

ACCA

SMART NOTES

40 Pages only

TAXATION

F6

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CHAPTER 1

UK TAX SYSTEM

1 PURPOSE OF TAXATION

1.1 ECONOMIC FACTORS

- Spending by the government and the system of taxation impacts on the economy of a country.
- Taxation policies have been used to influence economic factors such as employment levels, inflation and imports/exports
- Taxation policies are also used to direct economic behaviours of individuals and businesses. For example they encourage individual saving habits (Individual Savings Accounts), and giving to charity (Gift Aid Scheme).
- Further they may discourage motoring (fuel duties), smoking & alcohol (duties and taxes) and environmental pollution (landfill tax).
- As government objectives change, taxation policies may be altered accordingly.

1.2 SOCIAL JUSTICE

The taxation system accumulates and redistributes wealth within a country.

2 STRUCTURE OF THE UK TAX SYSTEM

The structure of the UK tax system can be shown as follows:

Structure	Role and responsibility
Chancellor of the Exchequer	The Chancellor has the overall responsibility for the UK tax system and one of his roles includes producing the Budget each year.
↓	
Treasury	The Treasury is the ministry responsible under the Chancellor for the imposition and collection of taxation.
↓	
Commissioners	The Treasury appoint permanent civil servants, the Commissioners for HMRC. Their duties include: <ul style="list-style-type: none"> - Administering the UK tax system - Implementing tax law.
↓	
HMRC	HM Revenue and Customs (HMRC) is a single body that controls and administers all areas of UK tax law. The structure of HM Revenue and Customs can be shown as follows: <ul style="list-style-type: none"> ➤ District offices The Commissioners appoint Officers of HMRC to carry out the day to day work of managing the tax system. Their roles include: <ul style="list-style-type: none"> • Issuing tax returns • Examining tax returns and accounts • Calculating tax liabilities under the self assessment tax systems and PAYE. ➤ Accounts and payments offices Accounts and payments offices deal with the collection and payment of tax.

3 PRINCIPLES OF TAXATION

Different taxes have different social effects.

Progressive taxation: As income rises the proportion of taxation raised also rises, for example UK income tax

Regressive taxation: As income rises the proportion of taxation paid falls, for example, tax on cigarettes is the same regardless of the level of income of the purchaser, so as income rises it represents a lower proportion of income.

Proportional taxation: As income rises the proportion of tax remains constant.

Ad Valorem principle: A tax calculated as a percentage of the value of the item, for example Value Added Tax



4 TYPES OF TAXES

- **Income Tax** Payable by individuals on most income
- **National Insurance Contributions** Payable by individuals who are employed or self-employed and businesses in relation to their employees
- **Capital Gains Tax** Payable by individuals on the disposal of capital assets
- **Inheritance Tax** Payable by individuals on lifetime and death transfers of assets
- **Corporation Tax** Payable by companies on income and chargeable gains
- **Value Added Tax (VAT)** Payable by the final consumer on purchases of most goods and services

5 DIRECT AND INDIRECT TAXATION

➤ Direct taxation

Taxes are paid directly to the Government, based on income and profit. e.g. Income tax, Corporation tax, Capital gains tax, Inheritance tax.

➤ Indirect taxation

Taxes are collected via an intermediary who passes them on to the government for example: VAT where the consumer pays VAT to a supplier, who then pays to the government

6 SOURCES OF TAX LAW

➤ Tax legislation / statutes

Adherence is mandatory because these are laws. It is updated every year by the annual Finance Act.

The Government may issue Statutory Instruments which are detailed notes on an area of tax legislation.

➤ Case law

This refers to decisions made in tax cases. The rulings in the courts are binding and so provide guidance on the interpretation of tax legislation.

➤ HMRC guidance

This is issued due to the complexity of the legislation

- **Statements of practice** – sets out how HMRC intend to apply the law
- **Extra statutory concessions** – sets out circumstances in which HMRC will not apply the strict letter of the law.
- **Internal guidance manuals** – HMRC's own manuals, produced for their staff which provide guidance on interpretation of law and also available to the public
- **Press releases/Briefs** – provide details of a specific tax issue, for example, used to communicate the information stated in the annual budget
- **HMRC website, leaflets and booklets** – provide explanations of various tax issues in non-technical language

7 MONEY LAUNDERING REGULATIONS

Money Laundering is the term used for offences including benefiting from or concealing the proceeds of a crime.

An individual is engaged in money laundering if they:

- a) conceal, disguise, transfer or remove criminal property from the UK
- b) enter into or become concerned in an arrangement that they know or suspect involves the acquisition of criminal property on behalf of another person
- c) acquire or have possession of criminal property.

All businesses within regulated sectors must appoint a money laundering reporting officer (MLRO) within the firm.

The **MLRO** will decide whether a transaction should be reported to the Serious Organised Crime Agency (SOCA).

Where a report is made the client should not be informed as this may amount to '**tipping off**', which is an offence.

A report to SOCA does not remove the requirement to disclose the information to HMRC.



8 DISHONEST CONDUCT OF TAX AGENTS

There is a civil penalty of upto £50,000 for dishonest conduct of tax agent. If penalty exceeds £50,000 then HMRC may publish details of the penalized tax agent. HMRC may check the working papers of a dishonest agent with the agreement of tax tribunal.

9 THE INTERACTION OF THE UK TAX SYSTEM AND OVERSEAS TAX SYSTEMS

9.1 OTHER COUNTRIES

The UK has entered into Double Tax Treaties with various countries. These contain rules which prevent income and gains being taxed twice, but may include a non-discrimination provision preventing a non-resident individual from being treated less favourably than a resident individual. Where there is no double tax treaty the UK system will allow relief for double tax.

9.2 THE EUROPEAN UNION

The aim of the EU is to remove barriers and distortions due to different economic and political policies imposed in different member states.

EU members do not have to align their tax systems, members can agree to jointly enact specific laws known as Directives.

The most important example is VAT, as EU members have aligned their policies according to EU legislation but the members do not need to align the rate.

Cases have been brought before the European Court of Justice regarding the discrimination of non-residents, some of which have led to a change in UK tax law.

10 TAX AVOIDANCE AND TAX EVASION

TAX EVASION

Any action taken to evade taxes by illegal means, for example

- a) suppressing information - failing to declare taxable income to HMRC
- b) providing false information - claiming expenses that have not occurred

Tax evasion carries a risk of fines and/or imprisonment

TAX AVOIDANCE

Any legal method of reducing your tax burden, for example taking advantage of an Individual Savings Account or making best use of available allowances, exemptions and reliefs..

The term is also used to describe tax schemes that utilise loopholes in the tax legislation.

HMRC have introduced new disclosure obligations regarding tax avoidance schemes.

11 PROFESSIONAL AND ETHICAL GUIDANCE

Accountants often act for taxpayers in dealings with HMRC.

Their duties and responsibilities should be towards both clients and HMRC

THE ACCOUNTANT MUST UPHOLD STANDARDS OF THE ACCA THAT IS

- To adopt an ethical approach to work, employers and clients
- Acknowledge the professional duty to society as a whole
- Maintain an objective outlook
- Provided professional high standards of service, conduct and performance at all times.

ACCA "CODE OF ETHICS AND CONDUCT"

The ACCA "Code of Ethics and Conduct" sets out five fundamental principles which members should adhere to:

- Integrity
- Objectivity
- Professional competence and due care
- Confidentiality
- Professional behavior



CHAPTER 2

Income Tax Computation

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

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

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

Taxable Person: All individuals including children are called taxable person and pay income tax.

1 TAXABLE PERSON:

STEP 1: Automatic Non UK Resident: (Pay UK Income tax on his UK Income only.)

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

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

STEP 2: Automatic UK Resident:

- (i) A person who is in the UK for 183 days or more during a tax year.
- (ii) A person whose only home is in the UK.
- (iii) A person who carries out full time work in the UK.

STEP 3: Sufficient Ties Test:

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

UK Ties:

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

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

2 TYPES OF INCOME

Exempt Income:

- Interest from national savings and investments certificates
- Gaming winning, Batting, lottery and premium bonds winnings
- Income received from New individual saving acc. (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 earned by a self-employed individual from his trade or profession.

Property income: Income received from land and building (e.g. Rental income).

Pension income: Income received after retirement.

Saving income (interest income):

Dividend Income:

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



3 INCOME TAX PERFORMA

Mr. A Income Tax computation 2015/16

		<u>OTHER INCOME</u>	<u>SAVING</u>	<u>DIVIDENDS</u>
Trading income		XX		
Employment income		XX		
Property income		XX		
Interest income (gross) (100/80)			XX	
Dividend income (gross) (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)				
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 Deducted At Source				
	Interest Income @ 20 %	(XX)		
	Dividend Income @ 10%	(XX)		
	PAYE	(XX)		
	Income Tax Payable	XX		

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

NOTE 1: Reliefs against Total Income:

Trading losses (covered in next chapters)

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

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

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

Date of Birth	Personal Allowance	Adjusted net Income
Born on or after 6 April 1948	£10,600	£100,000
Adjusted net income (ANI):		
Total Net income	XX	
<u>Less:</u> Gross Gift aid donation (100/80)	(XX)	
<u>Less:</u> Gross Personal Pension Contribution (100/80)	(XX)	
Adjusted net income (ANI):	XX	

Transferable amount of personal allowance: It is now possible to elect to transfer a fixed amount of the personal allowance to a spouse or registered civil partner. The transferable amount (also known as the marriage allowance or marriage tax allowance) is £1,060 for the tax year 2015–16,



NOTE 3: Calculation of Income Tax Liability:

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

4 EXTENSION OF BANDS:

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)

5 DONATIONS

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

(i) Donation under gift aid scheme:

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

(ii) Donation under gift aid scheme:

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

6 CHILD BENEFIT INCOME TAX CHARGE

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

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

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

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

7 TAXATION OF 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 \leq £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.

CHAPTER 3

PROPERTY & INVESTMENT INCOME

1 SAVING INCOME:

Interest income is received net of 20% tax e.g. interest received from Bank & Building society interest and from loan stock of unquoted companies. But an individual pays tax on gross income so net interest must be gross up as follows:

(Interest received X 100/80)

Exceptions:

- Interest received from new individual saving account (ISA) is exempt.
- Interest received from national saving and investment certificates is exempt.
- Interest received from national saving and investment bank A/c is received gross and is taxable.
- Interest received from government securities is received gross and is taxable.
- Interest received from debentures of listed companies is received gross and is taxable.

2 INDIVIDUAL SAVINGS ACCOUNTS (ISA'S)

ISA's are the most common form of tax efficient investment. An ISA can be opened by any individual aged 18 or over who is UK resident (although a cash ISA can be opened by an individual aged 16 or over)

➤ Advantages:

- Income is free of income tax
- No minimum holding period - withdrawals can be made at any time
- Disposals of investments within an ISA are free from capital gains tax

➤ Types of Investment (Components of an ISA):

<p>a) Cash and cash like equity Products: Bank and building society interest, national saving and investment products which are not exempt.</p>	<p>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.</p>
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- **Subscription limits:** For the tax year 2015-16 a person can invest up to £15,240 in ISA. The £15,240 limit is completely flexible, so a person can invest £15,240 in a cash ISA, or they can invest £15,240 in a stocks and shares ISA, or in any combination of the two – for example £10,000 in a cash ISA and £5,240 in a stocks and shares ISA.

3 DIVIDEND INCOME:

Dividend income is received net of 10% tax. But an individual pays tax on gross income so net dividend income must be gross up as follows: **(Dividend received X 100/90)**

10% Tax deducted at source on dividend can reduce income tax liability up-to nil it cannot create income tax repayable.

4 PROPERTY INCOME:

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

Premium: lump-sum payment paid by landlord to tenant at the time of grant (right to use the property for a fix period) of lease. Taxable Premium = Total Premium X (51 - Number of complete years of lease)/50



4.2 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)
<u>Expenses allowable to furnished property only:</u>	
- Wear & tear allowance	
10% of (Rent due less bad debts less water rates and council tax') or	(XX)
	XX

Property Business Profit/Loss

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

4.3 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.

4.4 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

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

4.5 Furnished Holiday Letting (FHL)

Conditions to qualify as FHL:

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

Benefits of FHL:

- 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.

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

CHAPTER 4

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

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

- a) Payment date
- b) Entitlement date

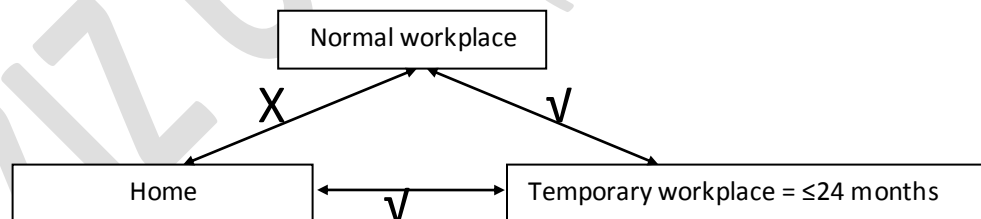
Receipt basis rule for all Directors

Earnings 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 and Determination date if earnings are determined after year end.

ALLOWABLE DEDUCTIONS

- 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.



Approved Mileage Allowance (AMA): Mileage allowance is paid by employer to employee if employee used his own vehicle. Amount up to AMA is exempt, excess is taxable and less is allowable deduction.

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

3 EXEMPT BENEFITS

- Free or subsidized meals at on-site canteen or restaurant if available to all employees.
- Provision of parking space at or near place of work including reimbursement of cost of such parking place.
- Workplace childcare, sports or recreation facilities.
- Payment to approved child care 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.
- Christmas parties, annual dinner dances, etc for staff are exempt, if employer incurs up to £150 p.a. per head.
- The provision of a security asset or security service by reason of employment.
- Welfare counseling service if available to all employees
- Relocation and removal expenses are exempt up to £8000, excess is taxable.
- Premium paid by employer for employee's Permanent Health Insurance.



- Entertainment to employee by reason of his employment, by a third party, e.g. a ticket at sporting or cultural event.
- Long service awards in kind (e.g. gold watches) are exempt up to £50 for each year of service of 20 years or more.
- 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.
- 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.
- Reimbursement of expenses by employer when employee is away from home.
 - £5/night in UK and £10/night if overseas. If exceeds whole amount is taxable.
- Pension advice of upto £150 per employee per tax year is exempt if available to all employees.
- Awards for upto £25 under staff suggestion scheme, which is available to all employees for suggestions outside their duties.
- The cost of work-related training course.
- An annual £500 exemption per employee has been introduced where an employer pays for medical treatment due to ill-health or injury.
- Some beneficial loans (see later)

4 BENIFITS TAXABLE ON ALL EMPLOYEES

GENERAL RULE: *cash equivalent value* of benefits is taxable to employees unless they have specific statutory rules.

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

Remember: No taxable benefit will arise if vouchers are provided for business purpose.

(ii) Living Accommodation: Taxable benefit will be

Annual value	X
Plus: Additional Benefit if cost of accommodation is > 75000 (note 1)	X
	<hr style="width: 50px; margin-left: auto; margin-right: 0;"/>
	X
Reduction for unavailability (if unavailability is >30 days)	(X)
Contribution by employee for use of house.	(X)
	<hr style="width: 50px; margin-left: auto; margin-right: 0;"/>
Taxable benefit	X

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

Cost of providing accommodation:

- | | |
|---|-----------|
| a) Purchase price (or market value- see point (b)) | XX |
| <u>Plus:</u> Capital improvements before start of current tax year | <u>XX</u> |
| | <u>XX</u> |
| b) If the duration between the date when employer purchase the property and the date when provided to employee for use is more than 6 years then cost of providing accommodation will be calculated as follows: | |
| Market value of accommodation when it was provided (provision date) to employee | XX |
| <u>Plus:</u> Capital improvements after provision date but before start of current tax year | <u>XX</u> |
| | <u>XX</u> |

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

Taxable benefit will be higher of:

- a) Rent actually paid by employer
- b) Annual value/Ratable value.

There is no concept of expensive or inexpensive accommodation in this case and so no calculation of additional benefit.

➤ **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.

5 BENIFITS TAXABLE ON P11D EMPLOYEES AND DIRECTORS



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

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

(i) 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.

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

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

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

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

- Use the method required in exam. If question is silent then use method which gives lower taxable benefit.
- If amount of all loans provided to employee is \leq £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.

(iii) Car Benefit:

POOL CARS: No taxable benefit will arise if car provided is a pool car. Car is considered pool car if all the following conditions are satisfied:

- 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 is unavailable for \geq 30 days)	(X)
Less: Employee contribution for private use	(X)
Taxable benefit	X

List Price:

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

CO2 Emission Percentage:

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

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

- If more than 1 car are provided separate taxable benefit will be calculated for each in same way.
- No extra benefit will arise for cost of insurance, repair & maintenance and running cost bcoz it is included in car benefit.
- An additional separate benefit (cost to employer) will arise if chauffeur (driver) is also provided for private use of car.

(iv) Fuel Benefit:

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

Fuel benefit = £22,100 x CO2% (calculated for car benefit)	XX
Less: unavailability	(XX)
	XX

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.

(v) Van Benefit:

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

(vi) 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:

- 20% × market value of the asset when first provided (reduce if not available whole year)
- Rent paid by employer (if asset is rented by employer)

(vii) Gift Of Asset:

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

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

6 PAYE (PAY AS YOU EARN) SYSTEM

The purpose of the PAYE system is to deduct the correct amount of income tax and National Insurance Contributions over the year.

Employers' duties:

The employer has a duty to:

- Deduct income tax from the pay of his employees
- Calculate the amount of NIC that should be deducted
- Keep a record of each employee's pay and deductions
- Pay the tax/NIC over on the due date – by the 19th of the month. But employers whose payments are, (on average), less than £1,500 per month are allowed to make payments quarterly rather than monthly. Note that employers with 250 or more employees must make their monthly PAYE payments electronically on the 22nd of the month.
- Send the appropriate returns to the HMRC when required.

Application of PAYE:

The following count as pay:

- salaries, wages, overtime, bonuses
- pensions

PAYE codes:

- An employee's PAYE code indicates the amount of tax free pay he is entitled to.
- The PAYE code will include the employee's personal allowance and any allowable deductions and be restricted by various taxable amounts.



It is calculated as follows:

	£	£
Allowances:		
Personal allowances	X	
Personal pension contributions - higher rate relief	X	
Expense deductions	<u>X</u>	
		X
Less Deductions,		
Benefits	X	
Untaxed income	X	
Tax under payments b/f (grossed up) $\times 100/20 \times 100/40 \times 100/45$	X	
		<u>(X)</u>
Allowance to set against pay		<u>X</u>

- To obtain the code number the last figure is removed and replaced with a letter
 - L - code for PA
 - K - increases taxable pay instead of reducing it (benefits exceed allowances) with no tax free allowances
 - BR - tax will be deducted at the basic rate
 - NT - no tax is to be deducted

Changes to coding:

An employer must use the last code notified to him for existing employees until new written instructions are sent from HMRC.

Year end returns:

- Employer must send to HMRC** P11D (Benefits for directors and employees earning in excess of £8,500/annum) and P9D (Benefits of other employees) by 6 July following the end of the tax year.
- Employer must give to employee:**
 - P60 (Permanent record of pay, tax deducted and NIC's made in the tax year) By 31 May following the end of tax year
 - P11D (Benefits for directors and employees earning in excess of £8,500 for the year) and P9D (Benefits of other employees) By 6 July following the end of the tax year.

Employees leaving or joining:

- Employees leaving** (Form P45 is provided to a leaving employee.)
- Employees joining**
 - When an employee joins and has a P45 the employer can operate PAYE
 - The employer uses the tax code on the P45 if it relates to the current year; otherwise he uses the emergency code.
 - If the employee does not have a P45, the new employee must complete form P46.

Real time reporting:

With real time reporting, employers send income tax and NIC information to HM Revenue and Customs electronically every time employees are paid (either weekly or monthly) rather than waiting until after the end of the tax year as was previously the case.

Since information must be filed electronically, it is no longer possible to produce a payroll manually. Employers must either run payroll software or use the services of a payroll provider.

PAYE – Real time reporting late filing penalty

With real time reporting, employers submit income tax and NIC information to HM Revenue and Customs electronically every time employees are paid. Penalties are now imposed on a monthly basis if these submissions are made late. There is no penalty for the first month in a tax year for which submissions are late, but thereafter a monthly late filing penalty of



between £100 and £400 is charged depending on the number of employees. An additional penalty of 5% of the tax and NIC due can be charged where a submission is more than three months late.

CHAPTER 5

INCOME FROM SELF EMPLOYMENT

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

TRADING PROFIT ADJUSTMENTS

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

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

ALLOWED AND DISALLOWED EXPENSES

- **Capital Expenditure is disallowed and Revenue Expenditure is Allowable.**
 - Initial purchase price and improvement is capital expenditure and is disallowed.
 - Replacement of an asset with extended capacity is disallowed.
 - Repair to an asset is revenue expenditure and is allowable while initial repair to bring an asset in useable condition is disallowed.
- **Rental Expense**
 - Any rent paid for the purpose of trade is allowable.
 - Lease charge of car emitting ≤ 130 g/km Co2 is allowable.
 - If CO2 emission of car exceeds 130g/km then 15% of Rental/leased charges are disallowed.
- **Entertaining and Gifts**
 - entertaining is disallowed, unless entertaining employees
 - gifts to employees are allowable
 - gifts to customers are only allowable if
 - They cost less than £50 per person per year, and
 - Gift is not food, drink, tobacco or vouchers exchangeable for goods and services
 - Gift carries a conspicuous advertisement for the business.

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

 - Gift of samples of goods for a advertisement purpose is allowable.
- **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.
- Legal fee to chase trade debts (receivable) is allowable
- Legal fee to defend ownership of non-current asset is allowable.
- 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.

➤ **Car Leasing**

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

$$\frac{(51 - n)/50}{N} \times \text{Premium} \quad n = \text{no of years of lease.}$$

➤ **Bad Debts/Allowance For Receivables**

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

➤ **Other Expenses**

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



- The general rule is that expenditure not wholly and exclusively for the purpose of the trade is not allowable. Remoteness test and the duality principle are considered for this purpose.

CHAPTER 6

CAPITAL ALLOWANCES

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

- Plant and machinery is something with which a trade is carried on except doors, walls, windows, ceiling, floors and water system, electrical system, gas system.
- Capital allowances are given on original cost and any subsequent capital expenditure. Cost of alterations to the building needed for installation of plant and computer software cost will also become part of plant & machinery.

GENERAL POOL OR MAIN POOL

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

SPECIAL RATE POOL:

Following P&M will become part of special rate pool

- **Long-life assets:** it includes P&M with a working life of ≥ 25 years or more (from the time the asset is brought into use for the first time) and annual running cost of $\geq \text{£}100,000$.
- **'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 (both new & second hand) with co2 emissions > 130g/km**
- **Thermal insulation of building.**

Remember: cars and P&M in a building which used as a retail shop, hotel or office, showroom, can never be classified as long life asset.

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.

FIRST YEAR ALLOWANCE (FYA)

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

ANNUAL INVESTMENT ALLOWANCE (AIA)

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



- It is most beneficial to claim the AIA in the following order:
 - a) Special rate pool
 - b) General pool
 - c) Short life assets
 - d) Private use assets

WRITTEN DOWN ALLOWANCE (WDA)

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

Small pool WDA

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

SHORT-LIFE ASSETS (SLA)

- P&M except cars which individual wishes to sell or scrap within 8 years of the end of the period of account in which asset is purchased are called short-life assets. Every short life asset is kept in separate pool.
- The election (written notice to HMRC) must be made for short life asset this is called de-pooling.
- AIA and WDA are available as normal.
- 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.

CARS

- Cars emitting ≤ 75 g/km CO_2 (low emission Cars) are eligible for FYA of 100%.
- Second hand motor cars emitting ≤ 75 g/km CO_2 or less are included in main pool.
- Both new and second hand Cars emitting CO_2 between 76 g/km to 130 g/km are included in main pool.
- Both new and second hand Cars emitting CO_2 over 130 g/km are included in special rate pool.
- If there is private usage of car by proprietor (Not employee) than only business proportion of the capital Allowance can be claimed.

Cessation of trade

- Not FYA, AIA and WDA is available in last year of trade.
- Add addition and deduct disposals made in last period of account from the relevant pool.
- Calculate balancing allowance (if loss) or balancing charge (if profit) as appropriate.

Balancing Allowance (BA)/Balancing Charge (BC)

Net Value (WDV plus addition less disposal).

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



Cessation Year = BA	Cessation year = BC	(8% /18%)	Disposal Year = BC
		Disposal Year = BA	Cessation year = BC
		Cessation year = BA	

Proforma capital allowances computation:

	Main Pool	Special	Short Life	Short Life	Private Use	Private Use	Allowance
	Rate Pool	asset 1	asset 2	Assets 1	Assets 2		
				(Business %)	(Business %)		
	£	£	£	£	£		£
WDV b/f		X	X	X	X		
Purchase of CAR which Qualify for FYA							
New Motors Cars CO2 ≤ 75 g/Km	X						
FYA @ 100%	(X)						X
Purchase of CAR which Qualify for AIA							
Cars CO2 emission 76 – 130 g/km	X						
Cars CO2 emission of > 130 g/km		X					
Additions qualify for AIA (£ 500,000)							
a) Special Rate Pool Additions	X						
Less: AIA	(X)	X					X
b) Main Pool Additions	X						
Less: AIA (Remaining Amount)	(X)	X					X
c) Short Life Assets	X						
Less: AIA (Remaining Amount)	(X)			X			X
d) Private Use Assets	X						
Less: AIA (Remaining Amount)	(X)				X		X
Disposals:							
Lower of cost and Selling Price	(X)	(X)	(X)		(X)		
	X	X	X/(X)	X	X/(X)	X	
WDA @ 18%	(X)						X
WDA @ 8%		(X)					X
WDA @ 18%/8%				(X)		(X)	X
							BU % only
Balancing Allowance/Balancing Charge			X/(X)		X/(X)		X/(X)
							BU % only
	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.

1st Year Rule	1st Basis period will be from start of trade to following 5th April.		
2nd Year Rule	Closing date of 1st period of account falls in 2nd tax year.		
	Yes		No
	Check length of 1st period of account		B.P = 2nd Tax Year
	≥ 12 Months	< 12 Months	
B.P will be 12 month back from closing date of 1st period of account.	B.P will be next 12 month from start of trade.		
3rd & subsequent year Rule	3rd & subsequent B.P will be 12 month back from closing date that falls in relevant tax year.		
NOTE: Some profits may fall into more than one basis period in the opening years and are known as <i>overlap profits</i> . An 'overlap', relief will be available on cessation, or sometimes, on change of accounting date.			
Closing Year Rule	<ol style="list-style-type: none"> 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. 		

Choice of accounting date

<p>➤ Just after 5 April.</p> <ul style="list-style-type: none"> • Maximum time to pay tax. • Increased overlap profit. • Maximum time for planning 	<p>➤ Just before 5 April</p> <ul style="list-style-type: none"> • Less time to pay tax. • No overlap profit • Less time for planning
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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.

<p>➤ Carry forward of trading losses (S.83)</p> <ul style="list-style-type: none"> Trading loss may be carry forward and set-off from first available future trading profits from same trade. Losses may carry forward for indefinite number of years until all the loss is relieved. Partial claim is not allowed. Claim must be made to carry forward trading losses within 4 years from the end of year of loss. E.g until 5 April 2020 for losses arising in 2015/16. It is disadvantageous from perspective of <u>cash flow, time value of money, uncertainty about future profit and relief may take long time to materialise.</u> 	<p>➤ Relief of trading losses against capital gains</p> <ul style="list-style-type: none"> Under this section current year trading loss can be set off against the chargeable gains of: <ul style="list-style-type: none"> 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 deduct trading loss from capital gain the total net income of that year must be reduced to nil. So in order to deduct trading loss from capital, fist it must be deducted from total net income of that year. Partial claim is not allowed. Claim for loss must be made by 31 January which is 22 months after the end of tax year of loss. E.g until 31 January 2018 for losses arising in 2015/16.
<p>➤ Loss relief against total net income</p> <ul style="list-style-type: none"> Trading Losses may be set-off from total net income of: <ul style="list-style-type: none"> 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: <ul style="list-style-type: none"> – Set off against capital gains – Set off against future trading profit. <u>CAP limit for Current Year:</u> Maximum loss that can be deducted from current year is <u>higher of:</u> <ul style="list-style-type: none"> – £50,000 – 25% of adjusted total income <p>Adjusted Total Income: Total net income less gross personal pension contribution.</p> <ul style="list-style-type: none"> <u>CAP limit for previous Year:</u> Maximum loss that can be deducted from previous year is <u>previous year CAP limit (as above) plus previous year trading profit.</u> Claim for loss relief must be made by 31 January which is 22 months after the end of tax year of loss. E.g until 31 January 2018 for losses arising in 2015/16. 	<p>➤ Relief of trading losses incurred in early years of trade (opening years loss relief)</p> <ul style="list-style-type: none"> Loss can never be overlapped. So loss considered in B.P of one tax year will not be considered in next tax year. Trading loss incurred in any of the first Four Tax years of trade then this loss may be set off against total income of previous 3 years on FIFO basis. Early years trading loss can be relieved through: <ul style="list-style-type: none"> a) Opening year loss relief OR b) Relief against total income OR c) From Capital gains OR d) From future trading profit Partial claim is not allowed. Claim for loss relief must be made by 31 January which is 22 months after the end of tax year of loss. E.g until 31 January 2018 for losses arising in 2015/16.



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

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

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

➤ **Business transferred to a company:** Relief is available for trading losses on incorporation of an unincorporated trade. Trading losses are carried forward by 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

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

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

Note:

- The cash basis option is not available to companies, and limited liability partnerships (LLPs)
- If annual turnover is twice the VAT registration limit (£164,000) then business will not allowed using this scheme.
- **Under the cash Basis:**
 - A business can prepare its accounts to any date in the year on the basis of cash receipts and payments.
 - there is no difference between capital and revenue expenditure on plant & machinery for tax purposes therefore:
 - Purchases are allowable deductions when paid for, and
 - Proceeds are treated as taxable cash receipts when an asset is sold.
 - *A flat rate expense deduction for motor car expenses is claimed instead of capital allowances.*
- **Advantages of cash basis:**
 - Simpler accounting requirements as there is no need to account for receivables, payables and inventory
 - Profit is not accounted for and taxed until it is realised so cash is available to pay the associated tax liability.
- **Disadvantages of cash basis:**
 - Losses can only be carried forward to set against future trading profits, whereas under the accruals basis many more options for loss relief are available.
- **Flat rate expense deduction option for any unincorporated business**

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

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

CHAPTER 10

PENSION & NATIONAL INSURANCE CONTRIBUTIONS

PENSION

OCCUPATIONAL PENSION SCHEME (OPC)	PERSONAL PENSION SCHEME (PPC):
<ul style="list-style-type: none"> • Only employees can contribute into employer's OPC scheme. • Both employee and employer (for employee) contribute. • Employee Contribution is deducted from his employment income and employer contribution (exempt benefits for employee) is deducted from his trading profit. • Contribution made to OPC is gross. 	<ul style="list-style-type: none"> • Anyone may contribute in a personal pension for himself or for anybody else. • PPC is managed by private institutions. (eg banks) • Contribution in PPC is gross up by 100/80 and basic & higher rate bands will be extended by this gross amount

- **Relief:** Relief is only available if pension is registered scheme, individual is UK resident and aged under 75.
- **Contribution:** Any amount can be contributed but relief is available on higher of £3,600 and 100% of relevant earning. (Relevant earnings include employment income for employee; tax adjusted trading profit for self-employed and income from furnished holiday letting for both.)
- **Annual Allowance:** Individual can contribute any amount into pension scheme but relief is available on maximum £40,000 per annum for 2014/15 and 2015/16. £40,000 limit will be calculated by adding employee pension contribution, employer pension contribution and contribution. 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. Therefore for any year in which a person is not a member of a pension scheme the annual allowance is lost.
- **Annual Allowance Charge:** Contribution made in excess of annual Allowance will be added in other income and named annual allowance charge.
- **Life Time Allowance:** An individual can contribute £1.25 million during his life time. If contribution exceeds £1.25 million then There will be a tax charge of:
 - 55% on excess, if the excess pension funds are taken lump sum.
 - 25% on excess, if the excess pension funds are used to provide pension income.
- **Pension Benefit:** Received when an individual is aged 55 years or more. At eligible age Individual can take tax free lump sum payment of lower of:
 - a) 25% of amount in fund
 - b) 25% of Life time allowance
 Remainder 75% amount in fund is used to provide pension income. Pension can be claimed before this age if the individual is incapacitated due to ill health.
- **Benefits of Pension contribution:** The following benefits are available if pension is registered with HMRC.
 - (i) Tax relief
 - (ii) employer contribution into pension is exempt benefit for employee.
 - (iii) On retirement some pension can benefit can be obtained as tax free lump-sum payment.



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NATIONAL INSURANCE CONTRIBUTIONS

➤ **Class 1 Employee:** Payable by employees employed in UK, above 16 years until state pension age.

- It is payable on cash employment income paid by employer only which includes: Wages, salary, overtime pay, Sick pay, Commission, Bonus, Remunerations, tips and gratuities from employer, Quoted shares, vouchers, payment of travel between home and work, all vouchers, Approved millage allowance of above 45p/mile
- Contribution by employee is calculated as follows.

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

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

➤ **Class 1 Employer:**

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

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

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

➤ **Class 1A:**

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

➤ **Class 2:**

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

➤ **Class 4:**

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

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

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

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

CHAPTER 11

CAPITAL GAIN TAX - INDIVIDUALS

1 Introduction

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

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

Date of disposal:

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

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

Exempt assets include:

- Motor vehicles
- National Savings & Investment certificates
- Cash, Debtors and trading inventory
- Decorations awarded for bravery
- Damages for personal injury
- Shares in Venture Capital Trust
- Foreign currency for private use
- Works of art given for national use
- Gilt edged securities
- Qualifying Corporate Bonds
- Company loan notes
- Some Chattels
- Investments held in an NISA
- Prizes and betting winning

- **Chargeable Person:** An individual who is resident in the UK is liable to pay UK CGT on his worldwide gains and non-resident person in UK will not pay CGT (not even those situated in UK)

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 a 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
 - Expenditure to establish, preserve or defend taxpayer's title of 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	(11,100)
Taxable Gains	X

Remember:

- if an asset is acquired as a result of gift then acquisition cost = MV at date of gift
- if an asset is inherited as a result of death then acquisition cost = MV at date of death.



- **Annual exemption:** Every individual has an exempt amount for each tax year. For 2015/16 it is £11,100
- **Rates of CGT:** CGT rates are determined after considering a taxable income. CGT rate of 18% is applied on gains up to remaining basic rate band of £31,785. CGT rate of 28% is applied on gains in excess of the basic rate band.
- **Payment of CGT**
CGT is due in one amount on 31 January following the tax year (2015/16 by 31 January 2017)

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

The transfer of assets is considered at acquisition cost instead of actual Proceeds so No gain/ No loss. So spouse can utilize their annual exempt amount, basic rate band and capital losses in an efficient way.

3 Capital Losses

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.

4 Capital Gains: Special Rules

4.1 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, jewellery 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 but the gain is restricted to 5/3 [Gross proceeds - 6,000]
> £6,000	≤ £6,000	Allowable loss but Deemed Proceeds = £6,000
> £6,000	> £6,000	Normal calculation

➤ Wasting Chattels:

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

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

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

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

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

4.2 Asset Lost or Destroyed

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



4.3 Asset Damaged

No Insurance Proceed	Insurance Proceed Received	
No Disposal	Not Used to Restore the Asset:	USED TO RESTORE ASSET WITHIN 12 MONTHS
	Treat as Part Disposal.	Part disposal unless Taxpayer can elect to defer the gain.
	Disposal Proceed X	If defer there is no part disposal and deduct insurance proceed from the cost of restored asset.
	Allowable cost:	
	Original cost X $\frac{A}{A+B}$ (X)	Cost of restored asset (original + restore cost) X
	Gain/ Loss X	Less: Insurance Proceed (X)
	A= insurance proceed	Revised base cost (X)
	B= M.V of damaged asset	

4.4 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	A= market value of part disposed off
Less: Allowable cost [Cost x A/A+B]	(X)	B= market value of remaining part
	X	

5 DISPOSAL OF SHARES (individuals)

5.1 Valuation rule for shares

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

Matching Rules on Sale of Shares (Individuals)

Shares sold will be matched in the following order:

- Shares purchased on the same day
- Shares purchased on the following 30 days of sale
- 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 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 the shareholder receives more than one type of shares in exchange for the original shares, then cost of original shares is allocated to the new shares by reference to the market value of new shares.

➤ **Consideration in cash and shares**

It is treated as part disposal and gain or loss is calculated is follows:

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

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. |
- Points **b, c and 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 18 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) Gain related to letting period {Total gain x (letting period/ownership period)} | |

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

➤ **Qualifying Business Disposals:**

- Disposal of the whole or part of a business (which can operate independently) runs as an unincorporated business (both sole trader & partnership.)
- Disposal of assets of sole trader or partnership trading business within 3 years from cessation.
- Disposal of shares if:
 - Shares are in individual's personal trading company and he is also an employee (full time or part time) of CO. (CO. in which individual owns ≥5% of ordinary shares & ≥5% voting right is called personal trading company.)

➤ **Qualifying Ownership Period:**

The assets must have been owned for one year prior to the date of disposal

➤ **Further points**



- Relief is not available on gains arising from disposal of individual assets or assets held for investment purpose.
- The annual exemption and any capital losses should however be deducted from gains that do not qualify for entrepreneurs' relief as they are taxed at a higher capital tax gains rate (18% and/or 28%)
- Easy way is to keep the gains, qualifying for entrepreneur's relief and not qualifying in separate column.

6.3 Roll-Over Relief:

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

- This relief is available if a qualifying business asset is sold and another qualifying business asset is purchased within the qualifying time period.
- Base cost of new asset is calculated by deducting the gain on old asset against the cost of new/ reinvested asset.
- An individual must claim the relief within 4 years from the end of the tax year of later of:
 - a) When the disposal is made **or**
 - b) Replacement asset is acquired

➤ **Qualifying Business Asset:**

Rollover relief is available on assets which are used in business. Qualifying assets include Land and buildings, Fixed plant & machinery (unmovable) and Goodwill.

➤ **Qualifying Time Period:**

New asset must be purchased within 1 year before and 3 years after disposal of old asset.

➤ **Partial Reinvestment of Proceeds:**

If there is full reinvestment of net sale proceeds roll-over relief is available on full gain. If there is partial reinvestment of net proceeds then part of the gain is taxable at the time of disposal.

Gain Chargeable at the time of disposal is **lower of:**

- a) Amount of proceed not reinvested.
- b) Full gain

➤ **Non-business use**

Full rollover relief is only available if asset being disposed was used entirely for business during whole period of ownership. If there is private use of asset rollover relief is only available on business portion.

- #### ➤ **Reinvestment in depreciating assets** "An asset with an expected life of ≤ 60 years (e.g. Fixed plant & machinery) is called depreciating asset." If replacement asset is a depreciating asset then gain deferred is not deducted from cost of new asset (no calculation of base cost) Instead gain is postponed and will be taxable on earlier of:

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

➤ **Tax planning**

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

6.4 RELIEF FOR THE GIFT OF BUSINESS ASSETS

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

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

➤ **Availability of the relief:**

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

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

➤ **Qualifying assets:**

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

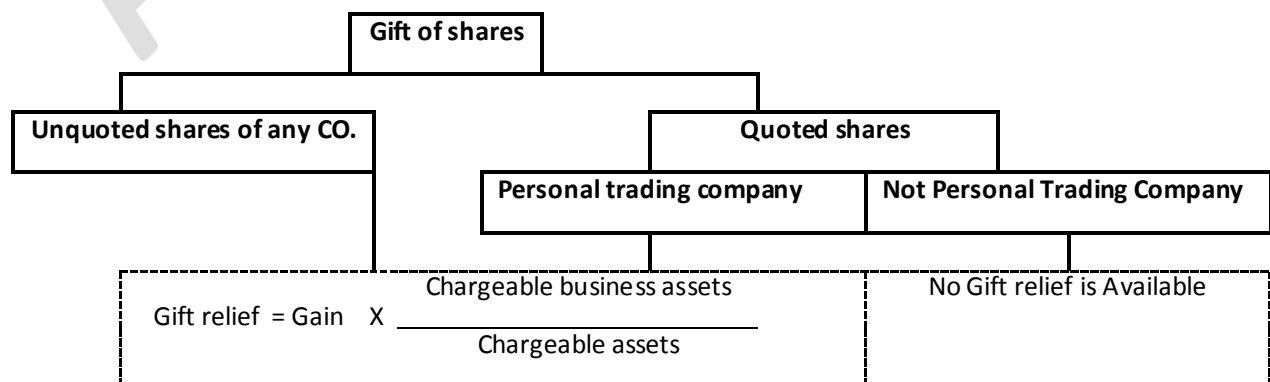
- Assets used in the trade of Donor (Sole trader or partner in partnership) or Donor's personal trading company
- Unquoted shares and securities of any trading company.
- Quoted shares or securities of the individual donor's personal trading company. (CO. in which individual owns ≥5% of ordinary shares & ≥5% voting right is called personal trading company.)

➤ **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.



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	<u>(X)</u>
Diminution in value/ transfer of value	<u>X</u>

Remember:

- *Gratuitous disposition means gift*

TYPES OF IHT: Death IHT & Life time IHT.

2 LIFE TIME IHT:

Life time IHT is payable on lifetime transfers.

POTENTIALLY EXEMPT TRANSFER (PET)

- It includes transfer Between individuals other than spouse
- No IHT liability on date of transfer only chargeable amount will be calculated and it will be freed.
 - If individual dies in 7 years from date of transfer then it will become chargeable otherwise it will be exempt.

CHARGEABLE LIFETIME TRANSFER (CLT)

- It includes transfers to trust.
- Half IHT will become payable right on the date of transfer. Gross Chargeable amount is calculated and freed.
- 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	<u>(X)</u>
Chargeable Amount	<u>X</u>

EXEMPTIONS

➤ 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.

➤ Small gifts exemption:

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

➤ Gifts on marriage:

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

➤ Normal expenditure out of income

A transfer of value is exempt if:

- Made for normal expenditure out of income and
- Does not affect the donor's standard of living.

Calculation of Life Time IHT Liability on 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



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

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

3 DEATH IHT ON LIFE TIME GIFTS:

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

Taper Relief:

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

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

4 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)

Gross chargeable estate

XX

IHT Liability:

Gross chargeable estate	XX
Less: Death unused NRB	(XX)

XX

IHT payable (IHT @ 40%)

XX

- Cost of administrating the estate by executor is not an allowable expense as it is incurred after the death.
- **Due Dates of Payment of Death IHT:** IHT arising on death is payable by the Personal Representatives (PRs) and suffered by residual legatee. The time limit for this is 6 months from the end of the month in which death occurred.

5 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.

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)
<i>Total Taxable Profit (TTP)</i>	XX

➤ **Financial Years (FY):** The tax rates to be used for corporation tax are set for Financial Years (FY). Financial starts on 1st April and ends on 31 March. FY 2015 = 1 April 2015 to 31 March 2016

➤ **Period of Account:** It is the duration for which the company prepares its accounts. It is generally 12 months long, but can be longer or shorter than 12 months.

➤ 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 Liability:

- Corporation tax liability is calculated as:

Taxable Total Profits X corporation tax rate for financial year (for FY 2015 20%)

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

- No private element of expenses added back



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

- Interest payable on a loan taken for trading purpose is allowable deduction from trading profit.
- 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.

Any plant and machinery in 7 years before start of trade will be treated as if bought on 1st day when trade starts.

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.

2.3 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.

2.4 Franked investment Income (Gross 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.
- Dividend from associated CO. is not included in FII.

2.5 Foreign Income:

Any foreign income must be included to calculate TTP. Foreign income is gross up by any foreign tax suffered.

2.6 Qualifying Charitable Donations:

- Qualifying charitable donations which disallowed from trading profit will be deducted from total profit in main Performance of corporation tax computation.
- All donations by company are gross so no need of grossing up.
- If qualifying charitable donations exceeds trading profit then remaining donation will be wasted or can be transferred to 75% group member.

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.

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 = $\frac{\text{RPI in month of disposal} - \text{RPI in month of expenditure}}{\text{RPI in month of expenditure}}$

➤ **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:

- The total profits before gift aid of the current year.
- 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.
- 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

4 GROUP ASPECTS

4.1 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.

4.2 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 relieved group can transfer:
 - Unused Trading losses & property business loss
 - Unused Gift Aid Donation
 - Unused non trading interest expense.
- Only current year losses are eligible for relief and 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 offset loss against Taxable Total Profits of its corresponding Acc. Period but after offsetting its own b/f trading loss.
- Losses which arise before joining the group or after leaving the group are ineligible for group relief.
- 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.

4.3 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 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.

CHAPTER 14 VALUE ADDED TAX (VAT)

INTRODUCTION:

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

1 Types of supply.

➤ Taxable Supply

- **Zero Rated:** No VAT is charged but considered as taxable supply for determination of registration limit.
- **Reduced Rated:** VAT is charged at low rate. (Will be given in exams)
- **Standard Rated:** Supply on which VAT is charged @20%.
- **Exempt Supply:** supply on which no VAT is charged.

VAT rates are:

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

- 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 on purchases)	(XX)
Net VAT Payable / (Recoverable)	<u>XX/(XX)</u>

➤ 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 become the actual tax point.

Exception:

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

Continuous supplies of services paid for periodically normally have tax points on the earlier of the receipt of each payment and the issue of each VAT invoice, unless one invoice covering several payments is issued in advance for up



to a year. The tax point is then the earlier of each due date or date of actual payment. However, for connected businesses the tax point will be created periodically, in most cases based on 12 month periods.

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

2 REGISTRATION

2.1 Compulsory Registration (Historical Test)

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

2.2 Compulsory Registration (Future Test)

- A person is also liable to be registered if at any time there are reasonable grounds for believing that his taxable supplies of just following 30 days will exceed £82,000 (Exclusive of VAT). Then individual is required to inform HMRC before end of those 30 days by completing form VAT1 or using HMRC's online services.
- Individual will be registered for VAT from beginning of those 30 days.

2.3 Voluntary Registration

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

Advantages	Disadvantages
<ul style="list-style-type: none"> • Avoids penalties for late registration. • Can recover input VAT • Can disguise the small size of business 	<ul style="list-style-type: none"> • Must follow VAT administration rules • Makes product prices more expensive (vat inclusive prices)

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

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

Advantages of group registration:

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

Disadvantages of group registration:

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

2.5 Output VAT:

- **Goods for own use:** Where the trader withdraws goods from the business for own use, output VAT must be accounted for on the replacement value of the supplies.
- **Gifts of inventory or non-current assets** are treated as taxable supplies at replacement cost, except gifts of:
 - goods to the same person which cost the trader £50 or less in a 12-month period
 - Business samples, regardless of the number of same samples given to the recipient



- **Gifts of services**, whether to employees or customers, are not taxable supplies.

2.5 Recovery of Input VAT:

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

- **Recovery of Pre-Registration Input VAT on Goods:** It will be recoverable if Goods were acquired in previous 4 years from date of registration for business purpose and are still on hand upon the date of registration.
- **Recovery of Pre-Registration Input VAT on Services:** It will be recoverable if Services were acquired in previous 6 months from date of registration for business purpose.
- **Recovery of Normal Input VAT:**
 - **Capital vs revenue expenditure:** There is no distinction between capital and revenue expenditure for VAT. Output VAT and input VAT is calculated as normal if these expenditures are incurred for trade.
 - **Business entertaining:** Input VAT on entertainment expenses incurred for employees and overseas customers is recoverable. However Input VAT on entertainment expenses incurred for suppliers and UK customers is irrecoverable.
 - **Private Use:** input VAT cannot be claimed for goods or services that are not used for business purpose except for the treatment of cars which is given below.
 - **Motor cars:** Input VAT upon purchase of car is irrecoverable unless there is 100% business use (Pool Car) in which case 100% recovery available. In case of leased car 50% of input VAT is recoverable where the car has some private use.
Note that if input VAT cannot be recovered on the purchase of a motor car, no output VAT will be due on its disposal.
 - **Motor Expenses:** Input VAT upon fuel cost and repair & maintenance incurred for employees is recoverable even if there is private use of car by employee. If employee reimburses full fuel cost then output VAT will be payable upon reimbursed expenses. However If employee reimburses partial fuel cost then output VAT will be payable but as per HMRC scale charge. Note that VAT is not charged on the insurance and road fund licence
 - **Relief for Bad Debts:** Input VAT on bad debts is recoverable if:
 - a) ≥6 months elapsed from due date of payment and
 - b) Amount written off as bad debts in the seller's books.Relief is obtained by adding the VAT element of the impaired debt to the input tax claimed.
Claims for relief for impaired debts must be made within four years and six months of the payment being due.
 - **Business and non-business expenses:** Input VAT on business expenses is recoverable. VAT on non- business items passed through the business accounts is irrecoverable.

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

3 VAT on sale of a business

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

Transfer of business as a going concern:

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

- Will not be treated as a taxable supply
- No output tax will therefore be charged on the assets transferred by the seller, and
- No input tax is recoverable by the purchaser.
- **Conditions:**
 - The business is transferred as a going concern.
 - There is no significant break in the trading.
 - The same type of trade is carried on after the transfer.
 - The new owner is or is liable to be registered for VAT, immediately after the transfer.

Note that all these conditions must be met.



➤ **Transfer of registration:**

On the sale of a business it is normally compulsory to deregister. However, instead of doing so, both the transferor and the transferee may make a joint election, for the transferor's registration to be transferred to the transferee.

Where this is done, the transferee assumes all rights and obligations in respect of the registration, including the liability to pay any outstanding VAT. Therefore, this may not be a good commercial decision.

4 Deregistration

Compulsory Deregistration:

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

Voluntary Deregistration:

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

5 SPECIAL SCHEMES

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

Conditions to be satisfied to join the scheme:

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

Advantages:

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

Disadvantages:

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

5.2 ANNUAL ACCOUNTING SCHEME

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

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

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

Advantage: Only one VAT return each year so less occasions for VAT penalty and 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.

5.3 FLAT RATE SCHEME

VAT = Sale (VAT inclusive) X Flat rate %

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

Conditions to join the scheme:

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



6 IMPORTS, EXPORTS, ACQUISITIONS, DESPATCHES

Trading with Non-European Countries:

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

Trading with European Countries:

- **Exports (Dispatches)** (Sales to countries in the EU.)
 - The supply will be treated as zero rated if purchaser is registered for VAT and standard rate if the purchaser is not VAT registered.
- **Imports (Acquisitions)** (Purchases from countries in EU)
 - These are taxed at Standard Rate or Zero Rate as it would have been taxed as UK supplies.

Imports from outside the EU

Goods

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

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

Services

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

Exports outside the EU

Goods

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

Services

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

Transactions within the EU

Goods

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

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



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

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

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

Services

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

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

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

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

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

UK business		
Supplies services to	Overseas business customer	<ul style="list-style-type: none"> Place of supply is overseas Outside the scope of UK VAT
Receives services from	Overseas business	<ul style="list-style-type: none"> Place of supply is UK Reverse charge procedure: UK business accounts for 'output VAT' at standard UK rate on VAT return. This VAT can then be reclaimed as input VAT.

Time of supply for cross border supplies of services

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

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

7 ADMINISTRATION OF VAT

VAT return and payment procedures

Normal VAT accounting

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

VAT refunds

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



Normal VAT invoices

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

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

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

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%
4th or more default	15%

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

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

VAT Records:

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

VAT invoice:

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

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

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

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

Such an invoice must show:

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

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

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



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 2016 for 2015/16. However notification is not necessary if there is no actual tax liability.

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

2 AMMENDMENTS IN TAX RETURN:

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

The taxpayer may amend his return (including the tax calculation) within 22 months after the end of tax year. E.g. 31 January 2017 for 2014/15.

3 DETERMINATIONS OF TAX DUE IF NO RETURN IS FILED:

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

4 PAYMENT OF INCOME TAX AND CAPITAL GAINS TAX

Normal due Date: the due date to pay tax liabilities (income tax, class 4 NIC and CGT) are 31 January after the end of the tax year. E.g 31 January 2017 for 2015/16.

Payment on Account: Payment on account is required if there is a **relevant amount** in the previous year.

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

RELEVANT AMOUNT = Previous year Income Tax Payable + Previous year Class 4 NIC

Payment on Account = Relevant Amount X 50%

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

Note: POA is not required:

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

5 PENALTIES ON LATE BALANCING PAYMENT OF TAX

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

INTEREST ON LATE PAID TAX:



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

REPAYMENT INTEREST:

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

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

(ii) The date of repayment.

6 KEEPING OF RECORDS:

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

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

- a) 1 year after the 31 January following tax year.
- b) Date of completion of compliance check
- c) The date on which start of compliance check becomes impossible.

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

7 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.

8 TAX EVASION and TAX AVOIDANCE:

Tax evasion is illegal and Tax avoidance is legal way to reduce tax liability

9 DISCOVERY ASSESSMENTS:

If an officer of HMRC discovers an error an assessment may be raised to recover the tax lost. The normal time limit for discovery assessment is 4 years after the end of the tax year, but it may be extended to 6 years in case of careless error and 20 years where tax is lost due to deliberate understatement.

Discovery assessment may be appealed against.

10 PENALTIES FOR ERRORS:

Maximum Penalty:		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	Penalty (% of PLR)	Types of error	Unprompted	Prompted
Careless	30%	Careless	0%	15%
Deliberate not concealed	70%	Deliberate not concealed	20%	35%
Deliberate & concealed	100%	Deliberate and concealed	30%	50%

11 PENALTIES FOR LATE NOTIFICATION:

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

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

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

12 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: <ul style="list-style-type: none"> • 5% of Tax Liability • £300 	Greater of: <ul style="list-style-type: none"> • 70% of Tax Liability • £300 	Greater of: <ul style="list-style-type: none"> • 100% of Tax Liability • £300

13 Compliance check enquiries

➤ **Starting compliance check enquiry:**

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

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

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

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

➤ **During the compliance check enquiry:**

HMRC can demand taxpayer to produce Documents, Accounts or any other information required.

The information requested by HMRC should be limited to that connected with the return.

An appeal can be made against the request.

➤ **Completion of compliance check enquiry:**

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

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

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

14 Disputes and appeals

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

➤ **Internal reviews**

For direct taxes, appeals must first be made to HMRC, which will assign a 'caseworker'.

For indirect taxes, appeals must be sent directly to the Tax Tribunal, although the taxpayer can continue to correspond with his caseworker where, for example, there is new information.

At this stage the taxpayer may be offered, or may ask for, an '**internal review**', which will be made by an objective HMRC review officer not previously connected with the case. This is a less costly and more effective way to resolve disputes informally, without the need for Tribunal hearing. An appeal to Tax Tribunal cannot be made until any review has ended.

The taxpayer must either accept the review offer, or notify an appeal to the Tax Tribunal within 30 days of being offered the review; otherwise the appeal will be treated as settled.

HMRC must usually carry out the review within 45 days, or any longer time as agreed with the taxpayer.

The review officer may decide to uphold, vary or withdraw decisions.

After the review conclusion is notified, **the taxpayer has 30 days to appeal to the Tax Tribunal.**

➤ **Tribunal hearings:**



If there is no internal review, or the taxpayer is unhappy with the result of an internal review, the case may be heard by the Tax Tribunal. The person wishing to make an appeal (the appellant) must send a notice of appeal to the Tax Tribunal. The Tax Tribunal must then give notice of the appeal to the respondent (normally HMRC).

The Tax Tribunal is made up of two 'tiers':

- a) A First Tier Tribunal
- b) An Upper Tribunal

The case will be allocated to one of four case 'tracks':

(a) **Complex cases**, which the Tribunal considers will require lengthy or complex evidence or a lengthy hearing, or involve a complex or important principle or issue, or involves a large amount of money.

Such cases will usually be heard by the Upper Tribunal

(b) **Standard cases**, heard by the First Tier Tribunal, which have detailed case management and are subject to a more formal procedure than basic cases

(c) **Basic cases**, also heard by the First Tier Tribunal, which will usually be disposed of after a hearing, with minimal exchange of documents before the hearing

(d) **Paper cases**, dealt with by the First Tier Tribunal, which applies to straightforward matters such as fixed filing penalties and will usually be dealt with in writing, without a hearing

A decision of the First Tier Tribunal may be appealed to the Upper Tribunal.

Decisions of the Upper Tribunal are binding on the Tribunals and any affected public authorities. A decision of the Upper Tribunal may be appealed to the Court of Appeal.

SELF ASSESSMENT FOR COMPANIES

1 Notification of chargeability:

A company falling within the scope of corporation tax for the first time must notify HMRC within 3 months of start of the accounting period. Failure to notify chargeability to tax within 12 months of the end of the accounting period will lead to a standard penalty based on a percentage of the tax unpaid 12 months after end of the accounting period.

2 Payment of tax:

➤ **Normal:** corporation tax is payable 9 months and one day after the end of each accounting period.

➤ **QUARTERLY INSTALMENT PAYMENTS**

Despite the introduction of a single 20% rate of corporation tax, large companies still have to make quarterly installment payments in respect of their corporation tax liability.

A large company is basically one whose profits are more than £1,500,000. However, profits include franked investment income, whilst the threshold of £1,500,000 is divided by the number of 51% group companies at the end of the immediately preceding accounting period. The £1,500,000 threshold is proportionately reduced where an accounting period is less than 12 months.

3 Corporation tax return:

➤ **Notification of chargeability:** CO. receives a notice of chargeability to corporation tax after end of Acc. Period and must notify HMRC within 12 months 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 (3rd & consecutive failure)
Upto 3 months	£100	£500
More than 3 upto 6 months	£200	£1000
More than 6 upto 12 months	£200 + 10% of tax	£1000 + 10% of tax
More than 12 months	£200 + 20% of tax	£1000 + 20% of tax

4 Claims:

If a company believes it has made an error in a return, an error or mistake claim may be made within four years from the end of the accounting period. Other claims must be made within four years of the end of the accounting period unless a different time limit specified.

5 Records:

Companies must keep records until the latest of:

- **Six years** from the end of accounting period
- Date any enquiries are completed
- Date after which enquiries may not be commenced

Failure to keep records can lead to a penalty or up to £3,000 for each accounting period.

6 Determinations and Discovery assessments:

If a return is not delivered by the filing date, HMRC may issue a determination of the tax payable within 3 years of the filing date. There is no appeal against it.

Discovery assessment: HMRC can raise an assessment within 4 years from the end of the accounting period; this is extended to 6 years if there is a careless error or 20 years if there is a deliberate error or failure to notify chargeability to tax.

7 Appeals and Disputes

The company can appeal against amendments to the corporation tax return. The appeal must be normally be made within 30 days of the amendment and must state the grounds for appeal. The appeals procedure is as per VAT.

8 Penalties for incorrect returns

- No penalty where a taxpayer simply makes a mistake
- 30% unpaid tax where a tax payer fails to take reasonable care.
- 70% unpaid tax if error is deliberate.
- 100% unpaid tax if deliberate failure with concealment.

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



ABOUT THE AUTHOR

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