	4%
£1,000,001 - £2,000,000	5%		
£2,000,001 or more	7%		

  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
    - Changes in trustees.
    - Securities traded on AIM (Alternative Investment Market)

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, Ordinarily resident, and/or Domiciled in the UK.

1.1 Residence

➢ **Individual Coming Into The UK**	➢ **Individual Leaving The UK**
For individuals coming to the UK, the split year treatment applies in the following situations. • The individual comes to the UK, acquires a home in the UK, and the individual does not have sufficient ties to the UK in order to be UK resident prior to obtaining the UK home. The UK part begins when the individual acquires the UK home. • 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. • The individual returns to the UK following a period of working full-time overseas. The UK part begins when the individual stops working overseas. • The individual returns to the UK following a period where the individual's partner has worked full-time overseas. The UK part begins on the later of the partner stopping work overseas and the individual joining the partner in the UK.	For individuals leaving the UK, the split year treatment applies in the following situations. • The individual leaves the UK to begin full-time work overseas. The overseas part begins when the individual starts the overseas work. • The individual's partner (spouse, civil partner or someone with whom the individual lives) leaves the UK to begin full-time work overseas and the individual leaves the UK in order to continue living with them. The overseas part begins on the later of the partner starting work overseas and the individual joining the partner overseas. • The individual leaves the UK in order to live abroad, sells their UK home, spends a minimal amount of time in the UK and establishes ties with the overseas country by, for example, becoming resident there. The overseas part begins when the individual ceases to have a home in the UK.

1.2 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.

1.3 Splitting a 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.

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
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 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.

2.3 Special Rules For Employment Income

Resident	Domicile	Duties performed Abroad
Yes	Yes	Receipt Basis
Yes	NO	Receipt Basis or Remittance Basis
NO	NO	Exempt

2.4 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.

2.5 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 tax if the recipient is not ordinarily resident in the UK.

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

2.7 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.

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

2.9 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*.

2.10 Remittance Basis: **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.*

<table>
<tr><td colspan="2">A person is Resident but not Ordinary Resident and/or Not Domiciled in UK
Unremitted income and gains totalling</td></tr>
<tr><td>≤ £2000</td><td>> £2000</td></tr>
<tr><td>Automatic Remittance Basis
• Personal allowance Available
• Remittance Basis charge not arise
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.</td><td>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.</td></tr>
</table>

- **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 has been *UK resident for at least 7 out of 9 tax years* preceding that tax year. „
- 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 £50,000.
- These charges are payable in addition to the tax due on any amounts remitted to the UK.

2.11 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	All taxable	Exempt. However a liability to CGT may arise if the person is carrying on a trade, profession or vocation in the UK through a branch or agency and an asset which has been used for the purpose of the branch or agency is either disposed of or removed from the UK.

- A person is **Resident but not Domiciled** in UK
- Unremitted overseas income and gains totalling

<table>
<tr><td>≤ £2000</td><td colspan="2">> £2000</td></tr>
<tr><td>Automatic Remittance Basis
• Annual Exemption Available
• Remittance Basis charge not arise
• Overseas losses allowable</td><td><u>Option 1</u>
Automatically taxable in normal way
• Annual Exemption available
• Overseas losses allowable</td><td><u>Option 2</u>
Remittance basis can be claimed
If claimed:
• Annual Exemption is not available
• Gains taxed 28% regardless of income.
• Remittance Basis charge can arise</td></tr>
</table>

Temporary Non-Residence:

- A temporary non-resident is an individual who is overseas for a period of five years or less commencing with the date in the split year from when the overseas part starts.
- 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.

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

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 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.
- **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.
- **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.
- **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 museums and art galleries.
- **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.

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%

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.
- Any increase in value of asset transfer between the date of transfer and death is ignored

5 VALUATION RULES (For Specific Assets)

5.1 Valuation rule for shares:

➢ **UNQUOTED SHARES:** Market value will always be given in exams.

➢ **QUOTED SHARES:** When quoted shares are gifted, the sale value of the shares for CGT purpose will be lower of:

a) Lower quoted price + 1/4 (higher quoted price – lower quoted price)

b) (Highest marked bargain + Lowest marked bargain)/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

5.2 Related Property Rule:

- The property is related property if the *some kind of property is held by Donor's spouse or Exempt party* (charity, Housing society, National body as a result of gift.)
- 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 Gift with Reservation

- If an individual transfer an asset but still has a right to receive benefits then it is considered as gift with reservation.
- It is not taken as normal transfer and it is included in the death estate of donor at market value of death date.
- However if Donor pay commercial rent then it can be treated as normal transfer.

7 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 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 assets held by business for non-trading or investment purpose.
- If individual transfer shares of a company and company have some business assets and non-business assets then BPR upon shares will be restricted to proportion of business assets only.

➢ **Relevant Business Property:**

a) Un-incorporated business or interest in partnership.
b) Unquoted securities which gave the transferor 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 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 greater than 2 year out of last 5 years. BPR is given on lower of two property value.
- BPR is still available even if the transferor cannot fulfill either of the two year ownership criteria if when he acquired the property it was eligible for BPR and either the previous or this current transfer was made on death.

➢ **Withdraw of BPR**

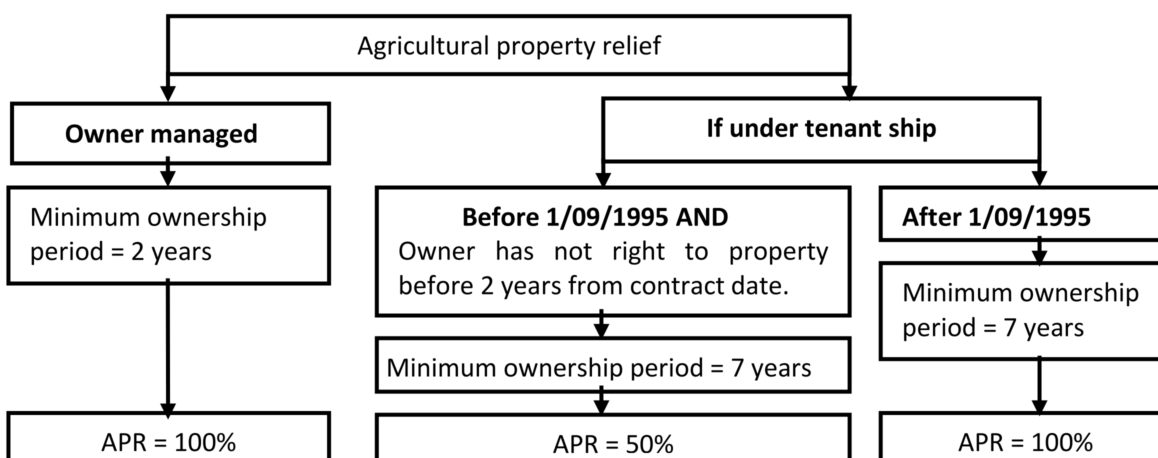
- If a CLT on whom BPR has claimed becomes chargeable on death then BPR will still be available if:

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.

8 Agricultural Property Relief:

- It is available upon both life time transfer & death transfers of agricultural value of agricultural property.
  - **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.
- It is automatic and deducted before other exemptions @ 50% or 100% upon agricultural property.



- 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 but according to shareholding.

➢ **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.

9 Death Estate Computation

Proforma Death Estate Computation	
Freehold Property less any Repayment mortgage	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, ISAs, Debts due to the deceased	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)
	XX
IHT @ 40% or 36% Reduced Rate	XX
Less: Quick succession Relief	(XX)
Calculate estate Rate(ER) = (Xa /chargeable estate) X 100	
Less: Double Tax Relief ; Lower of:	
a) Foreign tax suffered	
b) ER 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.
- **Life insurance Policies payment** will be included in death estate by proceeds received if for deceased individual.
- Valuation expenses for **foreign property** will be deducted from value of property but up to maximum of 5% of value of property. Lowest rate on death date is used to translate the value of property If given in foreign currency.
- Joint Property
- Cost of administrating the estate by executor is not an allowable expense as it is incurred after the death.
- **Reduced IHT Rate (36%) on death estate** is applied instead of 40% if 10% or more of the death estate (assets less liabilities less exemptions less reliefs less available nil rate band but before charity exemption) is left to charity.

➢ **Quick Succession Relief:** It is deducted from IHT liability. It is available when and individual dies and within previous 5 years, individual has inherited an asset and IHT was charged at that time. QSR is 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%

- **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.

10 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 amount of unused nil rate band of deceased partner.

11 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.

12 Overseas Aspects

- **Domicile**

- If individual is UK domiciled, or deemed UK domiciled, transfers of all assets, wherever situated, are subject to IHT
- A person is deemed to be domiciled in the UK for IHT purposes:
  a) If 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.

- **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.

- **Grossing up gifts on death**

- The value of UK death estate must be grossed on a death before computing death tax when the UK death estate is transferred to chargeable persons and residue is left to exempt recipient (e.g spouse or charity).
  Taxable Amount (Chargeable amount less Nil rate band) X 40/60
- 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.

- **Pre-owned Assets:** There is an income tax charge on annual benefit of using or enjoying the gifts with reservation

Asset transferred with reservation	Income tax charge
Land	Annual rental value of land.
Chattels or other property	Market value of asset X official rate of interest

- No income tax charge if the taxable amount is £5,000 or less. If the limit exceeds then all amount is taxable.
- A taxpayer can choose to disapply income tax charge by electing that disposition be treated as gift with reservation and included in death estate.

- **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.

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 for financial year
- Rate of corp. tax depends on level of augmented profits.
  Augmented profits = TTP + FII

➢ **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 2014 = 1 April 2014 to 31 March 2015

➢ **Period of Account:** It is the duration for which the 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.

➢ **Corporation tax rates:**

AUGMENTED PROFITS			FY2012	FY2013	FY2014
£1	to	£300,000	20%	20%	20%
£300,001	to	£1,500,000	24% Less Marginal Relief (MR)	23% Less Marginal Relief (MR)	21% Less Marginal Relief (MR)
£1,500,001	to	above	24%	23%	21%
Fraction			1/100	3/400	1/400

- If Augmented profit falls between £300,000 and £1,500,000 then marginal relief applies and corporation tax payable is calculated as follows:

Taxable Total Profits x Main Rate	=	X
Less: Marginal Relief	=	(X)
		X

Marginal relief = Fraction* x (upper limit - augmented profits) X $\frac{\text{Taxable Total Profits}}{\text{Augmented Profits}}$

➢ **Reduction of Upper and Lower limits:**

a) If the accounting period is less than 12 months then the limits are time apportioned.
b) By no of associated companies in group. [> 50% held UK and overseas subsidiaries]

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.

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 £500,000 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.

2.5 Property Income:

Same rules 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.

2.3 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.

2.4 Foreign Income:

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

2.6 Gift Aid Donations:

In adjustment of trading profit any gift aid payments should be added back 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 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 60% x ((MR – 10%) / MR)

where MR is the main rate of corporation tax.

2.8 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

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.

➢ **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.

➢ **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.

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:**
- Tax saving
- Cash flow
- Wastage of gift aid donations

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

Restriction on Loss Relief:

- If there is change in the ownership 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 ownership means transfer of more than 50% holding to a new owner.

4 DISINCORPORATION RELIEF

A relief has been introduced to enable relatively small companies to transfer their assets to their shareholders without giving rise to taxable profits. This relief removes tax liabilities that would otherwise arise where the owners of an incorporated business wish to assume direct ownership of the business assets in order to trade as an unincorporated entity, ie as a sole trader or partnership.

- **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 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 *225% 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*.
- If *deduction creates trading loss*, it may create an immediate repayable tax credit of 14.5% of lower of:
  a) 225% 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 10% of the costs incurred.

- **10% tax credit**

This 10% tax credit reduces the company's corporation tax liability. Any excess can be paid to the company up to a maximum of the company's PAYE/NIC liability in respect of those employees involved in R&D activities for the relevant accounting period. Any remaining credit balance can be carried forward and offset against the company's corporation tax liability for the next accounting period or any other accounting period or in the case of a group company, surrendered to another member of the group.

The 10% tax credit is also treated as taxable income, such that it increases the company's taxable income.

6 Goodwill and intangible non-current assets

- Intangible assets acquired before 1st April 2002 are chargeable to CGT but assets acquired after 1st April 2002 are outside the scope of CGT.
- Intangible assets include: *Purchased goodwill*, *Patents*, *copyrights and trademarks*, *Brands*, *Intellectual property*

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

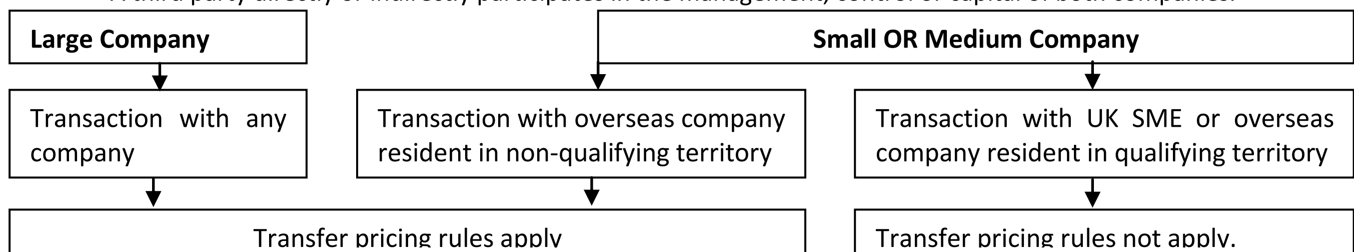
- Election for choice of treatment is irrevocable and should be made within 2 years from year of acquisition of asset
- If a company disposes off intangible assets then the difference between the disposal proceeds and carrying value will be treated as trading profit or trading loss. Company has the option 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.

7 Substantial Shareholding Exemption

- Substantial shareholding is, *holding of ≥10% shares in another CO. which are owned for ≥12 months out of last 2 year*
- Disposal of shares out of substantial shareholding is exempt 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 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.



- 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.

8 Purchase of Assets

- **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 instalment 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 (CO_2 >160 gram/km) for which 15% of rent paid is disallowed.

9 Types of companies

9.1 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.

- **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 close company to its shareholders:** 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.

- **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 @ 23% regardless of profit.
If close company is an investment company then no Gift relief or Business property relief is available.

- **Benefit in respect of the interest:** If the company lends the loan at less than official rate of interest (4%) 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.
- **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% holding in CO.

9.2 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.
- If the investment company is close company then its profit will be taxed @ 23% irrespective of the level of profit.

9.3 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	
Less: statutory deduction @ 5% (flat rate)	(XX)	
Less: salary paid by company	(XX)	
Less: NIC paid by company for employee	(XX)	
Less: other allowable expenses	(XX)	
Deemed salary including NIC	XX	(A)
Less: NIC upon deemed Salary: (A x 13.8%)/113.8%	(XX)	
Net Deemed Salary liable to income tax	XX	

10 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.

10.1 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.

10.2 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.

10.3 CONTROLLED FOREIGN COMPANY (CFC):

A controlled foreign company is

a) Which is resident outside the UK
b) Controlled by a person or company resident in UK
c) Subject to low rate of overseas corporation tax (Overseas corporation tax is <75% of UK corporation tax)

A new CFC regime has been introduced. This regime imposes a UK corporation tax liability, a 'CFC charge', on the owners of non-UK resident companies where UK profits have been artificially diverted from the UK.

➢ **CFC Charge**

The CFC charge is levied on UK resident companies (not individuals) entitled to at least 25% of the CFC's profits. The charge is calculated as follows:

- UK corporation tax at the main rate on the proportion of the CFC's chargeable profits (the profits artificially diverted from the UK) to which the UK resident company is entitled;
- less a deduction for an equivalent proportion of any creditable tax.

Creditable tax consists of:

- any double tax relief that would be available to the CFC if it were UK resident
- any income tax suffered by the CFC on its income, and
- any UK corporation tax on the income of the CFC that is taxable in the UK.

➢ **Exemptions from CFC charge**

In determining whether or not there will be a CFC charge there are two matters to consider:

- CFC must have *'chargeable profits'*, and
- CFC is not covered by one or more of the *exemptions.*

Chargeable Profits:

Chargeable profits are those income profits (not chargeable gains) of the CFC, calculated using UK tax rules, which have been artificially diverted from the UK.

Broadly, a CFC will be regarded as having no chargeable profits if any of the following conditions are satisfied.

- The CFC does not hold any assets or bear any risks under arrangements intended to reduce UK tax, ie under tax planning schemes.
- The CFC does not hold any assets or bear any risks that are managed in the UK.
- The CFC would be able to continue its business if the UK management of its assets and risks were to cease.

Exemptions:

Even though a CFC may have chargeable profits, there is no CFC charge if one of the following exemptions applies.

- *Exempt period exemption* – where a non-UK resident company is acquired by UK resident persons, such that it becomes a CFC, there is a 12-month exemption from the CFC rules. For this exemption to be available the company must continue to be a CFC for the accounting period following the exempt period but not be subject to a CFC charge.
- *Tax exemption* – the local tax paid by the CFC is at least 75% of the amount of tax the CFC would have paid in the UK if it were UK resident. This exemption was part of the definition of a CFC under the old rules.
- *Excluded territories exemption* – the CFC is resident in one of the territories specified as being excluded and certain conditions relating to its tax treatment in that territory are satisfied. This removes the need to prepare the detailed calculations necessary in respect of the tax exemption where the CFC is located in a tax regime with similar tax rates to the UK.
- *Low profits exemption* – the CFC's profits do not exceed £500,000 and its non-trading income does not exceed £50,000.
- *Low profit margin exemption* – the CFC's accounting profits are no more than 10% of its expenditure.

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 income on distribution.

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.
- 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 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.
- *Most beneficial order to surrender relief* is as follows:
  - To CO.s pay corp. tax @ marginal rate (effective 25%)
  - 2nd to CO.s subject to corporation tax @ 23%.
  - 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 ineligible 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:

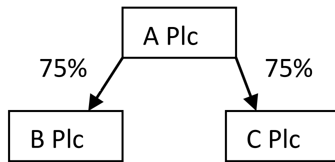
M.V at date of original intra group transfer	XX
Less: original cost plus indexation allowance	(XX)
De-grouping Charge	XX

- 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.

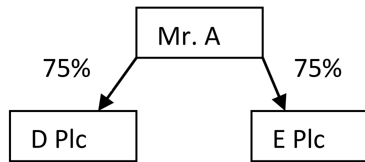
Pre Entry Capital Loss: When a CO. joins 75% gain group it capital losses before joining can be offset against gains:

- 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.

11.4 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.

12 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.

13 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 can take advantage of consortium features.

14 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.*

- 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 and ordinary resident in UK

➢ **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.

and must have sold either entire shareholding or substantial shareholding (≥75%)

- 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 after deduction of cost of shares.

➢ **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.

The proceeds received by individual are treated as disposal proceeds and this will be liable to capital gain tax after the deduction of related cost.

CHAPTER 14
VALUE ADDED TAX (VAT)

1 INTRODUCTION:

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 prompt payment discount whether taken or not. VAT on purchases is called input VAT. VAT rates are:

Standard Rated	20%	On most goods and Services supplied
Zero rated	0%	Non luxury food, Books, Sewerage and water services, Children's clothes and footwear, Medicine, Exports outside the EU.
Exempt		Finance, Insurance, Postal service and land (in some cases).
Low Rated	5%	Fuel for domestic purpose, energy saving materials

- Zero rated, standard rated and low rated supplies are considered to determine registration limit while exempt supplies are not.
- *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 usually replace that in (a).

➢ **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 £81,000.
- 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 £79,000.

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 £81,000 (Exclusive of VAT). Then individual is required to inform HMRC before end of those 30 days.
- 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 £81,000. It will be considered VAT registered from date of application.

2.4 VAT Group registration: Companies under common control may apply for group registration.

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
- 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 Recovery of Input VAT:

- **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:**

- Input VAT on business expenses is recoverable.
- VAT on non- business items passed through the business accounts is irrecoverable.
- 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.
- Input VAT upon purchase of car is irrecoverable unless there is 100% business use (Pool Car)
- 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 then output VAT will be payable but as per HMRC scale charge.
- Overpaid VAT can be claimed in four years from HMRC
- ***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 to input tax. Claim for relief should be made within four years of the time when debt became eligible for relief.

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 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 £79,000 in the following 12 month then individual can apply for VAT deregistration on voluntary basis by writing an application to HMRC. Individual will be considered VAT deregistered from date of application.

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. This charge will not be applicable if following conditions are satisfied:

- The business in transferred as going concern.
- Same nature of trade carried on by new business
- There is no significant break in the trade.
- The new owner is/or will be VAT registered.

4 SPECIAL SCHEMES

4.1 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.

4.2 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 Cash flows can be managed in a better manner.
- *Disadvantage:* Have to ensure that supplies does not exceed turnover limit and Timings of VAT payments may create problem for business.

4.3 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.

5 Land and Buildings

➢ ***Type of supply:***

- Freehold sales of new non-residential property are *standard rated.* ('New' means < 3 years old)
- Freehold sales or lease of > 21 years of residential or charitable property are *zero-rated*.
- Conversion of residential property into dwellings or vice versa, is chargeable at *reduced rate*.
- All other supplies of land and building are exempt, but with an *option to tax*.

➢ ***Option to Tax:*** A VAT registered vendor or Lessor of a building can opt to waive exemption and elect to opt for VAT.

- Supply of Land & Building will become taxable for VAT and Input VAT becomes recoverable.
- An irrevocable election must be made within 30 days from date of contract. However it could be withdrawn within 1st three months or after 20 years otherwise it is irrevocable.
- If election is made future rentals of the building will become liable to VAT.

If opt to tax option is taken then in future land & building can be transferred as part of business as a going concern. In this case it will be outside the scope of VAT.

6 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.
- 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:

De Minimis status must be reviewed at the end of each accounting period based on year as a whole, and an *annual adjustment* made if necessary (means added to or deducted from input VAT)

7 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:

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

8 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.

9 ADMINISTRATION OF VAT

- **VAT Return:** Businesses are required to file online VAT return & pay VAT within one month and 7 day from end of each quarter. Individual has the option to file return on monthly basis if wants.
- **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:** VAT invoice must include following detail and all records must be retained for six years by a registered person:
  - Supplier's name, address and VAT number
  - Name and address of customer
  - tax point and invoice number
  - Description of goods, type of supply and rate of VAT
  - Tax exclusive amount of each supply (unit price)
  - Amount of VAT
  - Rate of any cash or settlement discount offered.

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.

2 SUBMISSION OF TAX RETURNS: The tax return comprises a Tax Form, together with supplementary pages for particular sources of income. The time limit for submission of a tax return is as follows:

Notice Received	Electronic Return	Non-Electronic Return
By 31 July after end of tax year	31 January after end of tax year	31 October after end of tax year
After 31 July but before 31 October after tax year	31 January after end of tax year	3 months after notice
After 31 October after end of tax year	3 months after notice	3 months after notice

3 KEEPING OF RECORDS: All records must be retained until 5 years after the 31 January following tax year where taxpayer is in business (eg. a sole trader or partner or letting property) or 1 year after the 31 January following tax year otherwise (eg. employee). Maximum penalty to each failure to keep &retain records is £3,000 per tax year.

4 TAX RETURN: A return may be amended by HMRC to correct any obvious error or omission within nine months after the day on which the return was actually filed.
The taxpayer may amend his return (including the tax calculation) within twelve months after the filing date.

5 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.*

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

8 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 20 years where tax is lost due to deliberate understatement.

9 DETERMINATIONS: if tax return is not submitted by due filing 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. Such a determination

10 PAYMENT OF INCOME TAX AND CAPITAL GAINS TAX

DATE	PAYMENT
31 January in the tax year 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 = Previous year Income Tax + Previous year Class 4 NIC. Previous year tax at source
Relevant Amount X 50% = Payment on Account
Payments on account are not required if the relevant amount fails below a de minimis limit of £1000.

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

11 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%

Interest on late paid tax: Interest is chargeable on late payment 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)

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 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:

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%(< 12m)10%(>12m)	10%{<12m)20%(>12m)
Deliberate not concealed	20%	35%
Deliberate and concealed	30%	50%

16 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

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.

4 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

5 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.

6 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.

8 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 a chargeability to tax.

9 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 .

10 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 6 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.

Please feel free to contact at:

azizurrehman89@hotmail.com