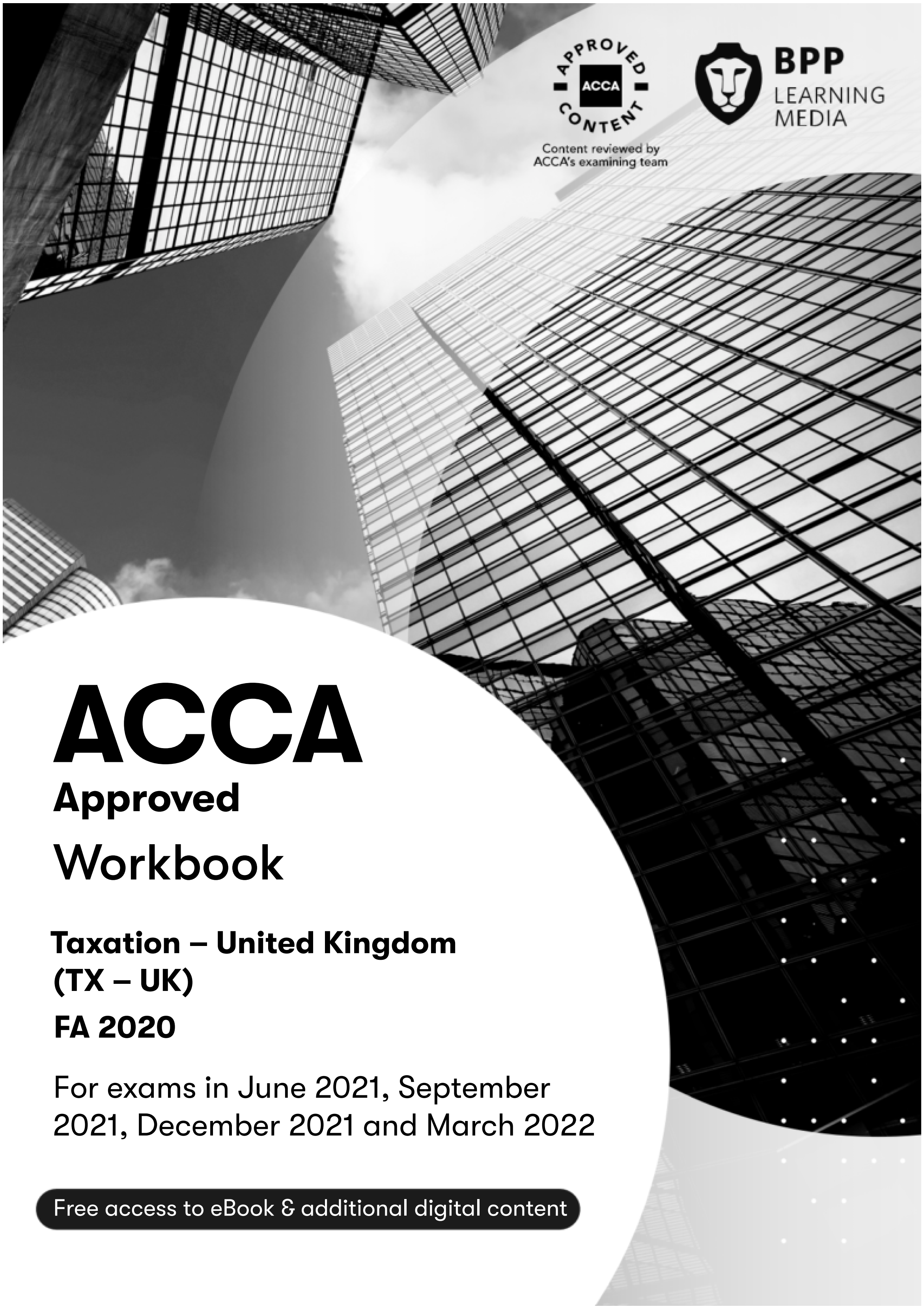

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ACCA

Approved

Workbook

Taxation – United Kingdom (TX – UK)

FA 2020

For exams in June 2021, September 2021, December 2021 and March 2022

Free access to eBook & additional digital content

ACCA

Applied Skills

Taxation (TX – UK) FA 2020

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BPP
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Contents

Essential Reading

Helping you to pass

BPP Learning Media – ACCA Approved Content Provider

As an ACCA Approved Content Provider, BPP Learning Media gives you the opportunity to use study materials reviewed by the ACCA examining team. By incorporating the examining team's comments and suggestions regarding the depth and breadth of syllabus coverage, the BPP Learning Media Workbook provides excellent, ACCA-approved support for your studies.

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The PER alert

Before you can qualify as an ACCA member, you not only have to pass all your exams but also fulfil a three-year practical experience requirement (PER). To help you to recognise areas of the syllabus that you might be able to apply in the workplace to achieve different performance objectives, we have introduced the 'PER alert' feature (see the next section). You will find this feature throughout the Workbook to remind you that what you are learning to pass your ACCA exams is equally useful to the fulfilment of the PER requirement. Your achievement of the PER should be recorded in your online My Experience record.

Chapter features

Studying can be a daunting prospect, particularly when you have lots of other commitments. This Workbook is full of useful features, explained in the key below, designed to help you get the most out of your studies and maximise your chances of exam success.

Key term

Central concepts are highlighted and clearly defined in the Key terms feature. Key terms are also listed in bold in the Index, for quick and easy reference.

Formula to learn

This boxed feature will highlight important formula which you need to learn for your exam.

PER alert

This feature identifies when something you are reading will also be useful for your PER requirement (see 'The PER alert' section above for more details).

Real world examples

These will give real examples to help demonstrate the concepts you are reading about.

Illustration

Illustrations walk through how to apply key knowledge and techniques step by step.

Activity

Activities give you essential practice of techniques covered in the chapter.

Essential reading

Links to the Essential reading are given throughout the chapter. The Essential reading is included in the free eBook, accessed via the Exam Success Site (see inside cover for details on how to access this).

At the end of each chapter you will find a Knowledge diagnostic, which is a summary of the main learning points from the chapter to allow you to check you have understood the key concepts. You will also find a Further study guidance which contains suggestions for ways in which you can continue your learning and enhance your understanding. This can include: recommendations for question practice from the Further question practice and solutions, to test your understanding of the topics in the Chapter; suggestions for further reading which can be done, such as technical articles; and ideas for your own research.

Introduction to the Essential reading

The electronic version of the Workbook contains additional content, selected to enhance your studies. Consisting of revision materials and further explanations of complex areas (including illustrations and activities), it is designed to aid your understanding of key topics which are covered in the main printed chapters of the Workbook.

A summary of the content of the Essential reading is given below.

Chapter		Summary of Essential reading content
1	Introduction to the UK tax system	• Function and purpose of tax • Economic factors ie to discourage/encourage certain types of activity • Social factors - different taxes, different effects • Environmental factors - eg climate change levy • Tax avoidance and tax evasion
2	Computing taxable income and the income tax liability	• Steps in computing the tax liability and tax payable • Working at the margin examples • Qualifying interest - loan purposes that qualify for relief • Examples of income tax planning for spouses/civil partners
3	Employment income	There is no essential reading for this chapter
4	Taxable and exempt benefits. The PAYE system	• Detailed example on car and fuel benefit • Further detail on beneficial loans • Further detail on expenses and exempt benefits
5	Pensions	• Contributions not attracting tax relief
6	Property income	There is no essential reading for this chapter
7	Computing trading income	• Further reading on the badges of trade • Case law information on the distinction between capital and revenue expenditure • The application of the 'wholly and exclusively' rule - the remoteness and duality tests • Table of sundry allowable and disallowable items • Detail of the operation of fixed rate expenses in the cash basis
8	Capital allowances	• Rule concerning date of expenditure for capital allowance purposes • Detailed definition of plant and machinery, buildings, and structures • Treatment of land and computer software • Relevant case law on function vs setting
9	Assessable trading income	• Basis period rules where cessation occurs in the first two years of trading • Illustration of basis periods over the life of a business • Detailed analysis of factor influencing choice of accounting date

Chapter		Summary of Essential reading content
10	Trading losses	• Loss relief against capital gains • Further example of basis period rules applicable to losses in early years of trading • Disclaiming capital allowances as a tax planning tool
11	Partnerships and limited liability partnerships	• Additional illustration of the use of losses in a partnership
12	National insurance contributions	• Detailed definition of 'earnings' for NIC • Operation of earnings periods for directors including an example comparing a director to an employee
13	Computing chargeable gains	• Further detail/example on computing a gain or loss
14	Chattels and private residence relief	• Business use of a residence
15	Business reliefs	• More detail on the business asset disposal relief lifetime limit • Rollover relief - non-business use
16	Shares and securities	There is no essential reading for this chapter
17	Self assessment and payment of tax by individuals	• Penalties for failure to notify chargeability • Penalties for late filing exceeding 12 months • Circumstances where payments on account are not required or may be reduced • HMRC powers - Determinations, discovery assessments and investigating dishonest conduct by tax agents • Detail regarding appeals and Tax Tribunal hearings
18	Inheritance tax: scope and transfers of value	• Deductibility of debts and funeral expenses
19	Computing taxable total profits and the corporation tax liability	• Loan relationships - accounting methods, tax treatment of incidental costs of loan finance, and capital costs • Illustration showing the calculation of property business profit for a company • Comprehensive illustration of the computation of TTP • Comparison of running a business as a sole trader vs a company
20	Chargeable gains for companies	• Detail, including an example, of the impact of bonus and rights issues on the FA 1985 share pool for a company • Treatment of reorganisations and takeovers for a corporate shareholder
21	Loss relief for single companies	There is no essential reading for this chapter
22	Groups	• The order of offset of losses for a claimant company • Illustration showing the different definitions of a group relief and chargeable gains group

Chapter		Summary of Essential reading content
23	Self assessment and payment of tax by companies	• Detail of iXBRL • Detail of how a company can make and amend claims
24	An introduction to VAT	• Example with standard and zero-rated and exempt supplies • Meaning of supplies of goods/services/taxable persons • Categorising a supply • Examples of zero-rated and exempt supplies
25	Further aspects of VAT	• VAT records

Introduction to Taxation (TX)

Overall aim of the syllabus

You are introduced to the rationale behind – and the functions of – **the tax system**. The syllabus then considers the **separate taxes** that an accountant would need to have a detailed knowledge of, such as **income tax from self-employment**, **employment and investments**, the **corporation tax** liability of individual companies and groups of companies, the **national insurance contribution** liabilities of both employed and self employed persons, the **value added tax** liability of businesses, the **chargeable gains** arising on disposals of investments by both individuals and companies, and the **inheritance tax** liabilities arising on chargeable lifetime transfers and on death.

You will be expected to have a **detailed knowledge** of these taxes, but **no previous knowledge is assumed**. You should **study the basics** carefully and **learn the pro forma computations**. It then becomes straightforward to complete these by slotting in figures from your detailed workings.

As well as being able to calculate tax liabilities, you may be required to **explain the basis of the calculations**, **apply tax planning techniques** for individuals and companies and **identify the compliance issues** for each major tax through a variety of business and personal scenarios and situations

Members of the Taxation (TX – UK) examining team have written several technical articles including two on Inheritance Tax, two on chargeable gains, one on groups, two on VAT, one on benefits, one on motor cars, one on adjustment of profit, one on higher skills and one on Finance Act 2020. All these articles are available on the ACCA website. Make sure you read them to gain further insight into what the Taxation (TX – UK) examining team is looking for.

The syllabus

The broad syllabus headings are:

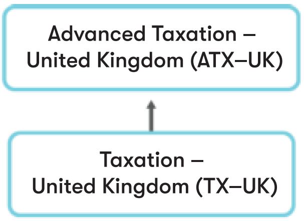
A	The UK tax system and its administration
B	Income tax and NIC liabilities
C	Chargeable gains for individuals
D	Inheritance tax
E	Corporation tax liabilities
F	Value added tax (VAT)
G	Employability and technology skills

Main capabilities

On successful completion of this exam, you should be able to:

A	Integrate knowledge and understanding from across the syllabus to enable you to complete detailed computations of tax liabilities
B	Explain the underlying principles of taxation by providing a simple summary of the rules and how they apply to the particular situation
C	Apply tax planning techniques by identifying available options and testing them to see which has the greater effect on tax liabilities

Links with other exams



The diagram shows where direct (solid line arrows) and indirect (dashed line arrows) links exist between this exam and other exams preceding or following it.

TX-UK provides a **foundation for Advanced Taxation (ATX – UK)** which will be chosen by those who work in a tax environment.

Achieving ACCA's Study Guide Learning Outcomes

This BPP Workbook covers all the Taxation (TX) syllabus learning outcomes. The tables below show in which chapter(s) each area of the syllabus is covered.

A	**The UK tax system and its administration**	
A1	The overall function and purpose of taxation in a modern economy	**Chapter 1**
A2	Principal sources of revenue law and practice	**Chapter 1**
A3	The systems for self-assessment and the making of returns	**Chapters 17, 23**
A4	The time limits for the submission of information, claims and payment of tax, including payments on account	**Chapters 17,23**
A5	The procedures relating to compliance checks, appeals and disputes	**Chapters 17,23**
A6	Penalties for non-compliance	**Chapters 17, 23**

B	**Income tax and NIC liabilities**	
B1	The scope of income tax	**Chapter 2**
B2	Income from employment	**Chapters 3, 4**
B3	Income from self-employment	**Chapters 7, 8, 9, 10, 11**
B4	Property and investment income	**Chapters 2, 6**
B5	The comprehensive computation of taxable income and income tax liability	**Chapters 2, 3**
B6	National insurance contributions for employed and self-employed persons	**Chapter 12**
B7	The use of exemptions and reliefs in deferring and minimising income tax liabilities	**Chapters 2, 5**

C	**Chargeable gains for individuals**	
C1	The scope of the taxation of capital gains	**Chapter 13**
C2	The basic principles of computing gains and losses	**Chapter 13**
C3	Gains and losses on the disposal of movable and immovable property	**Chapter 14**
C4	Gains and losses on the disposal of shares and securities	**Chapter 16**
C5	The computation of capital gains tax	**Chapters 13, 15**
C6	The use of exemptions and reliefs in deferring and minimising tax liabilities arising on the disposal of capital assets	**Chapters 13, 15**
D	**Inheritance tax**	
D1	The basic principles of computing transfers of value	**Chapter 18**
D2	The liabilities arising on chargeable lifetime transfers and on the death of an individual	**Chapter 18**
D3	The use of exemptions in deferring and minimising inheritance tax liabilities	**Chapter 18**
D4	Payment of inheritance tax	**Chapter 18**
E	**Corporation tax liabilities**	
E1	The scope of corporation tax	**Chapter 19**
E2	Taxable total profits	**Chapter 19, 21**
E3	Chargeable gains for companies	**Chapters 20, 21**
E4	The comprehensive computation of corporation tax liability	**Chapter 19**
E5	The effect of a group corporate structure for corporation tax purposes	**Chapter 22**
E6	The use of exemptions and reliefs in deferring and minimising corporation tax liabilities	**Chapters 19, 20, 21, 22**
F	**Value added tax (VAT)**	
F1	The VAT registration requirements	**Chapter 24**
F2	The computation of VAT liabilities	**Chapters 24, 25**
F3	The effect of special schemes	**Chapter 25**
G	**Employability and technology skills**	
G1	Use computer technology to efficiently access and manipulate relevant information	Skills checkpoint 2 and 4

G2	Work on relevant response options, using available functions and technology, as would be required in the workplace.	Skills checkpoint 2 and 4
G3	Navigate windows and computer screens to create and amend responses to exam requirements, using the appropriate tools.	Skills checkpoint 2 and 4
G4	Present data and information effectively using the appropriate tools.	Skills checkpoint 2 and 4

The complete syllabus and study guide can be found by visiting the exam resource finder on the ACCA website: www.accaglobal.com/gb/en.html.

The exam

Computer-based exams

Applied Skills exams are all computer-based exams (CBE).

Approach to examining the syllabus

The Taxation (TX) syllabus is assessed by a 3 hour exam. The pass mark is **50%**. All questions in the exam are **compulsory**.

There is no choice in this exam, all questions have to be answered. You must therefore study the **entire syllabus**, there are no short-cuts.

The first section of the exam consists of 15 **objective test questions**, worth two marks each. These will inevitably cover a **wide range of the syllabus**.

The second section of the exam consists of three scenarios each being tested with five **objective test questions,** worth two marks each. You must make sure you **understand the scenario** before attempting the related questions.

The third section of the exam consists of three **constructed response questions**, one 10 mark question and two 15 mark questions.

Practising longer questions set in the third section of the exam under **timed conditions** is essential. BPP's **Practice & Revision Kit** contains 10 mark and 15 mark questions on all areas of the syllabus.

Answer all parts of the question. Even if you cannot do all of the calculation elements, you will still be able to gain marks in the discussion parts.

Answer selectively – the examining team will expect you to consider carefully what is relevant and significant enough to include in your answer. Don't include unnecessary information.

Keep an eye out for **articles** as the **examining team** will use **Student Accountant** to communicate with students.

Tax rates, allowances and information on certain reliefs will be given in the exam. You should familiarise yourself with the information provided so that you know how to find it quickly in the exam.

Format of the exam		**Marks**
Section A	Objective test (OT) 15 questions × 2 marks	30
Section B	Objective test (OT) case 3 questions × 10 marks Each question will contain 5 subparts each worth 2 marks	30

Format of the exam		Marks
Section C	Constructed response (long questions) 1 question × 10 marks 2 questions × 15 marks	40
		100

Section A and B questions will be selected from the entire syllabus. The responses to each question or subpart in the case of OT cases are marked automatically as either correct or incorrect by computer.

The 10 mark Section C questions can come from any part of the syllabus. The 15 mark Section C questions will mainly focus on the following syllabus areas but a minority of marks can be drawn from any other area of the syllabus:

- Income tax (syllabus area B)
- Corporation tax (syllabus area E)

The responses to these questions are human marked.

Essential skills areas to be successful in Taxation (TX – UK)

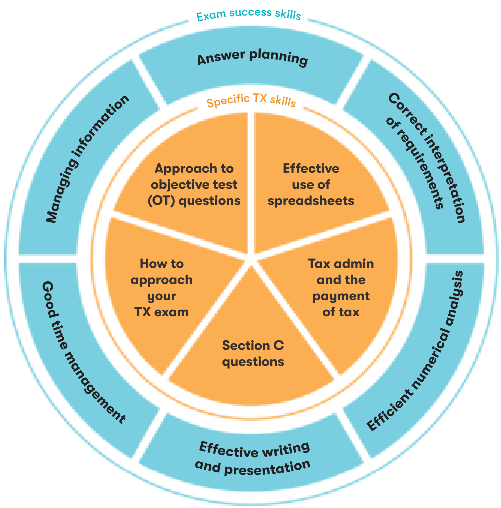
We think there are three areas you should develop in order to achieve exam success in TX:

(a) Knowledge application

(b) Specific Taxation skills

(c) Exam success skills

These are shown in the diagram below.



Specific TX skills

These are the skills specific to TX that we think you need to develop in order to pass the exam.

In this Workbook, there are five **Skills Checkpoints** which define each skill and show how it is applied in answering a question. A brief summary of each skill is given below.

Skill 1: Approach to objective test (OT) questions

Section A of the exam will include 15 OT questions worth two marks each. Section B of the exam will include three OT cases, worth 10 marks each. Each OT case contains a group of five OT questions based around a single scenario. 60% of your TX exam is therefore made up of OT questions. It is essential that you have a good approach to answering these questions. OT questions are auto-marked; your workings will therefore not be considered; you have to answer the whole question correctly to earn their two marks.

A step-by-step technique for tackling OT questions is outlined below:

General guidance for approaching OT questions

STEP 1: Answer the questions you know first.

If you're having difficulty answering a question, move on and come back to tackle it once you've answered all the questions you know.

It is often quicker to answer discursive style OT questions first, leaving more time for calculations.

General guidance for approaching OT questions

STEP 2: Answer all questions.

There is no penalty for an incorrect answer in ACCA exams; there is nothing to be gained by leaving an OT question unanswered. If you are stuck on a question, as a last resort, it is worth selecting the option you consider most likely to be correct and moving on. Make a note of the question, so if you have time after you have answered the rest of the questions, you can revisit it.

Guidance for answering specific OT questions

STEP 3: Read the requirement first!

The requirement will be stated in bold text in the exam. Identify what you are being asked to do, any technical knowledge required and **what type of OT question** you are dealing with. Look for key words in the requirement such as "which **TWO** of the following," "which of the following is **NOT**"

Guidance for answering specific OT questions

STEP 4: Apply your technical knowledge to the data presented in the question.

Take your time working through questions, and make sure to read through each answer option with care. OT questions are designed so that each answer option is plausible. Work through each response option and eliminate those you know are incorrect.

Skills Checkpoint 1 covers this technique in detail through application of an OT case question.

Skill 2: Effective use of spreadsheets

It is very likely that you will be required to use the spreadsheet response option in the constructed workspace for Section C questions. It is imperative that you know how to use the spreadsheet functions to prepare accurate and easy to follow calculations.

The key steps are outlined below.

Step 1	**Start by setting up the spreadsheet.**
Step 2	**Ensure the numbers are in a separate cell from the label.**
Step 3	**Always use formulae to perform calculations.**
Step 4	**Make efficient use of the SUM function.**
Step 5	**Only use separate workings for longer calculations and cross reference any workings using '=' rather than re-typing the numbers.**
Step 6	**Does your answer look reasonable?**

Skills Checkpoint 2 covers this technique in detail through application to a question.

Skill 3: The UK tax system and its administration

You must study the whole syllabus in order to pass the TX exam, but having the administration knowledge at your fingertips will give you extra time in the exam to answer the more difficult questions.

This skills checkpoint gives you a list of quick fire questions to help you learn the basic information.

Skill 4: Section C questions

Section C questions contain one 10-mark question and two 15-mark questions. One 15-mark question will focus on income tax and the other one will focus on corporation tax. This means that you know roughly what to expect and you can use proformas where relevant to help with the long calculations. Discursive elements will be relatively short. 10-mark questions often cover more than one tax and are designed to act as a bridge question between TX and the higher level exam, ATX.

A step-by-step technique for attempting these questions is outlined below.

Step 1	Read the requirements first and read them carefully.
Step 2	Learn and use the proformas where relevant.
Step 3	Input easy numbers from the question directly into your proforma.
Step 4	Always use formulae to perform basic calculations.
Step 5	Show longer workings separately.

Skills Checkpoint 4 covers this technique in detail through application to a question.

Skill 5: How to approach your TX exam

You can answer your TX exam in whatever order you prefer. It is important that you adopt a strategy that works best for you. We would suggest that you decide on your preferred approach and practise it by doing a timed mock exam before your real exam.

A suggested approach to tackling your TX exam is outlined below.

Complete Section A first - allocated time 54 minutes

Tackle any easier OT questions first. Often discursive style questions can be answered quickly, saving more time for calculations. Do not leave any questions unanswered. Even if you are unsure make a reasoned guess.

Complete Section B next - allocated time 54 minutes

You will have 18 mins of exam time to allocate to each of the three OT case questions in Section B. Use the same approach to OT questions as discussed for Section A.

There will normally be discursive and numerical questions within each case. Again, it is better to tackle the discursive type questions first and make a reasoned guess for any questions you are unsure on.

Finally, complete Section C - allocated time 72 minutes

Start with the question you feel most confident with.

Skills Checkpoint 5 covers this technique in more detail.

Exam success skills

Passing the TX exam requires more than applying syllabus knowledge and demonstrating the specific TX skills; it also requires the development of excellent exam technique through question practice.

We consider the following six skills to be vital for exam success. The Skills Checkpoints show how each of these skills can be applied in the exam.

1 Exam success skill 1

Managing information

Questions in the exam will present you with a lot of information. The skill is how you handle this information to make the best use of your time. The key is determining how you will approach the exam and then actively reading the questions.

Advice on developing Managing information

Approach

The exam is 3 hours long. There is no designated 'reading' time at the start of the exam, however, one approach that can work well is to start the exam by spending 10–15 minutes carefully reading through all of the questions to familiarise yourself with the exam.

Once you feel familiar with the exam, consider the order in which you will attempt the questions; always attempt them in your order of preference. For example, you may want to leave to last the question you consider to be the most difficult.

If you do take this approach, remember to adjust the time available for each question appropriately – see Exam success skill 6: Good time management.

If you find that this approach doesn't work for you, don't worry – you can develop your own technique.

Active reading

You must take an active approach to reading each question. Focus on the requirement first, underlining/ highlighting key verbs such as 'prepare', 'comment', 'explain', 'discuss', to ensure you answer the question properly. Then read the rest of the question, underlining/highlighting and annotating important and relevant information, and making notes of any relevant technical information you think you will need.

2 Exam success skill 2

Correct interpretation of the requirements

The active verb used often dictates the approach that written answers should take (eg 'explain', 'discuss', 'evaluate'). It is important you identify and use the verb to define your approach. The **correct interpretation of the requirements** skill means correctly producing only what is being asked for by a requirement. Anything not required will not earn marks.

Advice on developing correct interpretation of the requirements

This skill can be developed by analysing question requirements and applying this process:

Step 1	**Read the requirement** Firstly, read the requirement a couple of times slowly and carefully and highlight the active verbs. Use the active verbs to define what you plan to do. Make sure you identify any sub-requirements and any topics which you are specifically told you do not need to cover in your answer. Also note the number of marks available for each requirement or sub-requirement, as this will indicate the time available and hence the level of depth required in your answer.
Step 2	**Read the rest of the question** By reading the requirement first, you will have an idea of what you are looking out for as you read through the scenario. This is a great time saver and means you don't end up having to read the whole question in full twice. You should do this in an active way – see Exam success skill 1: Managing Information.
Step 3	**Read the requirement again** Read the requirement again to remind yourself of the exact wording before starting your answer. This will capture any misinterpretation of the requirements or any missed requirements entirely. This should become a

	habit in your approach and, with repeated practice, you will find the focus, relevance and depth of your answer plan will improve.

3 Exam success skill 3

Answer planning: Priorities, structure and logic

This skill requires the planning of the key aspects of an answer which accurately and completely responds to the requirement.

Advice on developing Answer planning: Priorities, structure and logic

Everyone will have a preferred style for an answer plan. For example, it may be a mind map, bullet-pointed lists or simply making some notes. Choose the approach that you feel most comfortable with, or, if you are not sure, try out different approaches for different questions until you have found your preferred style.

For 10 mark Section C questions, it can be useful to draw up a separate answer plan in the format of your choosing (eg a mind map or bullet-pointed lists). You will want to remind yourself of key facts from the scenario to avoid having to re-read the question – you should at the very least make a few notes including vital information such as the following key factors:

- Nature of the taxpayer: is it an individual or a company?
- For individuals: their age, any family relationships, their residence and domicile status, whether they're a basic, higher or additional rate taxpayer, and whether they've used their CGT annual exempt amount /IHT exemptions
- For companies: their ownership structure and group relationships
- Relevant dates: the year end(s) of businesses, dates of actual or proposed transactions, the date that a business started, dates of gifts (or death!) for IHT

4 Exam success skill 4

Efficient numerical analysis

This skill aims to maximise the marks awarded by making clear to the marker the process of arriving at your answer. This is achieved by laying out an answer such that, even if you make a few errors, you can still score subsequent marks for follow-on calculations. It is vital that you do not lose marks purely because the marker cannot follow what you have done.

Advice on developing Efficient numerical analysis

This skill can be developed by applying the following process:

Step 1	**Use a standard proforma working where relevant** If answers can be laid out in a standard proforma then always plan to do so. This will help the marker to understand your working and allocate the marks easily. It will also help you to work through the figures in a methodical and time-efficient way.
Step 2	**Show your workings** Keep your workings as clear and simple as possible and ensure they are cross-referenced to the main part of your answer.
Step 3	**Keep moving!** It is important to remember that, in an exam situation, it is difficult to get every number 100% correct. The key is therefore ensuring you do not spend too long on any single calculation. If you are struggling with a solution then make a sensible assumption, state it and move on.

5 Exam success skill 5

Effective writing and presentation

Written answers should be presented so that the marker can clearly see the points you are making, presented in the format specified in the question. The skill is to provide efficient written answers with sufficient breadth of points that answer the question, in the right depth, in the time available.

Advice on developing Effective writing and presentation

Step 1	**Use headings** Using the headings and sub-headings from your answer plan will give your answer structure, order and logic. This will ensure your answer links back to the requirement and is clearly signposted, making it easier for the marker to understand the different points you are making. Underlining your headings will also help the marker.
Step 2	**Write your answer in short, but full, sentences** Use short, punchy sentences with the aim that every sentence should say something different and generate marks. Write in full sentences, ensuring your style is professional.
Step 3	**Do your calculations first and explanation second** Questions sometimes ask for an explanation with supporting calculations. The best approach is to prepare the calculation first then add the explanation. Performing the calculation first should enable you to explain what you have done.

6 Exam success skill 6

Good time management

This skill means planning your time across all the requirements so that all tasks have been attempted at the end of the 3 hours available and actively checking on time during your exam. This is so that you can flex your approach and prioritise requirements which, in your judgement, will generate the maximum marks in the available time remaining.

Advice on developing Good time management

The exam is 3 hours long, which translates to 1.8 minutes per mark. At the beginning of a question, work out the amount of time you should be spending on each requirement If you take the approach of spending 10–15 minutes reading and planning at the start of the exam, adjust the time allocated to each question accordingly.

Keep an eye on the clock

Aim to attempt all requirements, but be ready to be ruthless and move on if your answer is not going as planned. The challenge for many is sticking to planned timings. Be aware this is difficult to achieve in the early stages of your studies and be ready to let this skill develop over time.

Question practice

Question practice is a core part of learning new topic areas. When you practise questions, you should focus on improving the Exam success skills – personal to your needs – by obtaining feedback or through a process of self-assessment.

Sitting this exam as a computer-based exam and practicing as many exam-style questions as possible in the ACCA CBE practice platform will be the key to passing this exam. You should attempt questions under timed conditions and ensure you produce full answers to the discussion parts as well as doing the calculations. Also ensure that you attempt all mock exams under exam conditions.

ACCA have launched a free on-demand resource designed to mirror the live exam experience helping you to become more familiar with the exam format. You can access the platform via the Study Support Resources section of the ACCA website navigating to the CBE question practice section and logging in with your myACCA credentials.

1 Introduction to the UK tax system

Learning objectives

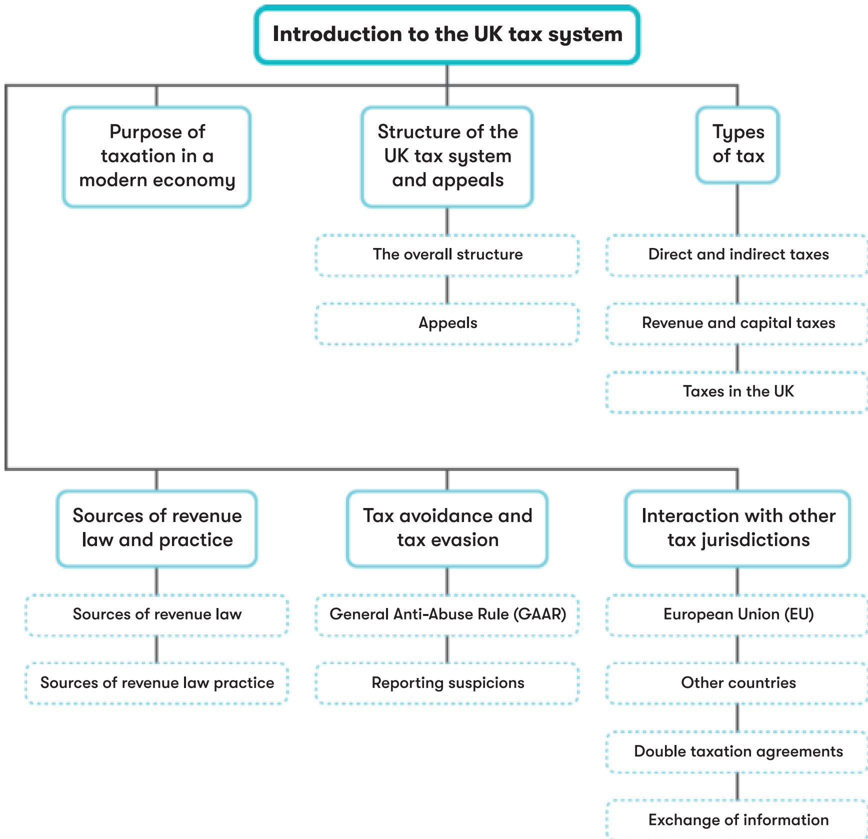
On completion of this chapter, you should be able to:

	Syllabus reference no.
Describe the purpose (economic, social etc) of taxation in a modern economy.	A1(a)
Explain the difference between direct and indirect taxation.	A1(b)
Identify the different types of capital and revenue tax.	A1(c)
Describe the overall structure of the UK tax system.	A2(a)
State the different sources of revenue law.	A2(b)
Describe the organisation HM Revenue & Customs (HMRC) and its terms of reference.	A2(c)
Explain the difference between tax avoidance and tax evasion, and the purposes of the General Anti-Abuse Rule (GAAR).	A2(d)
Appreciate the interaction of the UK tax system with that of other tax jurisdictions.	A2(e)
Appreciate the need for double taxation agreements.	A2(f)
Explain the need for an ethical and professional approach.	A2(g)

Exam context

You may be asked a question on a specific topic in the UK tax system in either Section A or Section B. An example would be to identify sources of revenue law. You are unlikely to be asked a whole Section C question on this part of the syllabus. You may, however, be asked to comment on one aspect, such as the difference between tax avoidance and tax evasion or how to act if a client has failed to disclose information to the tax authorities, as part of a question.

Chapter overview



1 Purpose of taxation in a modern economy

There are many factors which will influence the government's tax policy:

(a) **Economic factors:** Tax can be used to encourage and discourage certain types of activity.

Encourages	Discourages
Saving (ISA/pension)	Smoking
Charitable donations	Alcohol
Entrepreneurs	Motoring
Investment in plant and machinery	

Tax also raises money for defence, law and order, overseas aid and government and parliamentary costs.

(b) **Social factors:** Tax can be used in the redistribution of income and wealth. Different taxes have different social effects:

Tax	Social effect
Direct taxes (based on income, gains and wealth)	Tax only those who have these resources
Indirect taxes (tax on consumption eg VAT on products/services purchases)	Discourage spending (VAT) and encourage saving. Lower or nil rates of tax can be levied on essentials like food.
Progressive taxes (ie where the proportion of income paid increases as income or gains rise)	Target those who can afford to pay.

(c) **Environmental factors:** Taxes may be levied for environmental reasons (for example, a climate change levy or landfill tax).

Essential reading

See Chapter 1 Section 1 of the Essential reading for more detail on the purpose of taxation.

The Essential reading is available as an Appendix of the digital edition of the Workbook.

2 Structure of the UK tax system and appeals

2.1 The overall structure

HM Treasury formally **imposes and collects** tax.

HM Revenue & Customs (HMRC) is a part of HM Treasury and has responsibility for the

administrative function for the collection of tax. HMRC staff are referred to in the tax legislation as **'Officers of Revenue and Customs'** and are responsible for supervising the self-assessment system and raising queries about tax liabilities.

The Crown Prosecution Service (CPS) provides legal advice and institutes and conducts criminal prosecutions in England and Wales where there has been an investigation by HMRC.

2.2 Appeals

A taxpayer can appeal against a decision of HMRC. Appeals relating to direct taxes (see next section) must first be made to HMRC. Appeals relating to indirect taxes must be made directly to the Tax Tribunal.

The Tribunal hears appeals and is in two tiers:

- First Tier Tribunal - deals with **most cases**
- Upper Tribunal - deals with **complex cases** (important issue of tax law or large financial sums) or appeals against decisions of the First Tier Tribunal

Before an appeal is heard by the Tax Tribunal, there is an option for the taxpayer to request an internal review of a decision by a HMRC review officer.

3 Types of taxes

3.1 Direct and indirect taxes

KEY TERM

Direct tax: Direct taxes are those charged on income, gains and wealth. Income tax, national insurance, corporation tax, capital gains tax and inheritance tax are direct taxes. Direct taxes are collected directly from the taxpayer.

Indirect tax: Indirect taxes are those paid by the consumer to the supplier who then passes the tax to the HMRC. Value added tax is an indirect tax.

3.2 Revenue and capital taxes

KEY TERM

Revenue tax: Revenue taxes are those charged on income.

Capital tax: Capital taxes are those charged on capital gains or on wealth.

Note that corporation tax is charged on both income and capital gains of UK companies.

3.3 Taxes in the UK

The main taxes in the UK are:

Tax	Direct or indirect	Capital or revenue	Suffered by
Income tax	Direct	Revenue	Individuals and partners
National insurance	Direct	Revenue	Employees, employers, self-employed
Corporation tax	Direct	Both	UK companies
Capital gains tax	Direct	Capital	Individuals and partners
Inheritance tax	Direct	Capital	Individuals
VAT	Indirect	Neither	Businesses

4 Sources of revenue law and practice

4.1 Sources of revenue law

There are three sources of revenue law:

(a) Primary legislation (Acts of Parliament) which sets out the basic principles

(b) Secondary legislation (Statutory Instruments) which gives the detail of how the law applies

(c) Case law, which is the interpretation of legislation by the courts

At least one Finance Act is passed by Parliament each year to update the various rules governing the calculation and collection of tax for the current tax year and financial year. The Finance Act 2020 governs the rules for the tax year 2020/21 and for financial year 2020 and will be tested in exams from June 2021.

- The tax year runs from 6 April to the following 5 April.
- The tax year 2020/21 runs from 6 April 2020 to 5 April 2021.
- A tax year is the period in respect of which individuals submit returns and pay tax (eg income tax, capital gains tax, national insurance).
- A financial year runs from 1 April to the following 31 March.
- Financial year 2020 runs from 1 April 2020 to 31 March 2021.
- Corporation tax rates and rules are set for financial years

KEY TERM

Tax year: A tax year is the period in respect of which **individuals** submit returns and pay tax (eg income tax, capital gains tax, national insurance).

Financial year: A financial year runs from 1 April to the following 31 March and relates to **companies**.

4.2 Sources of revenue law practice

HMRC produces a number of sources setting out how it thinks revenue law works in practice. These do not have legal force but are useful guidance and include:

(a) Statements of practice which set out how HMRC intends to apply the law

(b) Extra statutory concessions which set out circumstances in which HMRC will not apply the law strictly where it would be unfair

(c) Internal manuals used by HMRC staff

5 Tax avoidance and tax evasion

PER alert

One of the competencies you require to fulfil Performance Objective 17 *Tax planning and advice* of the PER is to advise clients responsibly about the differences between tax planning, tax avoidance and tax evasion. You can apply the knowledge you obtain from this section of the Workbook to help to demonstrate this competence.

KEY TERM

Tax planning: Tax planning is the reduction in an individual's or company's tax liabilities in accordance with the tax legislation such as claiming capital allowances on machinery.

Tax avoidance: Tax avoidance is the legal minimisation of tax liabilities (including tax planning mentioned above).

Tax evasion: Tax evasion consists of seeking to mislead HMRC by either suppressing information or providing deliberately false information. It is illegal.

Essential reading

See Chapter 1 Section 2 of the Essential reading for more detail on tax avoidance and tax evasion.

The Essential reading is available as an Appendix of the digital edition of the Workbook.

5.1 General Anti-Abuse Rule (GAAR)

There is a General Anti-Abuse Rule (GAAR) enabling HMRC to counteract tax advantages from abusive tax arrangements.

(a) The GAAR provides the means for HMRC to counteract tax advantages from abusive tax arrangements.

(b) Abusive tax arrangements involve obtaining a tax advantage as one of their main purposes.

(c) Arrangements are abusive if they cannot be regarded as a reasonable course of action (for example, involving contrived steps) and result in, for example, significantly less income, profits or gains being taxable.

(d) A tax advantage includes relief from or reduction in tax charged, repayment of tax, deferral of tax payment or acceleration of payment.

(e) HMRC may counteract tax advantages arising by, for example, increasing the tax payer's tax liability.

5.2 Reporting suspicions

The practising accountant often acts for taxpayers in their dealings with HMRC and situations can arise where the accountant has concerns as to whether the taxpayer is being honest in providing information to the accountant for onward transmission. They must use their professional judgement and uphold the standards of the ACCA.

If a client evades tax, for example by making a material error or omission in a tax return, the accountant must first try to make the client change it and disclose the error or omission. If the client does not correct the error, omission or failure when advised, the accountant should cease to act for the client, inform HMRC of this cessation (without informing them of the reason to maintain client confidentiality) and consider making a money laundering report to the accountant's firm's money laundering reporting officer (or the National Crime Agency if the accountant is a sole practitioner).

Accountants who suspect, or are aware of, tax evasion by a client may be committing an offence if they do not report their suspicions. Furthermore, the accountant must not disclose to the client or a third party that a money laundering report has been made. Doing so would constitute a criminal offence of 'tipping-off'.

Exam focus point

Under self-assessment, all taxpayers (whether individuals or companies) are responsible for disclosing their taxable income and gains and the deductions and reliefs they are claiming against them.

Many taxpayers arrange for their accountants to prepare and submit their tax returns. The taxpayer is still the person responsible for submitting the return and for paying whatever tax becomes due; the accountant is only acting as the taxpayer's agent.

Activity 1: Tax avoidance and tax evasion

The following acts have been committed in the course of business of one of your clients.

Action 1: A customer invoice was omitted from accounting records in order to push it into the taxable profits of the following tax year.

Action 2 The client decided to gift an asset to their spouse in order to reduce a capital gains tax liability.

Required

Which of these actions amounts to tax evasion?

- O Action 1 only
- O Action 2 only

- Both Actions
- Neither Action

Solution

6 Interaction with other tax jurisdictions

6.1 European Union (EU)

There is no general common system of taxation in the EU.

However, value added tax (VAT) is an EU-wide tax and EU countries are obliged to pass laws to conform with the rules laid down in EU legislation.

For TX-UK exams in the period 1 June 2021 to 31 March 2022, all questions will assume that the UK remains in the European Union.

6.2 Other countries

The rules of tax jurisdictions of other countries do not have a direct interaction with UK tax.

6.3 Double taxation agreements

Double taxation agreements are designed to protect against the risk of double taxation where the same income or gains are taxable in two countries.

They give relief from double taxation by, for example:

- Taxing the source only in one country; or
- Giving credit for tax paid in one country against tax in another country

Double taxation agreements may also include non-discrimination provisions which prevent a foreign national from being treated more harshly than a national of a country.

6.4 Exchange of information

There are provisions regarding the exchange of information between the revenue authorities of EU member states.

Double taxation agreements also usually include rules for the exchange of information between revenue authorities.

Chapter summary

Introduction to the UK tax system

Purpose of taxation in a modern economy

- Economic factors (encouraging and discouraging certain activities)
- Social factors (redistribution of wealth)
- Environmental factors

Structure of the UK tax system and appeals

The overall structure

- HM Treasury imposes and collects tax
- HMRC has responsibility for the administrative function

Appeals

- First-tier Tribunal deals with most cases
- Upper Tribunal deals with complex cases

Types of tax

Direct and indirect taxes

- Direct taxes charged on income, gains and wealth, eg income tax, national insurance, corporation tax, capital gains tax, inheritance tax
- Indirect taxes are those paid by the consumer to the supplier who then passes the tax to the HMRC, eg VAT

Revenue and capital taxes

- Revenue taxes are those charged on income
- Capital taxes are those charged on capital gains or on wealth

Taxes in the UK

- Income tax = revenue tax = suffered by individuals and partners
- National insurance = revenue tax = suffered by employees, employers, self-employed
- Corporation tax = revenue tax and capital tax = suffered by UK companies
- Capital gains tax = capital tax = suffered by individuals and partners
- Inheritance tax = capital tax = suffered by individuals
- VAT = revenue and capital tax = suffered by businesses

Sources of revenue law and practice

Sources of revenue law
- Primary legislation (Acts of Parliament)
- Secondary legislation (Statutory Instruments)
- Case law
- The tax year runs from 6 April to following 5 April
- The financial year runs from 1 April to following 31 March

Sources of revenue law practice
- Statements of practice
- Extra-statutory concessions
- Internal manuals

Tax avoidance and tax evasion

- Tax avoidance = legal minimisation of tax liabilities
- Tax evasion = seeking to mislead HMRC by suppressing information/providing deliberately false information

General Anti-Abuse Rule (GAAR)
- HMRC may counteract tax advantages arising

Reporting suspicions
- Recommend client discloses error to HMRC
- If client does not disclose/correct error, accountant should:
  - Cease to act for client
  - Inform HMRC of cessation (but no details why)
  - Consider making money laundering report
  - Avoid 'tipping-off' the client

Interaction with other tax jurisdictions

European Union (EU)
- VAT is an EU-wide tax and EU countries are obliged to pass laws to conform with the rules laid down in EU legislation

Other countries
- Rules of tax jurisdictions of other countries do not have a direct interaction with UK tax

Double taxation agreements
- Protect against risk of double taxation where same income/gains are taxable in two countries
- Give relief by:
  - Taxing the source only in one country; or
  - Giving credit for tax paid in one country against tax in another country

Exchange of information
- Information agreements between the Revenue authorities of EU member states
- Double taxation agreements usually include exchange of information rules between Revenue authorities

Knowledge diagnostic

1. **Purpose of taxation in a modern economy**

   Taxation can be used to encourage or discourage economic, social and environmental behaviour.

2. **Structure of UK tax system and appeals**

   Taxes are administered by HM Revenue & Customs (HMRC). The Tax Tribunal hears appeals.

3. **Types of tax**

   Taxes may be direct or indirect and revenue or capital.

4. **Sources of revenue law and practice**

   Revenue law consists of legislation (primary and secondary) and case law. HMRC provides guidance on revenue law.

5. **Tax avoidance and tax evasion**

   Tax evasion is illegal. Tax avoidance is legal, although may be challenged by HMRC. Accountants should cease to act for clients who evade tax and should also consider making a money laundering report.

6. **Interaction with other tax jurisdictions**

   There is no general system of taxation within the EU but VAT is an EU-wide tax. Double taxation agreements give relief from where the same revenue source is taxed in both the UK and another country. There are provisions for exchange of information between the UK and other countries.

Further study guidance

Question practice

Now try the following from the Further question practice bank (available in the digital edition of the Workbook):

Section A questions

Q1, Q2, Q3

Activity answers

Activity 1: Tax avoidance and tax evasion

The correct answer is: Action 1 only

Action 1 is tax evasion as it involves misleading HMRC to delay a legitimate tax charge.

Action 2 is tax planning.

2 Computing taxable income and the income tax liability

Learning objectives

On completion of this chapter, you should be able to:

	Syllabus reference no.
Explain how the residence of an individual is determined.	B1(a)
Compute the tax payable on savings and dividends income.	B4(g)
Recognise the treatment of individual savings accounts (ISAs) and other tax exempt investments.	B4(h)
Understand how the accrued income scheme applies to UK Government securities (gilts).	B4(i)
Prepare a basic income tax computation involving different types of income.	B5(a)
Calculate the amount of personal allowance available.	B5(b)
Understand the impact of the transferable amount of personal allowance for spouses and civil partners.	B5(c)
Compute the amount of income tax payable.	B5(d)
Understand the treatment of interest paid for a qualifying purpose.	B5(e)
Understand the treatment of gift aid donations and charitable giving.	B5(f)
Explain and compute the child benefit tax charge.	B5(g)
Understand the treatment of property owned jointly by a married couple, or by a couple in a civil partnership.	B5(h)
Understand how a married couple or a couple in a civil partnership can minimise their tax liabilities.	B7(b)
Basic income tax planning.	B7(c)

Exam context

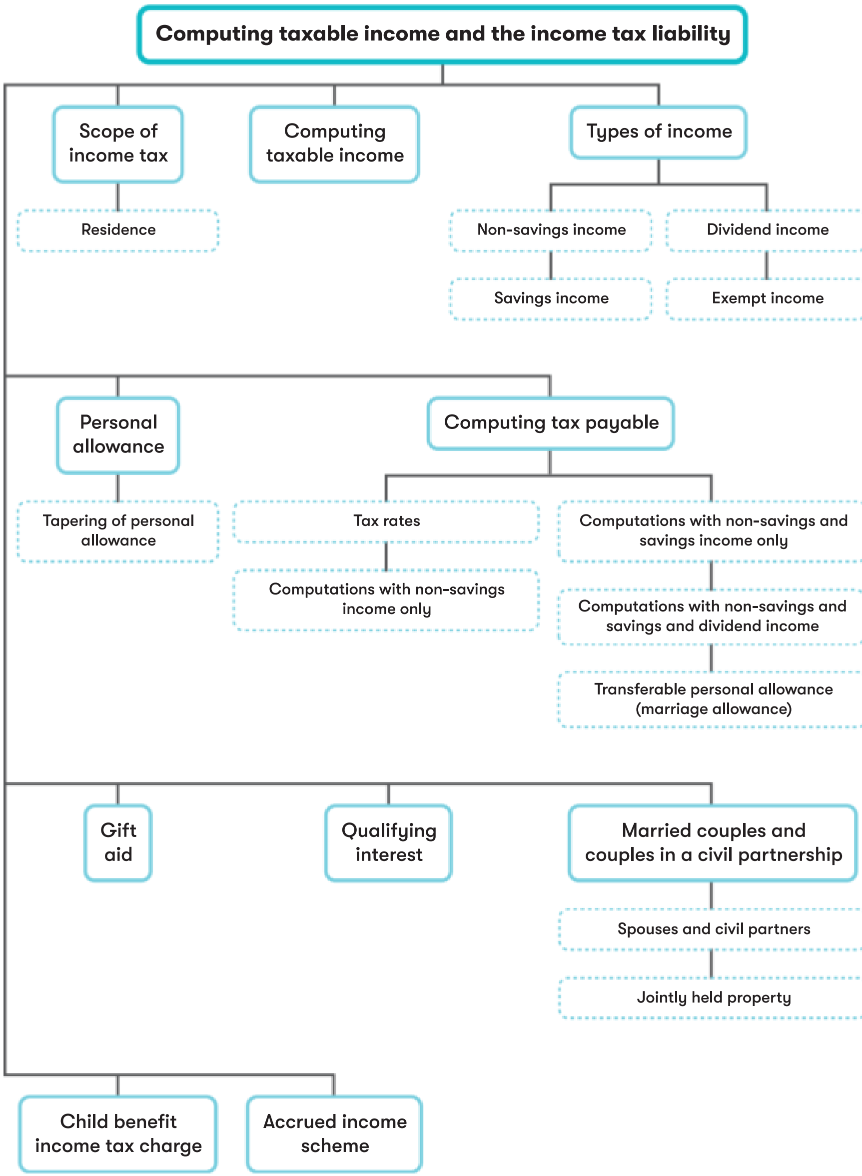
Section A questions on the topics in this chapter may include identification of different types of income or calculation of the personal allowance. They could also include a simple computation of income tax liability on one type of income, or a computation of the child benefit income tax charge. Section B questions on the topics in this chapter could focus on tax implications of various types of income and the treatment of married couples/civil partners.

It is likely that you will have to prepare a full computation of income tax liability (and possibly income tax payable) in a Section C question, in a 15-mark question or a 10-mark question. You should familiarise yourself with the layout of the computation, and the three types of income: non-savings, savings and dividends. It is then a simple matter of slotting the final figures into the computation from supporting workings for the different types of income.

Gift aid donations could feature in a question in any section. You will come across the technique of increasing the basic rate and higher rate limits again when you deal with pensions later in this Workbook.

Throughout this chapter, you should be aware of basic income tax planning such as investing in sources of exempt income. We will also deal with some tax planning for spouses/civil partners.

Chapter overview



1 Scope of income tax

1.1 Residence

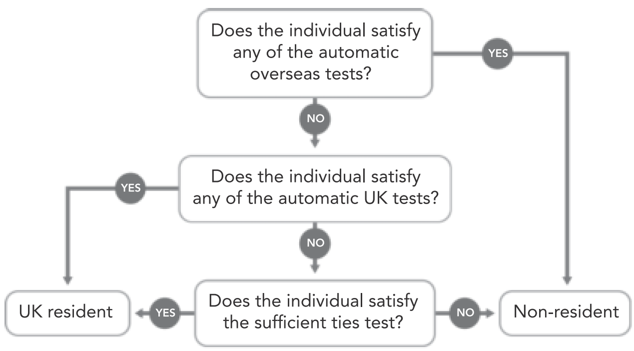
1.1.1 Statutory residence tests

A taxpayer's **residence** has important consequences in establishing the **tax treatment of their UK and overseas income and capital gains**. Generally, an individual who is UK resident is taxed on worldwide income whereas a non-UK resident is liable to UK income tax only on income arising in the UK.

Statute sets out tests to determine whether or not an **individual is UK resident in a tax year.**

The **operation of the tests** can be summarised as follows:

Figure 2.1: Statutory test of residence



1.1.2 Automatic overseas tests

The automatic overseas tests must be considered first.

An individual will automatically **not** be UK resident for the whole tax year if:

- They spend **less than 16 days in the UK** during that tax year; or
- They spend **less than 46 days in the UK** during a tax year and were **not resident during the previous three tax years**; or
- They **work full time overseas** throughout that tax year and **spend less than 91 days in the UK during that tax year.**

1.1.3 Automatic UK tests

If none of the automatic overseas test are met, then the automatic UK tests are considered.

An individual will automatically be UK resident if:

- They are **in the UK for 183 days or more** during a tax year; or
- Their **only home** is in the UK; or
- They carry out **full-time work in the UK** during that tax year

1.1.4 Sufficient ties test

If an individual's residence **cannot be determined by any of the automatic tests** their status will be determined by the **number of ties they have with the UK** and how **many days they are present in the UK** in a tax year.

There are **five ties**:

- Having **close family in the UK** (spouse/civil partner or minor child)
- Having accommodation **in the UK** in which the individual spends at least one night during the tax year
- Doing **substantive work in the UK** (at least 40 days working at least 3 hours a day)

- Being in the UK for **more than 90 days** during **either of the two previous tax years**
- **Spending more time in the UK** than in **any other country** in the tax year (only relevant if **individual was UK resident in any of the previous three tax years**).

The **following table**, showing the **number of ties** by reference to the **number of days in the UK**, will be **provided in the Tax rates and allowances in the exam**.

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

1.1.5 Days spent in the UK

A **day in the UK** is **any day** in which an individual is **present in the UK at midnight.**

Activity 1: UK resident or not UK resident

In one tax year, Sally spent 15 days in the UK.

Required

State with reasons, whether Sally would be UK resident in that tax year.

Solution

Activity 2: UK resident?

Jimmy has lived in Tokyo all of his life where he owned a house. He came to the UK on 1 May 2020 having sold his house in Tokyo the month before. He decided to buy a flat in London which he uses as his only home.

Jimmy lived in the London property until 30 September 2020 and then went on a backpacking holiday for a year.

Required

State with reasons, whether Jimmy would be UK resident in the tax year 2020/21.

Solution

Activity 3: Sufficient ties test

Andy was UK resident in the tax year 2019/20, but was only present in the UK for 80 days in that tax year. He does not satisfy either the automatic overseas test or the automatic UK test in the tax year 2020/21.

In the tax year 2020/21, Andy spent 48 days working five hours a day in the UK where he was present at midnight. Andy's wife lives in the UK in their joint home and Andy lives in this home when he is in the UK. Andy spent the rest of the tax year 2020/21 in Spain.

Required

State with reasons, whether Andy is UK resident in the tax year 2020/21.

Solution

2 Computing taxable income

An individual's income from all sources is brought together (aggregated) in a personal tax computation for each tax year.

KEY TERM

Tax year: The **tax year**, or **fiscal year**, or **year of assessment** runs from 6 April to 5 April. For example, the tax year 2020/21 runs from 6 April 2020 to 5 April 2021.

Income tax is charged on **taxable income**. Here is a proforma computation of taxable income:

	Non-savings income	Savings income	Dividend income
	£	£	£
Trading income	X		
Less loss relief	(X)		
	X		
Employment income	X		
Property income	X		
UK dividends			X
Building society/bank interest		X	
Other interest		X	
Total income	X	X	X
Less qualifying interest	(X)		
Less loss relief	(X)		
Net income	X	X	X
Less personal allowance (PA)	(X)		
Taxable income	X	X	X

KEY TERM

Total income: Total income is all income subject to income tax. Each of the amounts that make up total income is called a component.

Net income: Net income is total income after qualifying interest and trade losses.

Taxable income: Taxable income is net income less the personal allowance.

3 Types of income

Income must be classified according to the nature of the income as different computational rules apply to different types of income.

PER alert

One of the competencies you require to fulfil Performance Objective 15 *Tax computations and assessments* of the PER is to extract and analyse data from financial records and filing information relevant to the preparation of tax computations and related supporting documents. You can apply the knowledge you obtain from this section of the Workbook to help to demonstrate this competence.

3.1 Non-savings income

Non-savings income consists of:

- Trading income
- Employment income
- Property income
- Pension income

3.2 Savings income

Savings income is interest income, including:

- Bank interest
- Building society interest
- Interest from company loan stock
- Interest from government stocks (gilts)
- Interest from National Savings & Investments accounts

3.3 Dividend income

Dividend income is the dividends received from owning shares in companies.

3.4 Exempt income

Income from certain investments is exempt from income tax. They are therefore useful for tax planning to minimise tax from investments.

PER alert

One of the competencies you require to fulfil Performance Objective 17 *Tax planning and advice* of the PER is to mitigate and/or defer tax liabilities through the use of standard reliefs, exemptions and incentives. You can apply the knowledge you obtain from this section of the Workbook to help to demonstrate this competence.

Exempt income:

- Income from National Savings Certificates
- Statutory redundancy money
- Winnings (including premium bond prizes)
- Scholarships
- Interest on damages for personal injuries
- Local authority grants
- Income from investments made through individual savings accounts (ISAs)

3.4.1 Individual savings accounts (ISAs)

There are two types of ISA:

- Cash ISA (which only has a cash component)
- Stocks and shares ISA (which only has a stocks and shares component unless the provider allows some cash to be held in this type of ISA)

The annual subscription limit for ISAs is £20,000 per tax year (2020/21). It is possible to withdraw funds from a flexible cash ISA and reinvest them without that reinvestment using up any of the annual limit.

Dividend income and interest income received from investments held in an ISA are exempt from income tax. Likewise, gains on disposal of such investments are free from capital gains tax.

Note that **additional rate taxpayers** and individuals who have already **used their savings income nil band will benefit from using a cash ISA** (see savings income nil band later in this Workbook).

4 Personal allowance

The personal allowance is £12,500. It is deducted from net income to arrive at taxable income, firstly against non-savings income, then savings income and finally against dividend income. It is given to all individuals (subject to tapering – see next paragraph) including children.

4.1 Tapering of the personal allowance

If an individual's **adjusted net income** (ANI) exceeds £100,000, the personal allowance is reduced by £1 for every £2 excess income. Once an individual's 'adjusted net income' reaches £125,000 or over, the personal allowance will be reduced to nil.

KEY TERM

Adjusted net income: Adjusted net income is net income less the gross amounts of personal pension contributions and gift aid donations.

Exam focus point

The limit of £125,000 will be given to you in the Tax Rates and Allowances available in the exam.

The examining team has stated that, if adjusted net income clearly exceeds £125,000, there is no need to perform the calculations to restrict the personal allowance. A simple statement that no personal allowance is available because adjusted net income exceeds £125,000 is sufficient.

Illustration 1: Personal allowance

In 2020/21, Clare receives employment income of £95,000, bank interest of £8,000 and dividends of £7,500.

Required

Calculate Clare's taxable income for 2020/21.

Solution

	Non-savings income	Savings income	Dividend income	Total
	£	£	£	£
Employment income	95,000			
Bank interest		8,000		

	Non-savings income	Savings income	Dividend income	Total
	£	£	£	£
Dividends			7,500	
Net income	95,000	8,000	7,500	110,500
Less PA (see below)	(7,250)			(7,250)
Taxable income	87,750	8,000	7,500	103,250

Net income	110,500
Less income limit	(100,000)
Excess	10,500

PA	12,500
Less half excess (£10,500/2)	(5,250)
	7,250

Note. Where there is no qualifying interest, so that total income is the same as net income, it is acceptable just to state the net income at this stage of the computation.

Activity 4: Personal allowance

Jesse has net income of £105,000.

Required

What is his personal allowance for the tax year 2020/21?

£ ____________

Solution

5 Computing tax payable

PER alert

One of the competencies you require to fulfil Performance Objective 15 *Tax computations and assessments* of the PER is to prepare or contribute to the computation or assessment of tax computations for individuals. You can apply the knowledge you obtain from this section of the Workbook to help to demonstrate this competence.

Having calculated the taxable income, an exam question could ask for one of two things:

- Tax liability
- Tax payable

KEY TERM

Income tax liability: the amount of tax charged on the individual's taxable income.

Income tax payable: the balance of the income tax liability still to be settled in cash.

Income tax payable is computed on an individual's taxable income. The tax rates are applied to taxable income first to non-savings income, then to savings income and finally to dividend income.

5.1 Tax rates

When calculating the income tax liability the tax bands are:

	NSI	SI	DI
Additional-rate band (>£150,000)	45%	45%	38.1%
Higher-rate band (>£37,500)	40%	40%	32.5%
Basic-rate band	20%	20% 0% *	7.5%

*The 0% savings starting rate applies to savings income only in the first £5,000 of taxable income. If non-savings income after the personal allowance is greater than £5,000 then the starting rate does not apply.

Exam focus point

Certain aspects of income tax are devolved. However, since none of the devolved taxes for Scotland, Wales and Northern Ireland are, or will be, examinable, all questions will require application of the income tax rates as shown in the Tax Rates and Allowances available in the exam. Therefore, questions will not state in which part of the UK taxpayers live.

5.2 Computations with non-savings income only

Illustration 2: All rates of tax on non-savings income

In 2020/21 Milo has employment income of £145,000 and property income of £10,800.

Required

Calculate Milo's tax liability for 2020/21.

Solution

	Non-savings income £
Employment income	145,000
Property income	10,800
Net income/taxable income (no PA available as net income exceeds £125,000)	155,800

Income tax

	£
Non-savings income	
£37,500 × 20%	7,500
£112,500 (150,000 – 37,500) × 40%	45,000
£5,800 (155,800 – 150,000) × 45%	2,610
Tax lability	55,110

5.3 Computations with non-savings and savings income only

5.3.1 Savings income starting rate

There is a **tax rate of 0% for savings income up to £5,000 (the savings income starting rate limit)**. This rate is called the **savings income starting rate**. The savings income starting rate only applies where the **savings income falls in the first £5,000 of taxable income.**

Remember that income tax is charged first on non-savings income. So, in most cases, an individual's non-savings income will exceed the savings income starting rate limit and the savings income starting rate will not be available on savings income.

The savings income starting rate counts towards the basic rate limit of £37,500 and the higher rate limit of £150,000.

5.3.2 Savings income nil rate band

There is a **tax rate of 0%** for **savings income** within the **savings income nil rate band.** The savings income nil rate band for 2020/21 is **£1,000** if the individual is a **basic rate taxpayer** and **£500** if the individual is a **higher rate taxpayer.** There is **no savings income nil rate band** for **additional rate taxpayers.**

The savings income nil rate band counts towards the basic rate limit of £37,500 and the higher rate limit of £150,000.

Illustration 3: Savings income starting rate and savings income nil rate band

In 2020/21 Alicia has trading income of £15,100 and bank interest of £8,000.

Required

Calculate Alicia's tax liability for 2020/21.

Solution

	Non-savings income	Savings income	Total
	£	£	£
Trading income	15,100		
Bank interest		8,000	
Net income	15,100	8,000	23,100
Less PA	(12,500)		(12,500)
Taxable income	2,600	8,000	10,600

Income tax

	£
Non-savings income	
£2,600 × 20%	520
Savings income	
£2,400 (5,000 – 2,600) × 0% (savings starting rate)	0
£1,000 × 0% (savings income nil rate band)	0
£4,600 (8,000 – 2,400 – 1,000) × 20%	920
Tax liability	1,440

Illustration 4: Savings nil rate, basic rate and higher rate with savings income

In 2020/21, Joe has employment income of £46,450 and bank interest of £5,550.

Required

Calculate Joe's tax liability for 2020/21.

Solution

	Non-savings income	Savings income	Total
	£	£	£
Employment income	46,450		
Bank interest		5,550	
Net income	46,450	5,550	52,000
Less PA	(12,500)		(12,500)
Taxable income	33,950	5,550	39,500

Income tax

	£
Non-savings income	
£33,950 × 20%	6,790
Savings income	
£500 × 0% (savings income nil rate band - higher rate taxpayer)	0
£3,050 (37,500 - 33,950 - 500) × 20%	610
£2,000 (5,550 - 500 - 3,050) × 40%	800
Tax liability	8,200

The savings income nil rate band of £500 counts towards the basic rate limit. Therefore, the limit of £37,500 is reduced by both the non-savings income taxed at the basic rate, and the savings income taxed at 0%, to calculate how much of the remaining savings income is taxed at 20% rather than 40%.

Illustration 5: All rates of tax with savings income

In 2020/21 Maddie has trading income of £146,800 and building society interest of £6,700.

Required

Calculate Maddie's tax liability for 2020/21.

Solution

	Non-savings income Total £	Savings income Total £	Total £
Trading income	146,800		
Building society interest		6,700	
Net income/taxable income (no PA available)	146,800	6,700	153,500

Maddie is not entitled to the PA as her net income exceeds £125,000.

Income tax

	£
Non-savings income	
£37,500 × 20%	7,500
£109,300 (146,800 – 37,500) × 40%	43,720
Savings income	
£3,200 (150,000 – 146,800) × 40%	1,280
£3,500 (6,700 – 3,200) × 45%	1,575

	£
Tax liability	54,075

No savings income nil rate band is available because Maddie is an additional rate taxpayer.

5.4 Computations with non-savings, savings and dividend income

5.4.1 Dividend nil rate band

There is a **tax rate of 0%** for **dividend income** within the **dividend nil rate band.** The dividend nil rate band is **£2,000** for **all taxpayers.**

The dividend nil rate band counts towards the basic rate limit of £37,500 and the higher rate limit of £150,000.

Illustration 6: Dividend nil rate, basic rate and higher rate with dividend income

In 2020/21 Margery has employment income of £60,450, building society interest of £1,600 and dividends of £12,000.

Required

Calculate Margery's tax liability for 2020/21.

Solution

	Non-savings income	Savings income	Dividend income	Total
	£	£	£	£
Employment income	60,450			
Building society interest		1,600		
Dividends			12,000	
Net income	60,450	1,600	12,000	74,050
Less PA	(12,500)			(12,500)
Taxable income	47,950	1,600	12,000	61,550

Income tax

	£
Non-savings income	
£37,500 × 20%	7,500
£10,450 (47,950 – 37,500) × 40%	4,180
Savings income	
£500 × 0% (savings income nil rate band – higher rate taxpayer)	0
£1,100 (1,600 – 500) × 40%	440
Dividend income	
£2,000 × 0% (dividend nil rate band)	0

	£
£10,000 (12,000 - 2,000) × 32.5%	3,250
Tax liability	15,370

Activity 5: Income tax calculations

Holly receives a salary of £45,150 (PAYE deducted in the year was £6,530) and £8,000 of bank deposit interest in the tax year.

Marella has property income of £13,500 and interest income of £15,000 in the tax year.

Fabian has interest income of £163,650 in the tax year.

Required

1 What is Holly's income tax payable for the year?

- O £8,660
- O £2,130
- O £2,030
- O £7,030

2 What is Marella's income tax liability for the tax year?

- O £3,200
- O £2,300
- O £3,000
- O £2,200

3 What is Fabian's income tax liability for the tax year?

£ [ ]

Solution

Activity 6: Income tax payable

Faryl has the following income in the tax year:

	£
Salary	11,100 (PAYE £75)
Building society interest	10,000
Dividends	54,500

Required

What is Faryl's income tax payable?

Solution

Activity 7: Non-savings income, savings income and dividend income

Rajesh has trading income of £130,000 in the tax year. He also received building society interest of £3,750 and dividends of £40,000.

Required

Calculate Rajesh's income tax liability.

Solution

Essential reading

See Chapter 2 Section 1 of the Essential reading for a summary of the steps in the income tax liability and some examples of calculating additional tax due by working at the margin.

The Essential reading is available as an Appendix of the digital edition of the Workbook.

5.5 Transferable personal allowance (marriage allowance)

An individual can elect to transfer £1,250 of their PA to their spouse/civil partner if certain conditions are met. This is sometimes known as the marriage allowance.

Exam focus point

The transferable amount of PA will be given to you in the Tax Rates and Allowances available in the exam.

Neither the spouse/civil partner making the transfer nor the spouse/civil partner receiving the transfer can be a higher rate or additional rate taxpayer.

The spouse/civil partner receiving the transfer does not have an increased PA**. Instead, they are entitled to a tax reducer of £1,250 × 20% = £250. The tax reducer reduces the individual's tax liability.** If the individual has a tax liability of less than £250, the tax reducer reduces the tax liability to nil.

Illustration 7: Transferable personal allowance

Alec and Bertha are a married couple. In the tax year 2020/21, Alec has net income of £11,150 and Bertha has net income of £26,500. All their income is non-savings income. Alec has made an election to transfer part of his PA to Bertha.

Required

Show Alec and Bertha's taxable income for 2020/21 and compute Bertha's income tax liability.

Solution

Alec

	Non-savings income
	£
Net income	11,150
Less PA £(12,500 – 1,250)	(11,250)
Taxable income	0

Bertha

	Non-savings income
	£
Net income	26,500
Less PA	(12,500)
Taxable income	14,000
Income tax	
£14,000 × 20%	2,800
Less transferable personal allowance tax reducer £1,250 × 20%	(250)
Income tax liability	2,550

Activity 8: Transferable amount of personal allowance

Ash and Den are married. Ash has trading income of £10,090 and Den has employment income of £43,550.

Required

1 How will the transferable personal allowance work for Ash and Den?

- O It is not allowed as Den is a higher rate taxpayer
- O It is not allowed as Ash is using some of this year's personal allowance
- O Ash transfers £1,250 of his personal allowance to Den
- O Den transfers £1,250 of his personal allowance to Ash

2 What is Den's income tax liability for the tax year 2020/21?

- O £3,710
- O £250
- O £5,960
- O £6,210

Solution

6 Gift aid

KEY TERM

Gift aid: One-off and regular charitable gifts of money qualify for tax relief under the **gift aid scheme** provided the donor gives the charity a gift aid declaration.

(a) **Basic rate**

A gift aid donation is treated as though it is paid **net of basic rate tax** (20%). This gives basic rate tax relief when the payment is made. For example, if the taxpayer wants the charity to receive a donation of £1,000, they would only need to make a payment to the charity of £800. The charity reclaims the 20% tax relief that the taxpayer has received, resulting in a gross gift of £1,000.

(b) **Higher and additional rate**

Additional tax relief for higher rate and additional rate taxpayers is **given in the personal tax computation by increasing the donor's basic rate limit and higher rate limit by the gross amount of the gift.** To arrive at the gross amount of the gift you must multiply the amount paid (the net amount) by 100/80. In the above example, the gross amount would be the amount paid of £800 × 100/80 = £1,000. The effect of increasing the basic rate limit is to increase the amount on which basic rate tax is payable. This is sometimes called 'extending the basic rate band'.

The effect of increasing the higher rate limit is simply to preserve the amount of taxable income on which higher rate tax is payable.

No additional relief is due for basic rate taxpayers. Increasing the basic rate limit is irrelevant as taxable income is below this limit.

The gross gift aid donation is also deducted from adjusted net income (ANI) for the purposes of tapering the personal allowance.

Illustration 8: Gift aid, basic rate band and adjusted net income

Margaretta earns a salary of £112,000 in 2020/21. In January 2021, she made a gift aid donation of £5,000 (net).

Required

Compute Margaretta's income tax liability for 2020/21.

Solution

		Non-savings income
		£
Employment income/Net income		112,000
Less PA (W1)		(9,625)
Taxable income		102,375
Income tax		
Basic rate (W2)	£43,750 × 20%	8,750
Higher rate	£58,625 × 40%	23,450

		Non-savings income
		£
	102,375	32,200

Workings

1 ***Personal allowance***

	£
Net income	112,000
Less: gift aid donation £5,000 × 100/80	(6,250)
Adjusted net income	105,750
Less income limit	(100,000)
Excess	5,750
PA	12,500
Less half excess £5,750 × 1/2	(2,875)
	9,625

2 ***Basic rate limit***

£37,500 + (£5,000 × 100/80) = £43,750

Activity 9: Gift aid

Gloria has employment income of £120,000. She made a gift aid donation of £7,200 (net) to a charity.

Required

1 What is Gloria's personal allowance for this tax year?

- O £2,500
- O £5,500
- O £6,100
- O £7,000

2 What is the basic rate limit for Gloria for this tax year?

- O £37,500
- O £28,500
- O £46,500
- O £44,700

Solution

7 Qualifying interest/qualifying loan

Interest paid gross on the following can be deducted from total income:

(a) Loan to buy plant and machinery for use in a partnership or employment

(b) Loan to invest in partnership

(c) Loan to buy interest in employee-controlled company

(d) Loan to invest in a co-operative

For the purposes of TX, qualifying interest is deducted from non-savings income first, then from savings income and lastly from dividend income.

Essential reading

For more detail on qualifying interest and an example, see Chapter 2 Section 2 of the Essential reading.

The Essential reading is available as an Appendix of the digital edition of the Workbook.

8 Married couples and couples in a civil partnership

PER alert

One of the competencies you require to fulfil Performance Objective 17 *Tax planning and advice* of the PER is to review the situation of an individual or entity advising on any potential tax risks and/or additional tax minimisation measures. You can apply the knowledge you obtain from this section of the Workbook to help to demonstrate this competence.

8.1 Spouses and civil partners

Spouses and civil partners are taxed as two separate people. Each spouse/civil partner is entitled to a personal allowance depending on their income.

Spouses and civil partners should ensure, where possible, that **each spouse/civil partner uses their main nil rate band, savings income nil rate band and dividend nil rate band** (eg by transferring assets, bank accounts or shares).

8.2 Jointly held property

Income from jointly held property is split 50:50 unless the couple make a joint declaration to HMRC specifying the actual proportions they are each entitled to.

Essential reading

See Chapter 2 Section 3 of the Essential reading for some examples of tax planning for spouses/civil partners.

The Essential reading is available as an Appendix of the digital edition of the Workbook.

9 Child benefit income tax charge

An income tax charge applies if a taxpayer receives child benefit (or their partner receives child benefit) and the taxpayer has **adjusted net income over £50,000 in a tax year**. Adjusted net income is defined in the same way as for the restriction of the PA described earlier in this chapter. The effect of the charge is to recover child benefit from taxpayers who have higher incomes.

A 'partner' is a **spouse**, a **civil partner,** or an **unmarried partner** where the couple are **living together as though they were married or were civil partners**.

If the taxpayer has **adjusted net income over £60,000,** the charge is equal to the **full amount of child benefit received**.

If the taxpayer has **adjusted net income between £50,000 and £60,000**, the charge is **1% of the child benefit amount for each £100 of adjusted net income in excess of £50,000**. The calculation, at all stages, is rounded down to the nearest whole number.

Exam focus point

This information will be given in the Tax Rates and Allowances available in the exam.

If **both partners have adjusted net income in excess of £50,000**, the **partner with the higher adjusted net income** is liable for the charge.

Illustration 9: Child benefit income tax charge

Samantha is divorced and has two children aged ten and six. She has net income of £56,000 in 2020/21. Samantha made personal pension contributions of £4,500 (gross) during 2020/21. She receives child benefit of £1,788 in 2020/21.

Required

Calculate Samantha's child benefit income tax charge for 2020/21.

Solution

	£
Net income	56,000
Less personal pension contributions (gross)	(4,500)
Adjusted net income	51,500
Less threshold	(50,000)

	£
Excess	1,500
÷ £100	15
Child benefit income tax charge:	
1% × £1,788 × 15	268

Tutorial note. If Samantha had made an extra gross personal pension contribution of £1,500 during 2020/21, her adjusted net income would not have exceeded £50,000 and she would not have been subject to the child benefit income tax charge.

Activity 10: Child benefit

Ralph has a salary of £54,000. He received child benefit of £2,500.

Required

Calculate the child benefit income tax charge.

£ ________

Solution

10 Accrued income scheme

Gilts are securities issued by the UK Government as a way of borrowing money. Interest is paid to the holder of the gilt (the investor) in fixed amounts on fixed dates.

The accrued income scheme ensures that a taxpayer who **sells a gilt** is **taxed on any interest income** included in the proceeds. Similarly, **relief** is given to the **purchaser** of the gilt for the **interest included in the price** paid.

As a forthcoming interest payment approaches the price of the gilt will start to increase. This is because a purchaser of the gilt will be entitled to the next interest payment, so the closer to the interest date we get the more expensive the gilt becomes as investors are willing to pay more for the gilt.

Usual income tax rules state that interest is taxable on individuals when it is received. However, where an individual holds gilts with a total nominal (face) value of more than £5,000 and they sell the gilts for a price which includes interest then the amount of interest which has **accrued** since the last interest payment up to the date of the sale is taxed as savings income on the seller.

When the interest is paid to the buyer of the gilt, they are given tax relief by deducting the seller's accrued income.

Illustration 10: Accrued income scheme

Owen owned £10,000 (nominal value) 5% UK Government Loan Stock. Interest was payable on 30 June and 31 December each year. Owen sold the loan stock to Yvonne on 30 November 2020 for sale proceeds of £11,208 including accrued interest of £208 for the period between 1 July 2020 and 30 November 2020 (£10,000 × 5% × 5/12).

Required

What are the amounts taxable on Owen and Yvonne as savings income in respect of the loan stock for 2020/21?

Solution

	£
Owen	
Interest received 30.6.20	
£10,000 × 5% × 6/12	250
Accrued interest deemed received 31.12.20	
£10,000 × 5% × 5/12	208
Total taxable as savings income	458
Yvonne	
Interest received 31.12.20	
£10,000 × 5% × 6/12	250
Less relief for accrued interest (amount taxable on Owen)	
£10,000 × 5% × 5/12	(208)
Total taxable as savings income (ie 1 month of interest £10,000 × 5% × 1/12)	42

Exam focus point

The accrued income scheme rules may seem complicated but remember that the aim is to tax each taxpayer on the interest which relates to their period of ownership, regardless of whether it was actually received by the buyer or the seller.

Activity 11: Interest assessable

On 1 August 2020 Caroline bought some 4% gilts from Jamie. They have a nominal value of £50,000 and pay interest on 30 June and 31 December each year. She paid £52,000 (including interest) on 1 August 2020 and sold them for £54,500 (including interest) on 31 March 2021 to Tyrone.

Required

How much interest is assessable on Caroline in the tax year 2020/21 in relation to these gilts?

£ ________

Solution

Chapter summary

Computing taxable income and the income tax liability

Scope of income tax

Residence
- UK residents taxed on worldwide income
- Non UK residents taxed on UK income only
- Statutory test of residence

Computing taxable income

- Tax/fiscal year runs from 6 April to 5 April
- Total income = all income subject to income tax
- Taxable income = net income less the personal allowance
- Net income = total income after qualifying interest and trade losses

Types of income

Non-savings income
- Trading income
- Employment income
- Property income
- Pension income

Savings income
- Building society/bank interest
- Received gross

Dividend income
- Received gross from UK companies

Exempt income
- Individual savings accounts (ISAs), limit £20,000 per year
- Income from National Savings Certificates
- Statutory redundancy
- Winnings

Personal allowance

- £12,500 deducted from net income

Tapering of personal allowance
- Taper if 'adjusted net income' ANI exceeds £100,000
- ANI = Net income less trading losses, qualifying interest, gross gift aid donations and gross personal pension contributions

Computing tax payable

- Tax liability = income tax on taxable income
- Tax payable = tax liability less tax already deducted at source

Tax rates
- NSI – Tax @ 20%, 40%, 45%
- SI – Tax @ 0% if in the starting rate band or savings income nil rate band (£1,000 for BR taxpayers, £500 for HR taxpayers) then 20%, 40%, 45%
- DI – Tax @ 0% if in the dividend nil rate band (£2,000) then 7.5%, 32.5%, 37.5%

Computations with non-savings income only
- Add up income, deduct qualifying interest and trade losses to compute net income
- Deduct PA to compute taxable income
- Tax @ 20% up to BR limit, between BR and HR @ 40%, above HR @ 45%

Computations with non-savings and savings income only
- Savings income starting rate – 0% for savings income up to £5,000
  - Where savings income falls wholly or partly below the starting rate limit
- Savings income nil rate band – £1,000 for BR taxpayers, £500 for HR taxpayers
- Tax @ 20% up to BR limit, between BR and HR @ 40%, above HR @ 45%

Computations with non-savings and savings and dividend income
- Dividend nil rate band = £2,000
- Tax @ 7.5% up to BR limit, between BR and HR @ 32.5%, above HR @ 37.5%

Transferable personal allowance (marriage allowance)
- Spouses/CPs
- Fixed amount of £1,250 (2020/21)
- Tax reducer @ 20% ie reduction in transferee's IT liability of £250
- Cannot trigger a repayment
- Not available if either spouse/CP is HR or AR taxpayer

Gift aid

- Paid net of 20%
- HR and AR taxpayers extend bands by payment × 100/80

Qualifying interest

- Loan to buy plant or machinery for use in partnership/employment
- Loan to invest in partnership
- Loan to buy interest in employee controlled company
- Loan to invest in a cooperative

Married couples and couples in a civil partnership

Spouses and civil partners

- Married couples/civil partners to minimise tax: using personal allowance and nil rate bands

Jointly held property

- Jointly owned property, assumed to be held 50:50 unless actual proportions declared

Child benefit income tax charge

- Charge if ANI >£50,000, entire benefit clawed back if ANI reaches £60,000

Accrued income scheme

- Interest included in the selling price of a government security is taxed as income on accruals basis
- Only if nominal value exceeds £5,000

Knowledge diagnostic

1. **Scope of income tax**

   UK resident individuals are liable to income tax on all income.

   Non-UK resident individuals are only liable to UK income tax on UK income only.

   There is a statutory test of residence.

2. **Income tax computation**

   Make sure you learn the proforma.

3. **Types of income**

   Income is categorised into three sections – non-savings, savings and dividend income.

4. **Personal allowance**

   Everyone receives a personal allowance. However, if adjusted net income > £100,000 it is reduced by £1 for every £2 excess income.

5. **Computing tax payable**

   Non-savings income is taxed at 20%/40%/45%.

   Savings income is taxed at 0%/20%/40%/45%.

   Dividend income is taxed at 0%/7.5%/32.5%/38.1%.

6. **Gift aid**

   Gift aid donations enable the taxpayer to save tax at their marginal rate. For higher and additional rate taxpayers this is achieved by extending the basic rate and higher rate limits by the gross donation.

7. **Qualifying interest**

   Interest on certain loans can be deducted from total income.

8. **Married couples/civil partners**

   Split property income 50:50 for spouses/civil partners unless election for actual entitlements.

   Each spouse/civil partner should use their personal allowance, savings income nil rate band and dividend nil rate band.

9. **Child benefit charge**

   If ANI is between £50,000 and £60,000 charge will be 1% of amount received for every £100 of income over £50,000.

10. **Accrued income scheme**

    Seller taxed on accrued interest received on sale. Buyer given tax relief against interest received of seller's accrued interest.

Further study guidance

Question practice

Now try the following from the Further question practice bank (available in the digital edition of the Workbook):

Section A questions:

Q4, Q5, Q6, Q7, Q8

Section C questions:

Q9 Sandeep, Harriet and Romelu

Q10 John and Helen

Q11 Michael and Josie

Activity answers

Activity 1: UK resident or not UK resident

Sally has spent fewer than 16 days in the UK in the tax year.

Sally is therefore automatically not UK resident for that tax year.

Activity 2: UK resident?

Jimmy does not satisfy the automatic overseas test because he is present in the UK ≥ 46 days in the tax year and does not work overseas full time.

Jimmy satisfies the automatic UK resident test; he only has a UK home.

Jimmy is therefore UK resident in the tax year.

Activity 3: Sufficient ties test

Andy has:

- Been present in the UK for 46–90 days (48 days)
- Three UK ties (close family, available accommodation, and substantive UK work)

Andy is therefore UK resident in the tax year 2020/21

Activity 4: Personal allowance

£ $\boxed{10,000}$

	£	£
Basic personal allowance		12,500
Less reduction		
ANI	105,000	
Less limit	(100,000)	
	5,000	
× 0.5		(2,500)
Personal allowance		10,000

Activity 5: Income tax calculations

1 The correct answer is: £2,130

	Non-savings income £	Savings income £	Total £
Employment income	45,150		
Bank interest		8,000	
Net income	45,150	8,000	
Less PA	(12,500)		
Taxable income	32,650	8,000	40,650

Income tax

	£
Non-savings income	
£32,650 × 20%	6,530
Savings income	
£500 × 0%	0
£4,350 × 20%	870
£3,150 × 40%	1,260
Tax liability	8,660
PAYE	(6,530)
Tax payable	2,130

The answer £8,660 is the tax liability. The answer £2,030 uses a savings income nil rate band of £1,000. The answer £7,030 does not deduct the personal allowance.

2 The correct answer is: £2,200

	Non-savings income £	Savings income £	Total £
Property income	13,500		
Interest income		15,000	
Net income	13,500	15,000	
Less PA	(12,500)		
Taxable income	1,000	15,000	16,000

Income tax

	£
Non-savings income	
£1,000 × 20%	200
Savings income	
£4,000 (£5,000 - £1,000 NSI) × 0% (starting rate)	0
£1,000 × 0% (NRB for basic rate payer)	0
£10,000 × 20%	2,000
Tax liability	2,200

3 £ 57,643

	Savings income £	Total £
Interest income	163,650	
Net income	163,650	
Less PA*	(–)	
Taxable income		

	Savings income	Total
	£	£
	163,650	163,650

*No personal allowance as ANI exceeds £125,000.

Income tax

	£
Savings income	
0% (starting rate)	0
32,500 × 20%	6,500
112,500 × 40%	45,000
13,650 × 45%	6,142
Tax liability	57,642

Activity 6: Income tax payable

	Non-savings income	Savings income	Dividend income	Total
	£	£	£	£
Employment income	11,100			
Building society interest		10,000		
Dividends			54,500	
Net income	11,100	10,000	54,500	75,600
Less PA	(11,100)	(1,400)		(12,500)
Taxable income	–	8,600	54,500	63,100

Income tax

	£
Savings income	
5,000 × 0%	0
500 × 0% (NRB - higher rate taxpayer)	0
3,100 (8,600 - 5,000 - 500) × 20%	620
Dividend income	
2,000 × 0% (NRB)	0
26,900 (37,500 - 8,600 - 2,000) × 7.5%	2,017
25,600 (54,500 - 2,000 - 26,900) × 32.5%	8,320
Income tax liability	10,957
Less PAYE	(75)
Income tax payable	10,882

Activity 7: Non-savings income, savings income and dividend income

	Non-savings income	Savings income	Dividend income
	£	£	£
Trading profit	130,000		
Building society interest		3,750	
Dividend income			40,000
Less PA	(0)*		
Taxable income	130,000	3,750	40,000

*No personal allowance as Rajesh's ANI of £173,750 (£130,000 + £3,750 + £40,000) exceeds £125,000.

Income tax

	£
Non-savings income	
37,500 × 20%	7,500
92,500 × 40%	37,000
130,000	
Savings income	
£3,750 × 40% (No NRB as Rajesh is an additional rate taxpayer)	1,500
Dividend income	
2,000 × 0%	0
£14,250 (150,000 - 2,000 - 3,750 - 130,000) × 32.5%	4,631
150,000	
23,750 (40,000 – 2,000 – 14,250) × 38.1%	9,049
Income tax liability	59,680

Activity 8: Transferable amount of personal allowance

1 The correct answer is: Ash transfers £1,250 of his personal allowance to Den

Den is not a higher rate taxpayer. After his personal allowance, his taxable income is £43,550 – £12,500 = £31,050. Ash is using some of his personal allowance but that does not prevent the transfer. It is still beneficial if some of Ash's personal allowance is unused. The transfer would be from Ash to Den.

2 The correct answer is: £5,960

	£
Employment income	43,550
Personal allowance	(12,500)
	31,050
Income tax at 20%	6,210
Tax reducer (20% × £1,250)	(250)

	£
	5,960

The answer £3,710 assumes that the whole of Ash's personal allowance can be transferred to Den. The answer £250 is the tax reducer. The answer £6,210 is the income tax before the tax reducer is applied.

Activity 9: Gift aid

1 The correct answer is: £7,000

Personal allowance

	£
Employment income	120,000
Less gift aid donation 7,200 × 100/80	(9,000)
ANI	111,000
Less limit	(100,000)
	11,000
Personal allowance	12,500
Less 1/2 × 11,000	(5,500)
	7,000

The answer £2,500 does not adjust for the gift aid donation. The answer £5,500 is the restriction on the personal allowance. The answer £6,100 does not gross up the gift aid donation.

2 The correct answer is: £46,500

Increase basic rate limit by gross gift donation

£37,500 + £7,200 × 100/80 = £46,500

The answer £37,500 is the unadjusted basic rate limit. The answer £28,500 decreases the basic rate band limit by the gross gift aid donation. The answer £44,700 does not gross up the gift aid donation.

Activity 10: Child benefit

£ 1,000

The child benefit income tax charge is £1,000 (£2,500 × 1% × 40 (54,000 – 50,000/100)).

Activity 11: Interest assessable

£ 1,333

	£
Interest actually received 31.12.20	
(½ × 4% × £50,000)	1,000
Less interest accrued to Jamie (July 2020)	
(1/12 × 4% × £50,000)	(167)

	£
Add interest accrued up to sale (Jan–Mar 2021)	
(3/12 × 4% × £50,000)	500
	1,333

Sense check: eight months' ownership, therefore 8/12 × 4% × £50,000 = £1,333

3

Employment income

Learning objectives

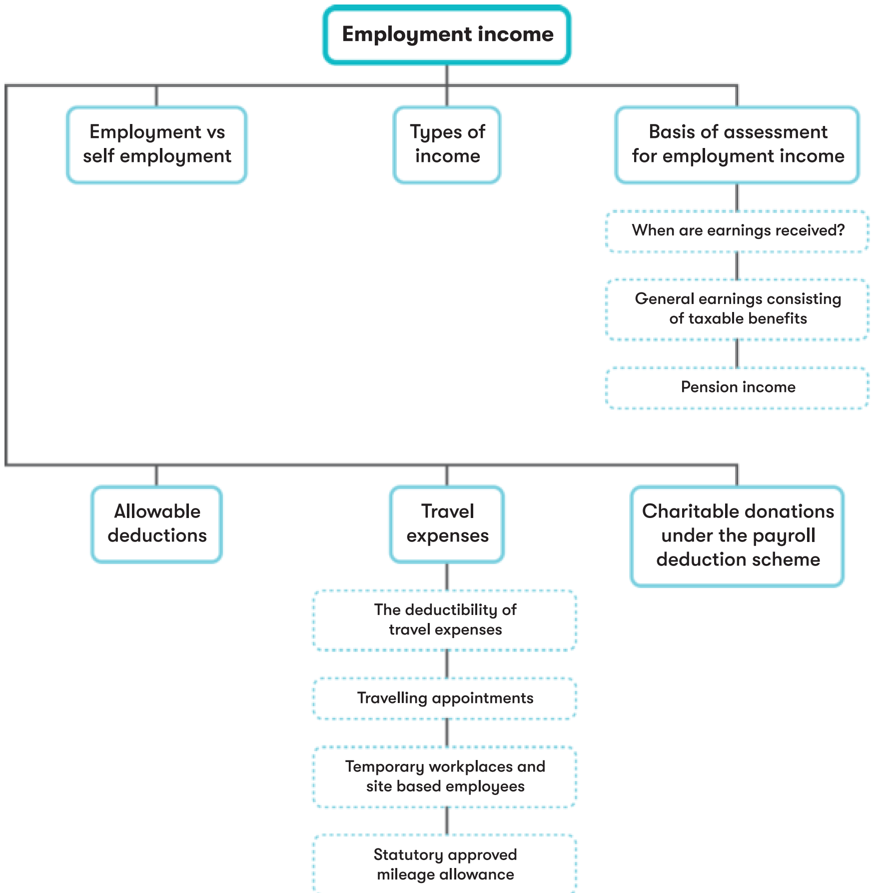
On completion of this chapter, you should be able to:

	Syllabus reference no.
Recognise the factors that determine whether an engagement is treated as employment or self-employment.	B2(a)
Recognise the basis of assessment for employment income.	B2(b)
Recognise the income assessable.	B2(c)
Recognise the allowable deductions, including travelling expenses.	B2(d)
Discuss the use of the statutory approved mileage allowances.	B2(e)
Understand the treatment of gift aid donations and charitable giving.	B5(f)

Exam context

You are very likely to be asked a question concerning at least one aspect of employment taxation in your exam. This could range from identifying the date on which earnings are received in Section A or Section B to a discussion of the distinction between employment and self-employment in Section C, either as part of a 15-mark question or a 10-mark question.

Chapter overview



1 Employment vs self-employment

It can be difficult to distinguish between employment (receipts taxable as earnings) and self-employment (profits taxable as trading income). Taxpayers tend to prefer self-employment, because the rules on deductions for expenses are more generous.

(a) The advantages of being self-employed are many:

    (i) For the client:

        (1) No national insurance contribution (NIC) liability

        (2) No need to apply Pay As You Earn (PAYE)

    (ii) For the worker:

        (1) Income received gross with a delay before having to pay a tax bill

        (2) Better deductibility of expenses (see later in this chapter)

(b) It has been held that employment is a **contract of service**, whereas self-employment is a **contract for services.**

(c) Factors which might lead to a presumption of employment rather than self-employment would include the following:

    (i) If the client provides any equipment necessary for the work, this is likely to indicate employment.

    (ii) Whether the individual can choose the place of their work, the hours of work and method of working (ie the degree of control). If they are subject to the direction of another person in these matters, they are likely to be employed.

    (iii) If the individual can choose whether they perform the work, they are likely to be self-employed. If they are subject to another person's instructions and cannot decline work they are offered, they are likely to be employed.

    (iv) If the individual holds an integral position within an organisation (eg manager), they are likely to be employed.

    (v) Where the individual bears individual risk in respect of the work performed, this would be a sign of self-employment. If they suffer no financial or personal risk in respect of the duties performed, they are likely to be employed.

    (vi) If the individual has rights under employment legislation, or has the right to receive regular remuneration, holiday pay, redundancy pay or benefits, this is likely to indicate employment rather than self-employment.

    (vii) If the individual can hire other people rather than having to perform the duties themselves, they are likely to be self-employed.

    (viii) If the individual works for multiple clients, they are likely to be self-employed.

2 Types of income

Any amounts deriving from an office or employment:

Salary	X
Bonus	X
Commission/tips	X
Benefits	X
	X
Allowable deductions (later in this chapter)	(X)
Employment income	X

3 Basis of assessment for employment income

Employment income includes income arising from an employment under a contract of service and the income of office holders, such as directors**.** The term 'employee' is used in this Workbook to mean anyone who receives employment income (ie both employees and directors).

General earnings are an employee's earnings (see the following key term) plus the 'cash equivalent' of any taxable non-monetary benefits.

KEY TERM

Earnings: Any salary, wage or fee, any gratuity or other profit or incidental benefit obtained by the employee if it is money or money's worth (something of direct monetary value or convertible into direct monetary value) or anything else which constitutes a reward of the employment.

3.1 When are earnings received?

Employees are assessed on amounts received in the current tax year. An amount is treated as received on the earlier of either:

- Cash receipt; or
- When the employee becomes entitled to payment

If the employee is a **director** of a company, earnings from the company are deemed to be received on the earliest of:

- The earlier of the two alternatives given in the general rule (above)
- The time when the amount is credited in the company's accounting records
- The end of the company's period of account (if the amount was determined by then)
- The time the amount is determined (if after the end of the company's period of account)

3.1.1 General earnings consisting of taxable benefits

Taxable benefits (see next chapter) are generally treated as received when they are provided to the employee.

3.1.2 Pension income

The receipts basis does not apply to pension income. Pension income is taxed on the amount accruing in the tax year, whether or not it has actually been received in that year.

Illustration 1: Receipt of money earnings

Josephine and Vincent are employed by Diamond plc. Josephine is a director of Diamond plc. Vincent is not a director of Diamond plc. Diamond plc makes up its accounts to 31 March each year.

Bonuses were awarded by Diamond plc as follows:

Josephine

£5,000. This amount was determined by the directors on 28 February 2021 and credited to Josephine's director's account on 10 March 2021, subject to a condition that she was could not draw down the bonus until 15 April 2021, on which date she became entitled to payment of the bonus. Josephine was actually paid the bonus on 28 April 2021.

Vincent

£3,000. Vincent became entitled to be paid this bonus on 31 March 2020, but agreed that payment should be delayed due to Diamond plc's cash flow problems. He was actually paid the bonus on 30 April 2020.

Required

Explain when each of the bonuses is received for the purposes of employment income, and determine the tax year in which each bonus will be taxed.

Solution

Josephine

Josephine is a director and so her bonus is received for the purposes of employment income on the earliest of:

Time payment made:	28 April 2021
Time of entitlement:	15 April 2021
Credited in records:	10 March 2021
End of period of account:	31 March 2021 (amount determined before end of period)

The earliest of these dates is 10 March 2021 and so this is the date of receipt of the bonus. The tax year in which the bonus is taxed is therefore 2020/21.

Vincent

Vincent is not a director so his bonus is received for the purposes of employment income on the earlier of:

Time payment made:	30 April 2020
Time of entitlement:	31 March 2020

The earlier of these dates is 31 March 2020 and so this is the date of receipt of the bonus. The tax year in which the bonus is taxed is therefore 2019/20.

Tax on earnings from employment income is collected through the **PAYE system** (covered in the next chapter).

4 Allowable deductions

Exam focus point

The general rule for allowable deductions states that expenses must be incurred **wholly, exclusively** and **necessarily** in the performance of duties.

The following are allowable deductions:

(a) Contributions by the individual to a registered occupational pension scheme (see Chapter 5)

(b) Fees and subscriptions to relevant professional bodies

(c) Travelling expenses incurred in the performance of duties (see next)

(d) Capital allowances on plant and machinery necessarily provided by the employee

(e) Donations to charity under payroll giving scheme

(f) Insurance premiums to cover directors' and employees' liabilities and payments to meet those liabilities (eg liability for negligence and related legal proceedings cost)

An employee required to work at home may be able to claim a deduction for the additional costs of working from home. Employers can pay up to £6 per week without the need for supporting evidence of the costs.

Note that the **cost of clothes** for work is **not deductible**, except for certain trades requiring protective clothing where there are annual deductions on a set scale.

5 Travel expenses

5.1 The deductibility of travel expenses

A deduction will be available for:

- Any amount **necessarily** expended on travelling and subsistence in the performance of duties

- Any amount attributable to the necessary attendance at any place in the performance of duties
- Any other expenses wholly, exclusively and necessarily incurred in the performance of duties
- Any travel to a temporary workplace

A deduction from employment income is **not available** for the cost of the **employee's normal commute to work.**

5.2 Travelling appointments

Where an individual has a **travelling appointment** (ie where travelling is an integral part of the job such as for a service engineer), it is accepted that duties commence on leaving home and it will still be possible to obtain a deduction for travelling expenses, even for those legs of a journey which start or finish at home, provided the employee lives within their normal work area. Otherwise, travel from home to the work area is ordinary commuting, as is travel from home to a regular depot or base.

5.3 Temporary workplaces and site-based employees

The cost of travel to a temporary workplace is allowable, whether direct from home or from another (permanent or temporary) workplace. Tax relief is also available for accommodation and subsistence expenses incurred by an employee who is working at a temporary workplace on a secondment expected to last up to 24 months.

Site-based employees are those individuals who have no permanent workplace and do not hold a travelling appointment but work at successive places spending a few days, weeks or months at each place, eg computer consultant.

A workplace is permanent if the employee:

(a) Spends at least 40% of their working time at the workplace; or

(b) The period they expect to work at the workplace exceeds 24 months.

If the employee initially expects to spend less than 24 months at the workplace but subsequently plans change (eg if the posting is extended) then travel expenses will be denied at that point (and *vice versa*).

Activity 1: Relief for travelling costs

Judi is an accountant. She often travels to meetings at the firm's offices in Scotland, returning to her office in Leeds after the meetings.

Required

What tax relief is available for Judi's travel costs?

Solution

5.4 Statutory approved mileage allowances

Amounts up to the statutory approved mileage allowance (given in the tax rates and allowances in the exam) are received tax free. If less than statutory approved mileage allowance is given, a deduction for the shortfall may be claimed. If an amount greater than the statutory approved allowance is received, then the excess is a taxable benefit. This is instead of claiming a proportion of the car running expenses and capital allowances.

Authorised mileage allowances: cars	
Up to 10,000 miles	45p
Over 10,000 miles	25p

Activity 2: Mileage allowance

Fred owns a car and travels 11,000 business miles in the car in a tax year. He is paid 35p per mile by his employer.

Required

What is the impact on Fred's assessable employment income for the tax year?

- O Deduction of £1,100
- O Deduction of £900
- O Increase of £1,100
- O Increase of £900

Solution

6 Charitable donations under the payroll deduction scheme

Employees can make charitable donations under the payroll deduction scheme by asking their employer to make deductions from their gross earnings. The deductions are then passed to a charitable agency which will either distribute the funds to the employees' chosen charities on receipt of their instructions or provide the employee with vouchers that can be redeemed by the recipient charities.

The donation is an allowable deduction from the employee's earnings for tax purposes. Tax relief is given at source as the employer must deduct the donation from gross pay before calculating PAYE.

Exam focus point

Make sure you understand the difference between how tax relief is given for gift aid donations and how tax relief is given through the payroll deduction scheme.

Chapter summary

Employment income

Employment vs self employment

- Employment is a 'contract of service'
- Self employment is a 'contract for services'
- Factors to consider:
  - Provision of equipment
  - Choice over place of work, hours and method of work
  - Ability to decline work
  - Integral position held
  - Bears physical or financial risk
  - Rights under employment legislation

Types of income

- Salary
- Bonus
- Commission/tips
- Benefits

Basis of assessment for employment income

When are earnings received?

- Received in tax year
- Additional rules for directors

General earnings consisting of taxable benefits

- Taxable benefits generally treated as received when they are provided to employee

Pension income

- Taxed on amount **accruing** in the tax year

Allowable deductions

- Wholly, exclusively and necessarily in the performance of duties
- Contribution to occupational pension scheme
- Fees and subscriptions to professional bodies
- Travel expenses occurred in the performance of duties
- Capital allowances on plant and machinery necessarily provided by employee
- Payroll giving scheme

Travel expenses

The deductibility of travel expenses

- Expenses occurred in the performance of duties
- Not available for normal commute to work

Travelling appointments

- Eg service engineer, duties can commence on leaving home

Temporary workplaces and site based employees

- Travel to temporary workplace is allowable

Statutory approved mileage allowance

- Mileage allowances
  - If given < approved mileage rates, deduct deficit from employment income
  - If given > approved mileage rates, add surplus to employment income

Charitable donations under the payroll deduction scheme

- Employer deducts donation from gross pay giving tax relief at source

Knowledge diagnostic

1. **Employment vs self-employment**

   Employment is a 'contract of service'. Self-employment is a 'contract for services'.

2. **Types of income**

   Any amount received from an office or employment is assessed under employment income.

3. **Basis of assessment**

   Basis of assessment is the amount received in a tax year.

4. **Administration**

   Tax is collected through the PAYE system.

5. **Allowable deductions**

   Deductions can be made but only if **wholly, exclusively and necessarily** in the performance of duties.

6. **Travel expenses**

   Normal commuting costs are not deductible. Cost of getting to and from work is allowable as a deduction against employment income for site-based employees, those with travelling appointments or those who travel to temporary workplaces.

   Business mileage allowance up to statutory approved mileage allowance is received tax free. Any shortfall is a deductible expense but any excess is a taxable benefit.

7. **Charitable donations via payroll**

   Employees can make tax deductible donations to charity under the payroll deduction scheme. The amount paid is deducted from gross pay.

Further study guidance

Question practice

Now try the following from the Further question practice bank (available in the digital edition of the Workbook):

Section A questions:

Q12, Q13, Q14

Activity answers

Activity 1: Relief for travelling costs

Relief is available for the full cost of these journeys as the travel is undertaken in the performance of Judi's duties.

To prevent manipulation of the basic rule normal commuting will not become a business journey just because the employee stops during the journey to perform a business task (eg to send an email). Nor will relief be available if the journey is essentially the same as the employee's normal journey to work.

Activity 2: Mileage allowance

The correct answer is: Deduction of £900

Fred's employment income will decrease by £900 as a result of the payment of the mileage allowance.

	£	£
Actually paid 35p × 11,000 miles		3,850
Allowed:		
10,000 × 45p	4,500	
1,000 × 25p	250	
11,000		(4,750)
Allowable deduction		(900)

A deduction of £1,100 assumes relief is given at 45p per mile. Fred is being paid less for his mileage than is allowed under the statutory rates so he is entitled to an additional deduction.

4 Taxable and exempt benefits. The PAYE system

Learning objectives

On completion of this chapter, you should be able to:

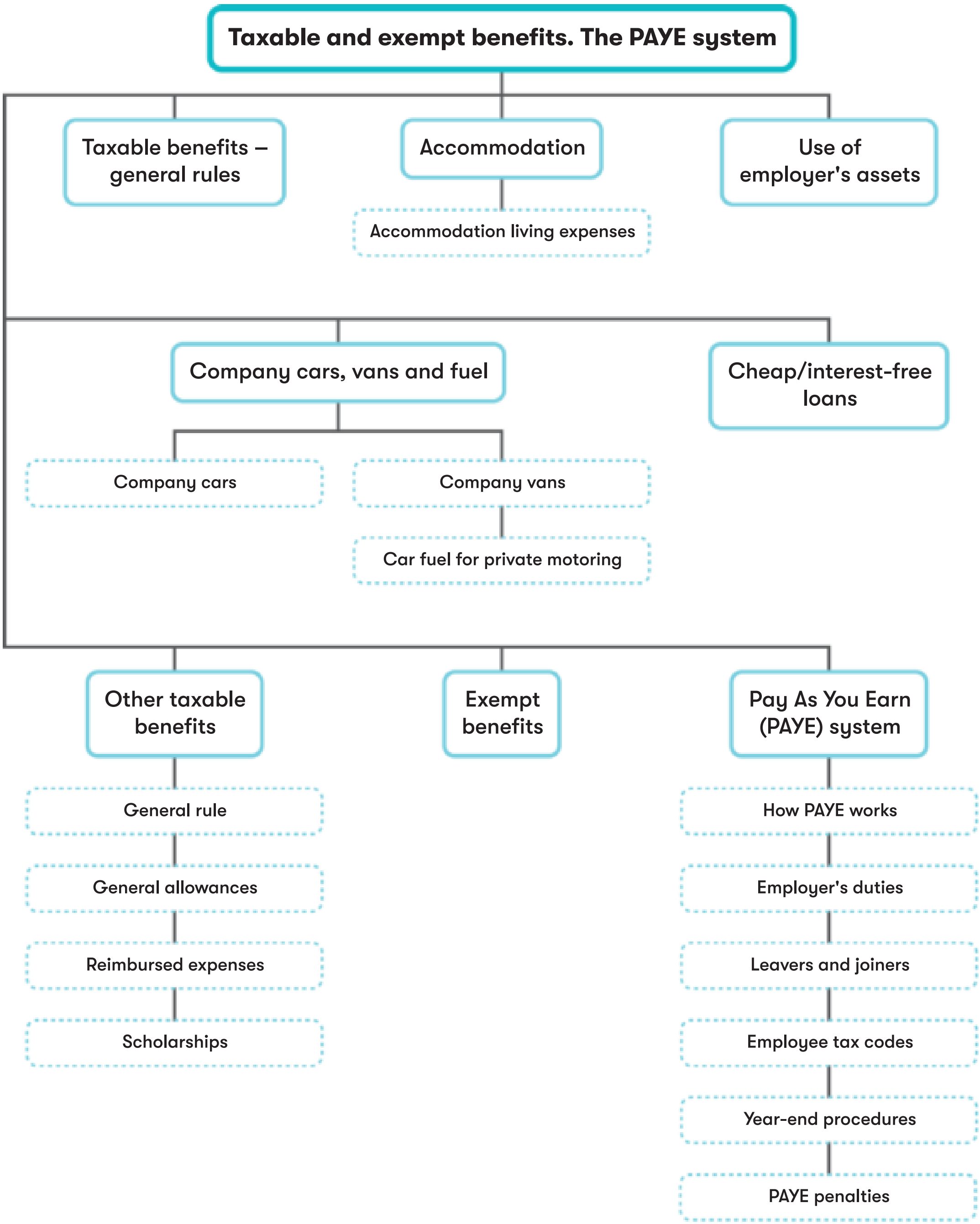
	Syllabus reference no.
Explain the PAYE system, how benefits can be payrolled, and the purpose of form P11D.	B2(f)
Explain and compute the amount of benefits assessable.	B2(g)
Recognise the circumstances in which real time reporting late filing penalties will be imposed on an employer and the amount of penalty which is charged.	B2(h)

Exam context

Benefits are a very important part of employment income and you are likely to come across them in your exam in any of Sections A, B or Section C, in a 15-mark question or a 10-mark question. If you come across exempt benefits in a Section C question, note this in your answer to show that you have considered each item.

The Pay As You Earn (PAYE) system is a system of deduction of tax at source. You should be able to explain how it collects tax. The forms for the PAYE system are important, as are the dates for submission.

Chapter overview



1 Taxable benefits - general rules

Certain benefits provided by employers are taxable on employees. They must be valued using rules set out in tax legislation and included in the taxpayer's employment income in their income tax computation for the tax year.

(a) **Time apportionment.** Time apportion the benefit if it is only available for part of the year by multiplying it by number of months (n)/12.

(b) **Employee contributions.** Any contributions made on or before 6 July following the end of the tax year, to the employer by employees for benefits provided by their employers, are deductible from the taxable benefit, with the exception of car and fuel benefit (see later in this chapter).

2 Accommodation

(a) An employee who is provided with job-related accommodation is not taxed on it under the benefit rules.

(b) Accommodation is job-related if it is:

 (i) Provided for security reasons;

 (ii) Necessary for the proper performance of duties; or

 (iii) Customary and ensures better performance of duties.

(c) If the accommodation is not job-related then a taxable benefit arises. The taxable value of accommodation provided to an employee is the rent that would have been payable if the premises had been let at their annual value (sometimes called 'rateable value'). There is an additional benefit if the property cost over £75,000. The benefit is calculated as follows:

 (i) Greater of:

 - Annual value
 - Rent paid by employer

 (ii) Additional charge if the original cost of the property is greater than £75,000: (Cost - £75,000) × official rate of interest

 The official rate of interest is 2.25% in the tax year 2020/21 (given in the Tax Rates and Allowances table)

(d) The cost used in the calculation is the cost of purchase plus any improvements to the property made before the start of the tax year for which the benefit is being calculated.

(e) If the property is first made available to the employee more than six years after the employer purchased it, use market value (MV) when made available instead of cost.

(f) Any contribution paid by the employee can be deducted in arriving at the taxable benefit.

Illustration 1: Accommodation

Quinton was provided with a company flat in January 2020. The rateable value of the flat is £1,200. The property cost his employer £125,000, but was valued at £150,000 in January 2020. Quinton paid rent of £500 in each tax year.

Required

What is the taxable benefit for 2020/21, assuming:

(a) His employer purchased the property in 2018?

(b) His employer purchased the property in 2012?

(c) Quinton was required to live in the flat as he was employed as the caretaker for the company premises (of which the flat was part)?

Solution

(a)

	£
Annual value	1,200
Less rent paid	(500)
	700
Additional amount (£125,000 – £75,000) × 2.25%	1,125
Taxable benefit	1,825

(b)

	£
Annual value	1,200
Less rent paid	(500)
	700
Additional amount (£150,000 – £75,000) × 2.25%	1,688
Taxable benefit	2,388

As Quinton first moved in more than six years after the company bought the flat, the value at the date he moved in is used.

(c) Job related accommodation: taxable benefit £ nil

Activity 1: Taxable benefit

Ralph has the use of a house belonging to his employer, for which he pays a notional rent of £2,000. It is not job-related accommodation. The annual value is £8,000.

Ralph has lived in the house since October 2010. It had cost the company £175,000 in October 2007.

Required

Calculate the taxable benefit for the current tax year.

Solution

2.1 Accommodation living expenses

A benefit arises on employees if living expenses are paid for by the employer. For example, heating, lighting, cleaning, repairing or decorating.

The benefit depends on the accommodation provided:

(a) Job-related accommodation

- Taxable benefit = cost to employer
- But cannot exceed 10% of employee's net earnings (not including expenses)

(b) Not job-related accommodation

- Taxable benefit = cost to employer

Activity 2: Accommodation and living expenses

Maggie lives in accommodation provided by her employer and her salary is £7,000 each tax year.

The accommodation was made available to her on 6 August 2020. It has an annual value of £8,000 and it cost her employer £225,000 in 2010. Its market value in August 2020 was £375,000.

Household expenses of £1,800 are paid by her employer and she has other benefits totalling £2,000.

Required

Calculate the taxable benefit for accommodation and the living expenses assuming:

(a) The accommodation is job-related

(b) The accommodation is not job-related

Solution

3 Private use of employer's assets

(a) When an employee is provided with employer's assets for private purposes this gives rise to a taxable benefit. The employee is taxed on the higher of:

 (i) 20% of the value when first made available to employee

 (ii) Rental paid by employer

(b) The 20% charge is time-apportioned when the asset is provided for only part of the year and is reduced by any contribution made by the employee.

(c) If the asset is subsequently given to the employee, the assessment would be the higher of:

 (i) Market value when given

 (ii) Market value when first used less amounts taxed as taxable benefits up to date of gift

(d) Furniture in accommodation provided by an employer is also taxed in this way.

(e) Mobile phones (including smartphones) are exempt, but this exemption is limited to one mobile phone per employee. An additional mobile phone is taxed at 20% of the cost plus any running costs paid by the employer.

(f) Bicycles provided for journeys to work, as well as being available for private use, are exempt from the private use benefit rules.

Illustration 2: Assets made available for private use

A suit costing £400 is purchased by an employer for use by an employee on 6 April 2019. On 6 April 2020, the suit is purchased by the employee for £30, its market value then being £50.

Required

1 What is the benefit in 2019/20?

2 What is the benefit in 2020/21?

Solution

1 The benefit in 2019/20 is £400 × 20% = £80.

2 The benefit in 2020/21 is £290, being the **greater** of:

(1)

	£
Market value at acquisition by employee	50
Less price paid	(30)
	20

(2)

	£
Original market value	400
Less taxed in respect of use	(80)
	320
Less price paid	(30)
	290

Activity 3: Private use of asset

Gustav was given the use of some video equipment on 6 October 2018 when it had a value of £1,000. On 1 January 2021, the company gave the equipment to Gustav when its market value was £600.

Required

What is the taxable benefit for Gustav of the gift in January 2021?

- ○ £600
- ○ £550
- ○ £450
- ○ £1,000

Solution

4 Company cars, vans and fuel

4.1 Company cars

(a) Employees are taxed on company cars provided for private use, but not on pool cars (cars kept at employer's premises, not exclusively for use by one employee and with no more than incidental private use).

(b) Private use includes home to work travel, ie commuting.

(c) The annual benefit = CO_2 % × the list price of the car.

A zero percentage applies to electric-powered motor cars with zero CO_2 emissions.

For hybrid-electric cars with emissions between 1 and 50g/km the CO_2 percentage is as follows:

Electric range	
130 miles or more	0%
70 to 129 miles	3%
40 to 69 miles	6%
30 to 39 miles	10%
Less than 30 miles	12%

For petrol cars with emissions of up to 55g/km (and diesel cars meeting RDE2 standard) the CO_2 percentage is as follows:

Petrol range	
51 grams to 54 grams per kilometre	13%
55 grams per kilometre	14%

Note that the percentages will be given to you in the tax rates and allowances table.

(d) For cars with CO_2 emissions higher than these levels the percentage starts at 14% as above and builds up in 1% steps for every 5g/km of carbon dioxide emitted in excess of 55g/km. To calculate, round the CO_2 emissions down to the nearest 5g/km then use the following calculation: taxable % = 14% + (CO_2 - 55)/5.

(e) Diesel cars (including the low emission cars) have a supplement of 4%. The supplement does not apply to cars meeting the RDE2 standard.

(f) The maximum percentage is 37% for both petrol and diesel cars.

(g) The price of the car is usually the list price as published by its manufacturer (including delivery charges, standard accessories and all customs duties, value added tax (VAT), car tax and the list price of any additional fitting costs of optional accessories). Any optional accessories fitted later which cost at least £100 are also included.

(h) Any capital contribution made by the director/employee is deducted from the list price up to a maximum deduction of £5,000. Any contribution for the use of the car is deducted from the value of the benefit.

(i) The benefit is pro-rated if the car is not available for use throughout the tax year.

Illustration 3: Company cars

Florrie was provided with a hybrid-electric company car throughout the tax year 2020/21. The car has a list price of £29,000 with CO_2 emissions of 30g/km and an electric range of 41 miles.

Jasper was provided with a petrol company car throughout the tax year 2020/21. The car has a list price of £15,000 with CO_2 emissions of 54g/km. Jasper contributes £500 annually towards the use of the car.

Nigel was provided with a diesel car on 6 July 2020 which did not meet the RDE2 standard. It had a list price of £22,000 when it was first registered. The car has CO_2 emissions of 118g/km.

Robyn is provided with a diesel car throughout the tax year 2020/21 which meets the RDE2 standard. The car had a list price of £18,000 when it was first registered. The car has CO_2 emissions of 90g/km.

Vicky starts her employment on 6 January 2021 and is immediately provided with a new petrol car with a list price of £25,000. The car was more expensive than her employer would have provided and she therefore made a capital contribution of £6,200. The employer was able to buy the car at a discount and paid only £23,000. Vicky contributed £100 a month for being able to use the car privately. CO_2 emissions are 218g/km.

Required

Calculate the car benefit for Florrie, Jasper, Nigel, Robyn and Vicky for 2020/21.

Solution

Florrie

The CO_2 emissions are between 1g and 50g so we need to use the electric range for the CO_2 percentage. The percentage for 41 miles is 6%.

Car benefit = £29,000 x 6% = £1,740

Jasper

Car benefit = (£15,000 x 13%) - £500 = £1,450

Nigel

The emissions are above 55g/km so we need to calculate the relevant percentage to apply to the list price.

Step 1 Round down to the nearest 5g/km

118g/km rounds down to 115g/km.

Step 2 Deduct 55g/km (from tax tables)

115g/km - 55g/km = 60g/km

Step 3 Divide by 5

60g/km/5 = 12

Step 4 Add the base % of 14%

12 + 14 = 26%

As the car is a diesel car that does not meet the RDE2 standard, we need to add the 4% surcharge.

26 + 4 = 30%

Car benefit = list price x CO_2% x 9 months of benefit = £22,000 x 30% x 9/12 = £4,950

Robyn

Car benefit = £18,000 x 21% (14% + (90 - 55)/5) = £3,780

Vicky

	£
List price*	25,000

	£
Less capital contribution (maximum)	(5,000)
	20,000

£20,000 x 37%** x 3/12***	1,850
Less contribution to running costs (£100 x 3)	(300)
Car benefit	1,550

* The discounted price is not relevant.

**14% + (215 - 55)/5 = 46% restricted to 37% max.

***Only available for three months in 2020/21.

Activity 4: Car benefit

Stuart has the use of a company car. The motor car has a list price of £16,500 and an official CO_2 emission rate of 98g/km.

Required

(a) Calculate Stuart's taxable benefit.

(b) Recalculate your answer in (a) assuming that Stuart had made a capital contribution of £5,500.

(c) Recalculate your answer in (a) assuming the car was a diesel (not meeting the RDE2 standard) rather than a petrol car.

(d) Recalculate your answer in (c) assuming Stuart only had use of the car from 6 October until the end of the tax year and he contributed £1,000 to his company for use of the car.

(e) If Stuart's car had an official emission rate of 54g/km, was petrol-fuelled and was available for the entire tax year, what would the taxable benefit be?

(f) If Stuart's car was a hybrid electric with an electric range of 39 miles, an emission rate of 45g/km and was available for the entire year, what would the taxable benefit be?

Solution

4.2 Car fuel for private motoring

(a) For fuel provided to users of company cars, the taxable benefit is a percentage of £24,500.

(b) The percentage is the same as the percentage used to calculate the car benefit. As with the car benefit, the fuel benefit is pro-rated if not provided throughout the tax year.

(c) There is no reduction in taxable benefit for **partial** refunds made for private cost of fuel by the employee. The charge is cancelled if full refunds are made.

4.3 Company vans

There is a standard benefit of £3,490 a year for employees with private use of a company van. Unlike cars, there is no taxable benefit where an employee takes a van home (ie uses the van for commuting). Where private fuel is provided, there is an additional charge of £666.

Essential reading

See Chapter 4 Section 1 of the Essential reading for an example on car and fuel benefits.

The Essential reading is available as an Appendix of the digital edition of the Workbook.

5 Cheap/interest-free loans

Employment related loans to employees and their relatives give rise to a benefit equal to:

(a) Any amounts written off (unless the employee has died)

(b) The excess of the interest based on an official rate prescribed by the Treasury, over any interest actually charged ('taxable cheap loan'). Interest payable during the tax year but paid after the end of the tax year is taken into account.

Only loans greater than £10,000 give rise to a benefit. However, if a loan is greater than £10,000, the entirety of the loan will be treated as a benefit, ie rather than the excess.

The taxable benefit is:

	£
Average loan × 2.25% (official rate of interest)	X
Less interest paid	(X)
	X

There are two methods of calculating the 'average loans': the 'average method' (using only the balance of the loan at the start and end of the period) and the 'strict method' (using the loan balance at the end of every month within the period). The default method is the average method but the taxpayer or HMRC can choose to use the strict method. HMRC will usually only choose to use the strict method if the average method is being deliberately exploited.

Essential reading

See Chapter 4 Section 2 of the Essential reading for an example and more detail on beneficial loans.

The Essential reading is available as an Appendix of the digital edition of the Workbook.

Activity 5: Interest-free loan

Laura was provided with an interest-free loan of £100,000 on 6 April 2020. She repaid £20,000 of the loan on 6 January 2021.

Required

What is Laura's taxable benefit in respect of the loan for 2020/21 under the:

(a) Average method?

(b) Strict method?

Comment on whether the strict method will be chosen by either Laura or HMRC.

Solution

6 Other taxable benefits

6.1 General rule

Generally, the taxable amount is the cost to the employer of providing the benefit eg medical insurance, vouchers, or the use of a credit card.

6.2 General allowances

General (or round sum) allowances are taxable but a deduction is available if the expenses paid out of the allowance would have been allowable had the employer paid them directly.

6.3 Reimbursed expenses

The general principle is that reimbursement by an employer of expenses incurred by an employee is a taxable benefit for the employee, but the employee may be able to claim a deduction if the expense is incurred wholly, exclusively and necessarily for their job eg business travel costs.

There is automatic exemption for the reimbursement of expenses if the amount of the deduction is at least equal to the amount of the expense. This can apply to actual expenses and also allowances, eg for travel and meals.

Essential reading

See Chapter 4 Section 3 of the Essential reading for more detail on reimbursed expenses.

The Essential reading is available as an Appendix of the digital edition of the Workbook.

6.4 Scholarships

If scholarships are given to members of an employee's family, the **employee is taxable on the cost** unless the scholarship fund's or scheme's payments by reason of people's employments are not more than 25% of its total payments.

7 Exempt benefits

(a) Free/subsidised canteen meals (if same facilities provided to all employees on similar terms)

(b) Medical treatment not taxable up to £500 for each employee if employer pays for medical treatment to assist the employee in their return to work after ill-health or injury lasting at least 28 days

(c) Workplace childcare (creches, nurseries)

(d) Qualifying removal expenses up to £8,000

(e) Car parking spaces at or near place of work

(f) Contributions by an employer to a registered pension scheme

(g) Staff parties, generally provided that the cost per head per year is £150 or less

(h) Sport and recreational facilities available generally for the staff

(i) Outplacement counselling services to employees made redundant who have been employed full time for at least two years; the services can include counselling to help adjust to the loss of the job and to help in finding other work

(j) Weekly tax-free allowance of £6 can be paid by an employer to an employee who works from home

(k) Trivial benefits – cost ≤ £50 and not cash or cash vouchers
(l) Pension advice – cost ≤ £500 per employee per tax year, if exceeds £500, first £500 is exempt
(m) Workplace charging points for electric or hybrid cars
(n) Mobile phone

Essential reading

See Chapter 4 Section 4 of the Essential reading for more detail on exempt benefits.

The Essential reading is available as an Appendix of the digital edition of the Workbook.

8 Pay As You Earn (PAYE) system

KEY TERM

Pay as you earn (PAYE): PAYE is a system of deducting income tax and national insurance from salary before the salary is received.

The objective of the PAYE system is to deduct the correct amount of income tax and national insurance contributions from employees over the year. Its scope is very wide. It applies to most cash payments, other than reimbursed business expenses, and to certain non-cash payments.

In addition to wages and salaries, PAYE applies to round sum expense allowances and payments instead of benefits. It also applies to any readily convertible asset.

A readily convertible asset is any asset which can effectively be exchanged for cash. The amount subject to PAYE is the amount that would be taxed as employment income. This is usually the cost to the employer of providing the asset.

The following count as pay:

(a) Salaries, wages, overtime, bonuses
(b) Pensions
(c) Commissions
(d) Benefits
(e) Statutory sick pay/maternity pay
(f) Tips

Tips paid direct to an employee are normally outside the PAYE system (although still assessable as employment income).

Benefits may be included within the payroll if the employer chooses to do so. Otherwise they will be reported on Form P11D and the employee's PAYE code will be adjusted to collect the income tax due on these benefits.

8.1 How PAYE works

Employers must report their PAYE information in real time (RTI = real time information). Every time an employee is paid, the employer must electronically send a 'full payment submission' (FPS) on or before the day the employee is paid which includes:

- Amount paid to each employee
- Deductions of income tax and NIC
- Starter and leaver information

The software used to submit the RTI to HMRC will calculate the amount of deductions that must be made from the payment. This is done on a cumulative basis.

8.2 Employer's duties

Under RTI, **an employer is required to submit information to HMRC electronically**. This can be done by:

(a) Using commercial payroll software;
(b) Using HMRC's Basic PAYE Tools software (designed for use by an employer who has up to nine employees); or
(c) Using a payroll provider (such as an accountant or payroll bureau) to do the reporting on behalf of the employer.

The employer has a duty to:

(a) Deduct the correct income tax and NIC from employees' pay
(b) Keep a record of pay and deductions
(c) Pay tax/NIC over on the due date which is 14 days from the end of the tax month
(d) Send relevant income tax and NIC information electronically every time employees are paid

8.3 Leavers and joiners

When an employee **leaves** employment the employer must:

(a) Fill in the relevant parts of the deductions working sheet
(b) Complete P45, send part 1 to HMRC and give parts 1A (which the employee keeps for their own records), 2 and 3 to the employee

When an employee **joins** and has a P45 they give it to their new employer who fills in part 3 and sends it to HMRC. The employer keeps part 2 for their own records.

The employer will usually use the tax code on the P45 to compute income tax for the joiner when the next payroll is run.

8.4 Employee tax codes

(a) An employee's tax code indicates the amount of tax-free pay that they are entitled to.
(b) In working out the coding, HMRC uses the following calculation:

	£	£
Allowances:		
Personal allowances	X	
Personal pension contributions – higher rate relief	X	
Expense deductions	X	
		X
Less deductions (reducing tax-free pay):		
Benefits	X	
Untaxed income	X	
Tax under payments b/f (grossed up) (x 100/20 or 100/40 or 100/45)	X	
		(X)
Allowance to set against pay		X

(c) To obtain the code number, the last figure is removed and replaced with a letter:

L	For people entitled to the full personal allowance
M	For people who are receiving the transferable personal allowance
N	For people who have elected to give the transferable personal allowance to their spouse/civil partner

BR	Basic rate tax deducted without allowances
DO	Higher rate tax deducted without allowances
OT	Personal allowance has been used up or started a new job and do not have a P45 form

Activity 6: Tax code

Finzi earns £15,000. In 2018/19, he underpaid income tax by £50. He has a company car with a taxable benefit of £3,905.

Required

What is Finzi's tax code for 2020/21? (Assume tax rates for 2020/21 apply throughout.)

- O 1615L
- O 1665L
- O 834L
- O 884L

Solution

8.5 Year-end procedures

The employer must send to HMRC the following items for each employee:

Date	Form/information
19 May	Final real-time submission
31 May	P60 provided to employees showing total taxable earnings for the tax year, tax deducted, code number and NI number
6 July	Form P11D – benefits for employees Form P11D(b) Class1A NIC return

8.6 PAYE penalties

Daily interest is charged on late payments of income tax and NICs under PAYE by taking the number of days by which a payment is late and applying the relevant late payment interest rate. HMRC make the charge after the end of the tax year.

Late payment penalties may be charged on PAYE amounts that are not paid in full and on time. Employers are not charged a penalty for the first late PAYE payment in a tax year, unless that payment is over six months late. The amounts of the penalties on subsequent late payments in the tax year depend on how much is late each time and the number of times payments are late in a tax year. The maximum penalty is 4% of the amount that is late in the relevant tax month and applies to the 11th (or more) late payment that tax year. **Where the tax remains unpaid at six**

months, the further penalty is 5% of tax unpaid, with a further 5% if tax remains unpaid at 12 months, even if there is only one late payment in the year.

There are also penalties for making late returns under RTI which are imposed on a monthly basis. The first late submission of the tax year is ignored. Further late submissions will attract penalties based on the **number of employees** as follows:

Number of employees	Monthly penalty
1 to 9	£100
10 to 49	£200
50 to 249	£300
250 or more	£400

If the return is more than three months late, there is an additional penalty due of 5% of the tax and NIC due.

Exam focus point

HMRC allows a return to be up to three days late before imposing a penalty. However, the examining team has specifically stated this aspect is **not examinable** in Taxation (TX – UK). There are also various other relaxations to the penalty rules which may apply but you should assume that the rules set out above apply when answering a Taxation (TX – UK) examination question.

Penalties for inaccurate returns are subject to the common penalty regime for errors (see later in this Workbook).

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Chapter summary

Taxable and exempt benefits. The PAYE system

Taxable benefits – general rules

- Cost to employer
- Pro-rate if benefit only available for part of year
- Deduct employee contributions if paid by 6 July following end of tax year, except for private fuel

Accommodation

- Job related - exempt
- Not job related - higher of
  – Rent paid by employer
  – Annual value
- and Additional charge = Official rate of interest 2.25% × (cost - £75,000)

Accommodation living expenses

- Job related: Cost to employer limited to 10% of net earnings
- Not job related: Cost to employer

Use of employer's assets

- 20% x MV (not cars, not mobile phones)
- Gifts of employer's asset, higher of
  – MV when given
  – MV when first used less amounts already assessed

Company cars, vans and fuel

Company cars

- CO_2% x list price
- Hybrid electric cars 1 – 50g/km, % depends on miles
- Petrol cars to 51-54g/km and diesel meeting RDE2 std, % = 13%
- Petrol cars 55g/km and diesel meeting RDE2 std, % = 14%
- Petrol cars > 55g/km and diesel meeting RDE2 std, 14% builds up 1% for every 5g of CO_2% emitted per km in excess of 55g/km
- Maximum 37% × list price
- Diesel cars 4% supplement added to CO_2% (maximum still 37%)
- Deduct capital contribution from list price (max deduction £5,000)

Company vans

- £3,490 plus an additional £666 if fuel provided
- No benefit if private use is only for home to work commute

Car fuel for private motoring

- £24,500 × CO_2%

Cheap/interest-free loans

- ORI x average loan or strict basis
- £10,000 *de minimis* limit

Other taxable benefits

General rule

- Taxable amount = cost to employer eg insurance, vouchers, use of credit card

General allowances

- Taxable but allowable deduction is available if necessarily incurred

Reimbursed expenses

- Not taxable

Scholarships

- If given to members of employee's family, employee is taxable on cost
- Unless the scholarship fund's or scheme's payments by reason of people's employments are not more than 25% of its total payments

Exempt benefits

- Free/subsidised canteen meals if available to all employees on similar terms
- Medical treatment exempt up to £500 paid by employer to assist return to work
- Workplace childcare
- Pension advice up to £500
- Relocation (max £8,000)
- Car parking near work and electric car charging points
- Employer's pension contribution
- Mobile phone
- Sports and recreational facilities
- £150 per head – annual parties
- Outplacement counselling services
- Weekly allowance of £6 for employees working from home
- Trivial benefits £50 or less, not cash or cash vouchers

Pay As You Earn (PAYE) system

How PAYE works

- System used for calculating and collecting income tax and NIC

Employer's duties

- Deduct correct amounts from employee's pay and keep records
- Pay tax/NIC over 14 days from end of tax month
- Send information electronically every time employees are paid

Leavers and joiners

- Complete P45 for leavers
- Joiners give employer their P45

Employee tax codes

- Tax code indicates tax free pay
- Penalties apply for both late payments and late returns

Year-end procedures

- 19 May – final real-time submission
- 31 May – P60
- 6 July – P11D – benefits for employees and P11D(b) Class 1A NIC return

PAYE penalties

- Interest and late payment penalties
- Penalties for late returns based on number of employees

Knowledge diagnostic

1. **Taxable benefits**

   Specific rules apply to determine the taxable amount of benefits but remember:

   - Employee contributions are deductible (except private fuel); and
   - Pro-rate if the benefit is only available for part of a tax year

2. **Exempt benefits**

   Certain benefits are tax free so make sure you know which ones.

3. **PAYE system**

   This system imposes the collection of tax of employees onto the employer. There are penalties for making late payments and late returns.

Further study guidance

Question practice

Now try the following from the Further question practice bank (available in the digital edition of the Workbook):

Section A questions:

Q15, Q16, Q17

Section B questions:

Q18 Clara

Section C questions:

Q19 Azure plc

Further reading

There is a technical article available on ACCA's website, called *Benefits*, which covers topics included in this chapter. There is also an article called *Motor cars* that explains the implications of acquiring, running, or having the use of a motor car for income tax, corporation tax, value added tax (VAT) and national insurance contributions (NIC).

You are strongly advised to read these articles in full as part of your preparation for the TX exam.

Activity answers

Activity 1: Taxable benefit

Accommodation

	£
Annual value	8,000
Additional charge	
(£175,000 – £75,000) × 2.25%	2,250
Employee contribution	(2,000)
Taxable benefit	8,250

Activity 2: Accommodation and living expenses

(a) If the accommodation is job-related, there is no charge for the accommodation.

Accommodation expenses – employee taxed on lower of:

		£
(1)	Expenses	1,800
(2)	10% net earnings	
	= 10% (£7,000 + £2,000)	900

Therefore, taxable benefit = £900 (lower amount)

(b) If the accommodation is not job-related, there is a charge for both the accommodation and the living expenses.

Accommodation

	£
Annual value	8,000
Additional charge	
[(£375,000 – £75,000) × 2.25%]	
NB more than six years since the property acquired so use MV	6,750
Annual benefit	14,750
Taxable benefit time apportioned (× 8/12)	9,833

Taxable benefit in relation to the expenses (unrestricted) = 1,800

Total benefit = £9,833 + £1,800 = £11,633

Activity 3: Private use of asset

The correct answer is: £600

Use of asset:

		£
2018/19	1,000 × 20% × 6/12 =	100
2019/20	1,000 × 20% =	200
2020/21	1,000 × 20% × 9/12 =	150
		450

Gift of asset:

2020/21 Higher of:

		£
(1)	MV of asset at date of gift =	600
(2)	MV when first provided minus the values already taxed:	
	= £1,000 – £450 =	550
	Therefore:	600 (higher amount)

The answer £550 is the lower amount. The answer £450 is the use benefit. The answer £1,000 is the market value when first provided.

Activity 4: Car benefit

(a) **Car benefit**

Company car g/km (round down) = 95

Therefore percentage = 14 + (95 - 55)/5 = 22%

Benefit = 16,500 × 22% = £3,630

(b)

	£
List price	16,500
Less capital contribution (maximum £5,000)	(5,000)
	11,500

Benefit = £11,500 × 22% = £2,530

(c) If car was diesel

Benefit = 22% + 4% = 26% × 16,500 = £4,290

(d) Basic benefit (above) × 6/12 - contribution = £4,290 × 6/12 - £1,000 = £1,145

(e) 16,500 × 13% = £2,145

(f) 16,500 x 10% = £1,650

Activity 5: Interest-free loan

(a) **Average method**

(a) $$\frac{100{,}000 + 80{,}000}{2} \times 2.25\% = £2{,}025$$

(b) **Strict method**

		£
£100,000 × 2.25% × 9/12	=	1,688
£80,000 × 2.25% × 3/12	=	450
		2,138

Laura will not choose to use the strict method as it produces a higher benefit, and HMRC will also not choose to use the strict method as the average method is not being deliberately exploited.

Activity 6: Tax code

The correct answer is: 834L

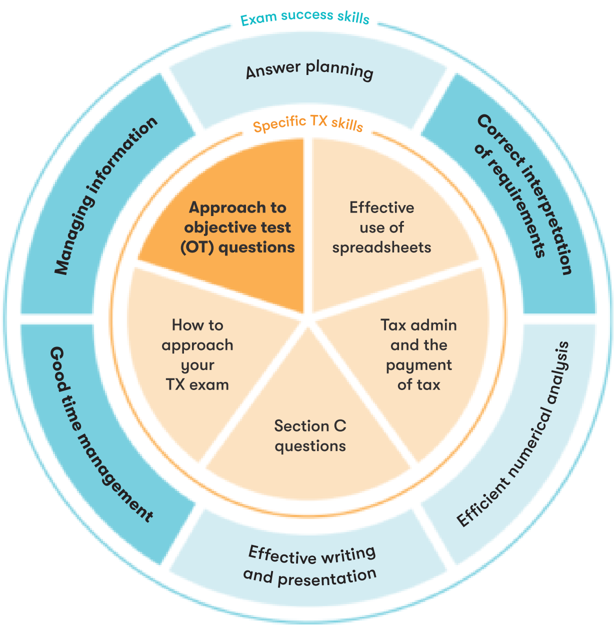
	£
PA	12,500
Car benefit	(3,905)
Tax underpaid £50 x (100/20)	(250)
	8,345
Tax code	834L

The answer 1615L adds the company car instead of deducting it. The answer 1665L adds both deductions. The answer 884L adds the adjustment for underpaid tax instead of deducting it.

Skills checkpoint 1

Approach to objective test (OT) questions

Chapter overview



Introduction

Sections A and B of the TX exam will contain OTs worth 60 marks (ie 60% of your exam) and, therefore, being able to answer OT questions effectively is extremely important.

Section A - Single OT questions

OT questions are single, short questions that are auto marked and worth two marks each. You must answer the whole question correctly to earn their two marks. There are no partial marks.

The OT questions in Section A aim for a broad coverage of the syllabus, and so all areas of the syllabus need to be carefully studied. You need to work through as many practice OT questions as possible, reviewing carefully to see how correct answers are derived.

The following types of OT questions commonly appear in the TX exam:

Question type	Explanation
Multiple choice questions (MCQ)	You need to choose one correct answer from four given response options.

Question type	Explanation
Multiple response options (MRO)	These are a type of multiple-choice question where you need to select more than one answer from a number of given options. The question will specify how many answers need to be selected. It is important to read the requirement carefully.
Fill-in-the-blank (FIB)	This question type requires you to type a numerical answer into a box. The unit of measurement (eg £) will sit outside the box. For TX, calculations and workings need only be made to the nearest £ and all apportionments should be made to the nearest month.
Drag and drop	Drag and drop questions involve you dragging an answer and dropping it into place. Some questions could involve matching more than one answer to a response area and some questions may have more answer choices than response areas, which means not all available answer choices need to be used.
Drop down list	This question type requires you to select one answer from a drop-down list. Some of these questions may contain more than one drop down list and an answer must be selected from each one. This requires the same skills as a multiple-choice question.
Hot area	This question type requires you to click on the correct area or words, such as 'true' or 'false', or 'exempt' or 'not exempt'.

Section B – OT Case questions

As with Section A, questions can come from any area of the syllabus, reinforcing the need for you to study the whole syllabus. Section B will include three OT case questions.

Each OT Case contains a group of five OT questions based around a single scenario. These can be any combination of the single OT question types and they are auto marked in the same way as the single OT questions.

OT Cases are worth ten marks (each of the five OTs contained within are worth two marks, and as with the OT questions described above, you will receive either two marks or zero marks for those individual questions).

OT cases are written so that there are no dependencies between the individual questions. Therefore, if you did get the first question wrong, your ability to get the other four correct is not affected. The OT Case scenario remains on screen so you can see it while answering the questions.

Each OT case normally consists of several numerical questions and at least one knowledge style question, such as tax due dates or true or false statements. It is often quicker to tackle the knowledge questions first, leaving some additional time to tackle calculations.

Note that the exam software contains a 'flag' functionality, meaning that you can flag any questions that you want to return to and review, if you have spare time at the end.

Approach to OT questions

TX Skill: Approach to OT questions

A step-by-step technique for approaching OT questions is outlined below. Each step will be explained in more detail in the following sections as the OT case question, 'Danni' is answered in stages.

General guidance for approaching OT questions

STEP 1: Answer the questions you know first.

If you're having difficulty answering a question, move on and come back to tackle it once you've answered all the questions you know.

It is often quicker to answer discursive style OT questions first, leaving more time for calculations.

General guidance for approaching OT questions

STEP 2: Answer all questions.

There is no penalty for an incorrect answer in ACCA exams; there is nothing to be gained by leaving an OT question unanswered. If you are stuck on a question, as a last resort, it is worth selecting the option you consider most likely to be correct and moving on. Make a note of the question, so if you have time after you have answered the rest of the questions, you can revisit it.

Guidance for answering specific OT questions

STEP 3: Read the requirement first!

The requirement will be stated in bold text in the exam. Identify what you are being asked to do, any technical knowledge required and **what type of OT question** you are dealing with. Look for key words in the requirement such as "which **TWO** of the following," "which of the following is **NOT**"

Guidance for answering specific OT questions

STEP 4: Apply your technical knowledge to the data presented in the question.

Take your time working through questions, and make sure to read through each answer option with care. OT questions are designed so that each answer option is plausible. Work through each response option and eliminate those you know are incorrect.

Exam success skills

The following question is a Section B OT case question worth ten marks.

For this question, we will also focus on the following **exam success skills**:

- **Managing information.** It is easy for the amount of information contained in an OT case question in Section B to feel a little overwhelming. **Active reading** is a useful technique to avoid this. This involves focusing on each of the five requirements first on the basis that, until you have done this, the detail in the question will have little meaning and will seem more intimidating.

Focus on the requirements, noting key verbs to ensure you understand the requirement properly, and correctly identify what type of OT question you are dealing with. Then read the rest of the scenario, making a note of important and relevant information and technical information you think you will need. (Note that you can highlight and strikethrough text in the question scenario in the CBE.)

Remember that Sections A and B are computer marked and so your answer will be either right or wrong. If you misread the information, you could be wasting valuable time as well as choosing the wrong answer.

- **Correct interpretation of requirements.** Identify from the requirement the different types of OT question. This is especially important with multiple response options (MRO) to ensure you select the correct number of response options.

- **Good time management**. Complete all OTs in the time available. Each OT is worth two marks and a whole Section B question should take 18 minutes.

Skills activity

The following scenario relates to Questions (a) to (e).

Danni joined a UK company, Clifton plc, as purchasing director on 1 July 2020, based at their Nottingham office.

Salary and bonus

Until 31 December 2020, Danni's monthly salary as a director was £6,000. From 1 January 2021, her salary increased by 2.5%.

Clifton plc awarded Danni a bonus of £10,000 in relation to a special purchasing project during Clifton plc's period of account ended 31 March 2021. This bonus was determined by the board of directors on 15 March 2021, credited in the company's accounts on 10 April 2021, which was also the date when Danni became entitled to payment of the bonus. The bonus was paid to Danni on 31 May 2021.

Travel to Clifton plc's offices

From 1 July 2020, Danni travelled to Clifton plc's office in Nottingham from home using the Nottingham Tram Network. Danni bought a monthly tram season ticket for each of the months from July 2020 to December 2020.

From 1 January 2021, Danni was seconded to Clifton plc's office in Manchester for a period of six months. Danni bought a monthly rail season ticket for each month of her secondment.

Travel to clients

Danni also used her own car for journeys to meet clients in Leicester, which is 24 miles from Nottingham. She made five return journeys between 1 July 2020 and 5 April 2021. Clifton plc paid Danni 30p per mile for these journeys.

Subscriptions

Danni is a member of the Chartered Institute of Purchasing and Supply (MCIP) and paid her annual membership fee on 31 December 2020. Danni is also a member of her local tennis club at which she sometimes meets potential suppliers for Clifton plc and paid her annual membership fee on 1 September 2020.

Payroll giving

Clifton plc has a payroll giving scheme. Danni made monthly contributions through the scheme from 31 December 2020.

Required

(a) **What is the amount of Danni's employment income from her salary and bonus taxable in the tax year 2020/21?**

£_________

(2 marks)

Note. This is a FIB question and so you need to enter your answer carefully, to the nearest pound. This particular question does not require rounding because the numbers are whole pounds. It tests your ability to recognise that Danni is a director and therefore this may affect the date and tax year in which the bonus is deemed to have been received.

(b) **Indicate, by selecting the relevant boxes below, whether Danni's travel to Clifton plc's offices will be qualifying or non-qualifying travel expenses?**

Travel from home to Clifton plc's office in Nottingham	QUALIFYING	NON-QUALIFYING
Travel from home to Clifton plc's office in Manchester	QUALIFYING	NON-QUALIFYING

(2 marks)

Note. This is a hot area question. Read the scenario and the question carefully and do not assume that if one option is qualifying then the other one must be non-qualifying. They could both be qualifying or they could both be non-qualifying.

(c) **What are the employment income consequences of Danni using her own car for journeys to meet clients in Leicester?**

- £72 taxable benefit
- £108 allowable deduction
- £12 taxable benefit
- £36 allowable deduction

(2 marks)

Note. This is an MCQ requiring one correct answer to be selected. Remember that the distractors (incorrect answer options) contain numbers that you will obtain if you make a particular mistake. Do not look at the options until you have finished your calculation as it is possible that a 'part finished calculation' is one of the incorrect distracters.

(d) **Indicate, by selecting the relevant boxes below, whether the following subscriptions will be deductible in computing Danni's employment income?**

Chartered Institute of Purchasing and Supply (MCIP)	DEDUCTIBLE	NON-DEDUCTIBLE
Tennis club	DEDUCTIBLE	NON-DEDUCTIBLE

(2 marks)

Note. This is another hot area question.

(e) **How is tax relief given for Danni's contributions through the payroll giving scheme?**

By whom	How tax relief given
• Clifton plc	Deducting the donation from Danni's gross pay before calculating PAYE
• Clifton plc	Increasing the basic rate limit when computing PAYE on Danni's gross pay
• Danni	Making contributions net of basic rate tax
• Danni	Making a claim in her self-assessment tax return

(2 marks)

(Total = 10 marks)

Note. This is another MCQ requiring one correct answer to be selected.

STEP 1 **Answer the questions you know first.**

If you are having difficulty answering a question, move on and come back to tackle it once you have answered all the questions you know. It is often quicker to answer discursive style OT questions first, leaving more time for calculations.

Questions (b), (d) and (e) are discursive style questions. It would make sense to answer these two questions first as it is likely that you will be able to complete them comfortably within the 1.8 minutes allocated to them. Any time saved could then be spent on the more complex calculations required to answer the remaining questions.

STEP 2 **Answer all questions.**

There is no penalty for an incorrect answer in ACCA exams so there is nothing to be gained by leaving an OT question unanswered. If you are stuck on a question, as a last resort, it is worth selecting the option you consider most likely to be correct and moving on. Make a note of the question, so if you have time after you have answered the rest of the questions, you can revisit it.

Two of the five questions in the OT case are MCQs. With these types of questions, you have a 25% chance of getting the question correct so do not leave any unanswered. It is obviously more difficult to get a fill in the blank question correct by guessing.

STEP 3 **Read the requirement first!**

The requirement will be stated in bold text in the exam. Identify what you are being asked to do, any technical knowledge required and **what type of OT question** you are dealing with. Look for key words in the requirement such as 'Which TWO of the following...' or 'Which of the following is NOT...'

Question (a) is a FIB question and so you need to read the question carefully and insert your answer to the carefully. Questions (b) and (d) require you to select a correct answer for each option. Each question is worth two marks but there is no partial marking. So, if you correctly select 'deductible' for one subscription but select the wrong answer for the other subscription, you will gain no marks for that question.

STEP 4 **Apply your technical knowledge to the data presented in the question.**

Take your time working through calculations and be sure to read through each answer option with care. OT questions are designed so that each answer option is plausible.

Let's look at a few of the questions in detail.

Question (a) asks for a calculation of Danni's employment income and bonus taxable in 2020/21.

To answer this, you need to read the scenario carefully.

Danni joined a UK company, Clifton plc, as purchasing director on 1 July 2020, based at their Nottingham office.

Notes.

1 As Danni is a director, this means that the rules relating to directors regarding the date of earnings will apply.

2 As Danni joined part way through the year, she has not worked a full 12 months.

Salary and bonus

Until 31 December 2020, Danni's monthly salary as a director was £6,000. From 1 January 2021, her salary increased by 2.5%.

Note. A calculation of Danni's monthly salary from January is required.

Clifton plc awarded Danni a bonus of £10,000 in relation to a special purchasing project during Clifton plc's period of account ended 31 March 2021. This bonus was determined by the board of directors on 15 March 2021, credited in the company's accounts on 10 April 2021, which was also the date when Danni became entitled to payment of the bonus. The bonus was paid to Danni on 31 May 2021.

Note. These dates need to be read carefully, applying the rules for directors in order to establish the tax year that the bonus should fall into.

The correct answer is £64,450.

	£
Salary	
1.7.20 – 31.12.20	
£6,000 × 6	36,000
1.1.21 – 31.3.21	
(£6,000 × 102.5%) × 3	18,450
Bonus	
31 March 2021 (receipts basis)	10,000
Taxable in tax year 2020/21	64,450

As Danni is a director of Clifton plc, bonus is received on the earliest of:

- The time when payment is made (31 May 2021)
- The time when she becomes entitled to payment of the bonus (10 April 2021)
- The time when the amount is credited in the company's accounting records (10 April 2021)
- The end of the company's period of account (as the amount was determined on 15 March 2021 which is within the period of account) (31 March 2021)

The earliest of these dates is provided by the last test and so the date of receipt is 31 March 2021.

Question (e) is an MCQ asking how tax relief is given for Danni's contributions through the payroll giving scheme. The scenario says:

Payroll giving

Clifton plc has a payroll giving scheme. Danni made monthly contributions through the scheme from 31 December 2020.

You will notice that this question is much quicker to answer than Question (a). If you have remembered the rules about charitable donations under the payroll deduction scheme, this is an easy question.

The correct answer is: By Clifton plc deducting the donation from Danni's gross pay before calculating PAYE. Note that you could answer this question before attempting the more time-consuming numerical questions.

Exam success skills diagnostic

Every time you complete a question, use the diagnostic below to assess how effectively you demonstrated the exam success skills in answering the question. The table has been completed below for the Danni activity to give you an idea of how to complete the diagnostic.

Exam success skills	Your reflections/observations
Managing information	• Did you read each of the five requirements first? • Did you actively read the scenario making a note of relevant points such as the fact that Danni is a director?
Correct interpretation of requirements	• Did you identify the correct technical knowledge needed to answer each requirement? For example, using the information in the scenario about Danni being seconded to Manchester for six months and your technical knowledge about qualifying travel expenses to a temporary workplace, to answer Question (b). • Did you identify what type of OT question you were dealing with? For example, knowing that only one correct answer is required for a multiple-choice question.
Good time management	• Did you manage to answer all five questions within 18 mins? • Did you manage your time well by answering Questions (b), (d) and (e) first?
Most important action points to apply to your next question	

Summary

60% of the TX exam consists of OT questions. Key skills to focus on throughout your studies will therefore include:

- Always reading the requirements first to identify what you are being asked to do and what type of OT question you are dealing with
- Actively reading the scenario, making a note of key data needed to answer each requirement
- Answering OT questions in a sensible order, dealing with any easier discursive style questions first

5 Pensions

Learning objectives

On completion of this chapter, you should be able to:

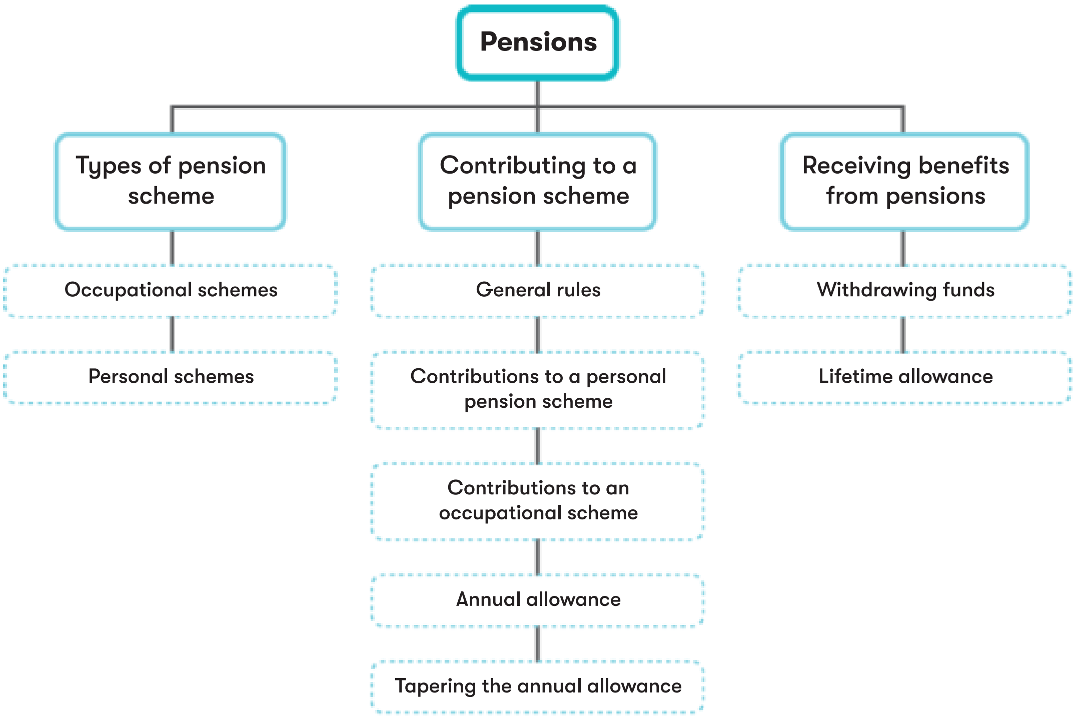
	Syllabus reference no.
Explain and compute the relief given for contributions to personal pension schemes and to occupational pension schemes.	B7(a)

Exam context

Pension contributions can be paid by all individuals and you may come across these contributions as part of an income tax question in Section C. In Section C, you may also be required to discuss the types of pension schemes available and the limits on the tax relief due, or you may have to deal with them in an income tax computation. Pensions may be tested in a 15 mark question or a 10 mark question. Section A or B questions might test a specific aspect of pensions such as the amount of the annual allowance.

You must be sure that you know how to deal with the two ways of giving relief – contributions to occupational schemes are deducted from earnings whilst contributions to personal pensions are paid net of basic rate tax and further tax relief is given by increasing the basic rate and higher rate limits.

Chapter overview



1 Introduction

Individuals are encouraged by the government to make financial provision to cover their needs when they reach a certain age. There are state pension arrangements which provide some financial support, but the government are keen for individuals to make their own pension provision to supplement their state pensions.

Under **automatic enrolment**, employers must automatically enrol most employees into a **workplace pension scheme** (although employees can then **opt out** of the scheme). There are **minimum contributions** to the workplace pension scheme required by law (usually equal to 8% of earnings of which a minimum amount equal to 3% of earnings must be contributed by the employer, as of April 2019).

Alternatively, individuals (employees, self-employed and those who are not working) may make their **own pension provision** through a personal pension provider.

Tax relief is given for both employer pension provision and personal pension provision. This includes both relief for contributions paid into pension schemes during an individual's working life and an exemption from tax on income and gains arising in the pension fund itself.

2 Types of pension scheme

2.1 Occupational schemes

KEY TERM

Occupational pension scheme: Employers may set up an occupational pension scheme. The employer may use the services of an insurance company (an insured scheme) or may set up a totally self-administered pension fund.

There are two kinds of occupational pension scheme – earnings-related (**defined benefits arrangements**) and investment-related (**money purchase arrangements**). In a **defined benefits arrangement** the pension is generally based on employees' earnings either at retirement (a **final salary** scheme) or throughout their employment (a **career average** scheme) and linked to the number of years they have worked for the employer.

A **money purchase pension** – also known as a **defined contribution scheme** – does not provide any guarantee regarding the level of pension which will be available. The individual invests in the pension scheme and the amount invested is used to build up a pension.

An individual has to be employed to have access to an occupational scheme.

2.2 Personal schemes

KEY TERM

Personal pension scheme: Personal pensions are money purchase (defined contribution) schemes, which are provided by banks, insurance companies and other financial institutions.

Any individual (whether employed or not) may join a personal pension scheme.

Stakeholder pensions are a particular type of personal pension scheme. They must satisfy certain rules, such as a maximum level of charges, ease of transfer and so on.

3 Contributing to a pension scheme

3.1 General rules

Employer contributions are a tax-free benefit for the employee and a deductible trading expense in the employer's tax computation.

Employer contributions are not limited but they will use up part of the annual allowance (see later in this chapter).

The maximum gross tax relievable contributions made by the individual are the higher of:

- £3,600; and
- An individual's relevant earnings chargeable to income tax in that year.

Relevant earnings are broadly employment income, trading income and income from furnished holiday lettings (see Chapter 6).

Exam focus point

£3,600 will be given to you in the Tax Rates and Allowances available in the exam.

Essential reading

Individuals can make contributions to their pensions which do not attract tax relief. These are covered briefly in the Essential reading for this chapter.

The Essential reading is available as an Appendix of the digital edition of the Workbook.

3.2 Contributions to a personal pension scheme

Any individual **under the age of 75 can make tax relievable pension contributions** in a tax year.

Payments into personal pension schemes are made net of basic rate tax of 20%, ie to end up with £1,000 in a personal pension fund the individual only needs to pay £800.

In this way, basic rate relief is given at source, as we have seen already with gift aid. Higher rate and additional rate taxpayers obtain additional relief by making a claim to increase the basic rate limit (and, if relevant, the higher rate limit) by the gross amount of the pension contribution.

Adjusted basic rate limit = £37,500 + (cash contribution × 100/80)

Adjusted higher rate limit = £150,000 + (cash contribution × 100/80)

Exam focus point

Make sure your workings show clearly how you have increased the basic rate and higher rate limits. Note the difference between this method and that used for net pay arrangements (see below).

Illustration 1: Personal pension contributions (1)

Joe has earnings of £68,650 in 2020/21. He pays a personal pension contribution of £7,200 (net). He has no other taxable income.

Required

Show Joe's tax liability for 2020/21.

Solution

	Non- savings income
	£
Earnings/Net income	68,650
Less PA	(12,500)
Taxable income	56,150

Tax

	£
£46,500 (W) × 20%	9,300
£9,650 × 40%	3,860
£56,150	13,160

Working

Basic rate limit

£37,500 + (£7,200 × 100/80) = £46,500

Remember that **gross personal pension contributions** are also used to compute **adjusted net income** and that **the restriction on the personal allowance** is calculated in relation to adjusted net income (see Chapter 2).

Activity 1: Personal pension contributions (2)

John earned £132,500 in the tax year. He made a cash contribution to a personal pension scheme of £20,000.

Required

1 What is John's personal allowance in the tax year?

- O £nil
- O £5,000
- O £6,250
- O £8,750

2 What are John's basic rate band and higher rate band limits?

- O BRB: £62,500 and HRB: £175,000
- O BRB: £57,500 and HRB: £175,000
- O BRB: £62,500 and HRB: £170,000
- O BRB: £57,500 and HRB: £170,000

Solution

Exam focus point

This topic was tested in Question 31, Jack, in the December 2016 exam. The examining team commented that few candidates appreciated that restricting the amount of personal pension contributions to the amount qualifying for tax relief at the higher rate minimises the cost of pension saving because each £100 saved effectively only costs £60 (£100 less 40% tax relief).

3.3 Contributions to an occupational pension scheme

Employee contributions get tax relief under 'net pay arrangements' where the employer deducts the employee's gross pension contribution before applying Pay As You Earn (PAYE). This gives the employee tax relief at the correct marginal rate (ie starting with highest rate) of tax without the need to make any additional claims.

Illustration 2: Occupational pension scheme (1)

Maxine has taxable earnings of £68,650 in 2020/21. Her employer deducts a pension contribution of £9,000 from these earnings before operating PAYE. She has no other taxable income.

Required

Show Maxine's tax liability for 2020/21.

Solution

	Non-savings Income
	£
Earnings/Total income	68,650
Less pension contribution	(9,000)
Net income	59,650
Less PA	(12,500)
Taxable income	47,150

Tax

	£
£37,500 × 20%	7,500
£9,650 × 40%	3,860
£47,150	11,360

This is the same result as Joe in the earlier illustration. Joe had received basic rate tax relief of £9,000 – £7,200 = £1,800 at source, so his overall tax position was £13,160 – £1,800 = £11,360.

Activity 2: Occupational pension scheme (2)

Wendy is paid a salary of £50,000.

She pays 10% of this salary into her employer's occupational pension scheme. The employer matches this contribution. Wendy also receives benefits of £8,000 in the tax year.

Required

1 What is Wendy's employment income for the tax year?

- £45,000
- £51,750
- £53,000
- £58,000

2 What is Wendy's basic rate band for the tax year?

- £37,500
- £42,500
- £43,750
- £47,500

Solution

3.4 Annual allowance

The 'annual allowance' effectively restricts the amount of tax relievable contributions that can be paid into an individual's pension scheme each year. The annual allowance is £40,000. It applies to gross contributions to both personal pension and occupational pension schemes, including any contributions made by an employer.

If the annual allowance is not fully used in any tax year, the unused allowance can be carried forward for up to three years, but only if the individual is a member of a pension scheme in the year the allowance relates to. If the individual is not a member of a pension scheme in any year, then the annual allowance for that year is wasted and cannot be carried forward.

The current year annual allowance is utilised first and then the earliest of the years brought forward.

Illustration 3: Annual allowance (1)

Jess made the following gross personal pension contributions:

2017/18 – £23,600

2018/19 – Nil (Not a member of a pension scheme in this year)

2019/20 – £30,400

Required

What is Jess's annual allowance for 2020/21?

Solution

	Unused allowance	£
2017/18	£40,000 – £23,600	= 16,400
2018/19		Nil
2019/20	£40,000 – £30,400	= 9,600
		26,000
2020/21		= 40,000
		66,000

As Jess was not a member of a pension scheme in 2018/19, the annual allowance for that year is lost.

Activity 3: Annual allowance (2)

Ted is a sole trader. His gross contributions to his personal pension scheme have been as follows:

2017/18	£16,000
2018/19	£36,000
2019/20	£25,000

In 2020/21, Ted will have taxable trading profits of about £100,000 and wishes to make a large pension contribution in January 2021. He has no other sources of income.

Required

1 What is the maximum gross tax relievable pension contribution Ted can make in January 2021, taking into consideration any brought forward annual allowance?

2 If Ted makes a gross personal pension contribution of £43,000 in January 2021, what are the unused annual allowances he could carry forward to 2021/22?

Solution

3.5 Tapering the annual allowance

Individuals who have adjusted income in excess of £240,000 have a reduced annual allowance.

The annual allowance is reduced by £1 for every £2 that the individual's adjusted income exceeds £240,000, subject to a minimum annual allowance of £4,000. The minimum annual allowance will apply where the individual has adjusted income of £312,000 or more.

Adjusted income is **net income** plus any **employee contributions** to **occupational** pension schemes plus any **employer contributions** to **any pension schemes** for the employee. For self-employed people, adjusted income is simply their net income for the tax year.

Exam focus point

There is a threshold level of income below which tapering does not apply but this is **not examinable** in Taxation (TX – UK).

Exam focus point

The £40,000 annual allowance, £4,000 minimum allowance and £240,000 income limit will be given to you in the Tax Rates and Allowances available in the exam.

Activity 4: Tapered annual allowance

Peter is a member of a partnership and his share of the trading income is £265,000 in the tax year 2020/21. During the tax year, Peter paid interest of £12,500 on a loan to invest in the partnership.

Peter's wife, Catherine, is employed by Peter's partnership. She is paid an annual salary of £290,000 in the tax year 2020/21. She pays 10% of her salary into her employer's occupational pension scheme and her employer (the partnership) pays a further 5% into the same scheme. Catherine also made a gross contribution into a personal pension scheme in the tax year of £10,000.

The couple jointly own an investment property which is let out to tenants and has generated profits of £67,000 in the tax year 2020/21.

Required

1 What is Peter's annual allowance for 2020/21?

- O £nil
- O £4,000
- O £27,500
- O £33,750
- O £17,000

2 What is Catherine's annual allowance for 2020/21?

- O £nil
- O £4,000
- O £12,750
- O £7,750

Solution

If gross contributions exceed the annual allowance available, the excess contributions will be taxed as an annual allowance charge for the tax year in which the contribution is paid. This charge is subject to income tax at the individual's marginal rates. In effect, the tax relief given for the contribution is clawed back.

Illustration 4: Annual allowance charge (1)

Jaida had employment income of £315,000 in 2020/21. She made a gross personal pension contribution of £70,000 in December 2020. She does not have any unused annual allowance brought forward.

Required

What is Jaida's income tax liability for 2020/21?

Solution

	Non-savings income
	£
Taxable income (no personal allowance available)	315,000
Tax	
£107,500 (W1) × 20%	21,500
£112,500 × 40%	45,000
£220,000 (W2)	
£95,000 × 45%	42,750
£315,000	
£66,000 (W3) × 45%	29,700
Tax liability	138,950

Workings

1 ***Basic rate limit***

£37,500 + £70,000 = £107,500

2 ***Higher rate limit***

£150,000 + £70,000 = £220,000

3 ***Excess pension contribution***

(£70,000 – £4,000 minimum as adjusted income exceeds £312,000) = £66,000

Activity 5: Annual allowance charge (2)

Shirley has employment income of £126,000 for the tax year and made a personal pension contribution of £46,000. She does not have any brought forward unused annual allowance.

Required

Calculate Shirley's income tax liability for 2020/21.

Solution

4 Receiving benefits from pensions

PER alert

One of the competencies you require to fulfil Performance Objective 17 *Tax planning and advice* of the PER is to assess the tax implications of proposed activities or plans of an individual or entity with reference to relevant and up to date legislation. You can apply the knowledge you obtain from this section of the Workbook to help demonstrate this competence.

Individuals with personal pensions have complete flexibility as to how they can access their pension fund once they reach the minimum pension age of 55.

25% of the pension fund can be withdrawn as a tax-free lump sum. The balance of the pension fund can be reinvested to provide taxable pension income whenever the individual wishes. The withdrawals are taxed as non-savings income in the tax years of withdrawal and subject to the normal rates of tax.

Exam focus point

There is an anti-avoidance annual allowance limit which applies when an individual starts to receive pension benefits flexibly but is also entitled to make further contributions to the pension fund. This annual allowance limit is **not examinable** in Taxation (TX – UK).

A lifetime allowance of £1,073,100 applies to the total value of a person's pension schemes when they start to make withdrawals from the schemes. If the pension fund **exceeds the lifetime allowance**, this will give rise to an **income tax charge** on the **excess value of the fund** when the individual receives pension benefits from the fund. The rate of the charge is 55% if the excess value is taken as a lump sum, or 25% if the funds are used to provide a pension income.

Chapter summary

Pensions

Types of pension scheme

Occupational schemes

- Set up by employer
- Defined benefit arrangements – based on employee's earnings
- Defined contribution – provides no guarantee of level of pension

Personal schemes

- Only defined contribution schemes
- Available to any individual (whether employed or not)

Contributing to a pension scheme

General rules

- Employer contributions
  - Exempt benefit
  - Deductible for employer
  - Not limited but use up annual allowance
- Maximum tax-relievable individual contributions are higher of:
  - £3,600
  - Relevant earnings (employment, self-employment, FHL income)

Contributions to a personal pension scheme

- Must be < 75 years of age
- Contributions made net of basic rate of income tax
- Higher and additional rate relief given by adjusting higher and additional rate thresholds
- Gross personal pension contributions deducted in calculation of adjusted net income for restriction of personal allowance

Contributions to an occupational scheme

- Contributions made under "net pay arrangements"

Annual allowance

- Restricts the amount of tax-relievable contributions each year
- £40,000 plus unused AA from previous three years, FIFO (as long as individual was a member of a scheme in that year)

Tapering the annual allowance

- If adjusted income > £240,000
- Reduce by £1 for every £2 adjusted income exceeds £240,000
- Minimum AA £4,000
- Adjusted income = net income + employee contributions to occupational schemes plus employer contributions to any pension schemes for the employee
- If gross contributions > available AA, excess taxed at marginal rate as AA charge

Receiving benefits from pensions

Flexibility with personal schemes once 55 years of age

Withdrawing funds

- 25% as tax free lump sum
- Balance of fund reinvested and taxed as non-savings income as and when withdrawn

Lifetime allowance

- Applies to total value of pension fund
- £1,073,100
- Income tax charge on withdrawal if fund exceeds lifetime allowance

Knowledge diagnostic

1. **Occupational pension schemes**

   Occupational schemes are run by an employer and can be defined benefit or defined contribution schemes.

2. **Personal pension schemes**

   Any individual may invest in a personal pension scheme. These schemes are defined contribution schemes.

3. **Employer contributions**

   Contributions made by an employer into an occupational or a personal pension are an exempt benefit and are tax deductible for the employer.

4. **Tax relief**

   For personal pension schemes basic rate relief is given at source. Higher and additional rate relief is given by increasing the higher and additional rate thresholds by the gross contribution.

   For occupational schemes under net pay arrangements the employer deducts the employee's contributions from their gross pay, thereby achieving tax relief at their marginal rate.

   Maximum tax relievable contributions are restricted to the higher of £3,600, and the individual's relevant earnings (broadly employment, trading and furnished holiday lettings income).

5. **Annual allowance**

   The annual allowance is an overriding restriction to the amount of contributions getting tax relief each year. The annual allowance is £40,000 per tax year and unused annual allowance can be carried forwards three years, as long as the individual is a member of a pension scheme that year.

   The annual allowance is tapered if adjusted net income is in excess of £240,000. There is a minimum annual allowance of £4,000.

   If gross contributions are greater than the annual allowance, then the excess contributions are taxed at the marginal rate as an annual allowance charge.

6. **Drawing benefits from a pension fund**

   25% of a pension fund can be withdrawn as a tax free lump sum. The rest is reinvested to be withdrawn as taxable non-savings income as the individual wishes.

   If the total pension fund exceeds the lifetime allowance, which is £1,073,100, at the point when funds are withdrawn, there is an income tax charge on the excess.

Further study guidance

Question practice

Now try the following from the Further question practice bank (available in the digital edition of the Workbook):

Section A: Q20, 21, 22

Section B: Q23

Activity answers

Activity 1: Personal pension contributions (2)

1 The correct answer is: £8,750

	£
Net income	132,500
Less pension contribution £20,000 × 100/80	(25,000)
ANI	107,500
Personal allowance	12,500
Less 1/2 × £(107,500 - 100,000)	(3,750)
	8,750

The answer £Nil does not adjust for the pension contribution. The answer £5,000 deducts the full excess of £7,500. The answer £6,250 does not gross up the pension contribution.

2 The correct answer is: BRB: £62,500 and HRB: £175,000

Extend BR and HR bands by gross pension contribution
BR band £37,500 + (20,000 × 100/80) = 62,500
HR band £150,000 + (20,000 × 100/80) = 175,000

The answers BRB £57,500 and HRB £170,000 do not gross up the pension contribution.

Activity 2: Occupational pension scheme (2)

1 The correct answer is: £53,000

	£
Salary	50,000
Less pension contribution (10%)	(5,000)
Add benefits	8,000
	53,000

Note. Employer's contribution is tax free.

The answer £45,000 does not add the taxable benefits. The answer £51,750 grosses up Wendy's occupational pension contribution as if it were a personal pension contribution. £58,000 treats the employer's contribution as a taxable benefit.

2 The correct answer is: £37,500

The basic rate band is not adjusted for occupational pension contributions.

The answer £42,500 adds Wendy's occupational pension contribution to the basic rate limit. The answer £43,750 grosses up Wendy's occupational pension contribution and adds it to the basic rate limit as if it were a personal pension contribution. The answer £47,500 adds both Wendy's contribution and her employer's contribution to the basic rate limit.

Activity 3: Annual allowance (2)

1

	£
Annual allowance 2020/21	40,000
Annual allowance unused in 2017/18 (£40,000 – £16,000)	24,000
Annual allowance unused in 2018/19 (£40,000 – £36,000)	4,000
Annual allowance unused in 2019/20 (£40,000 – £25,000)	15,000
Maximum gross pension contribution in 2020/21	83,000

2

	£
Annual allowance 2020/21 used in 2020/21	40,000
Annual allowance unused in 2017/18 used in 2020/21	3,000
Contribution in 2020/21	43,000

The remaining £24,000 – £3,000 = £21,000 of the 2017/18 annual allowance cannot be carried forward to 2021/22 since this is more than three years after 2017/18. The unused annual allowances are therefore £4,000 from 2018/19 and £15,000 from 2019/20 and these are carried forward to 2021/22.

Activity 4: Tapered annual allowance

1 The correct answer is: £17,000

	£
Trading income from partnership	265,000
Property business income	33,500
Less qualifying interest paid	(12,500)
Net income = adjusted income	286,000

Then compute the reduced annual allowance:

	£
Adjusted income	286,000
Less threshold	(240,000)
Excess	46,000
Annual allowance	40,000
Less half excess £46,000 × ½	(23,000)
Reduced annual allowance	17,000

The answer £nil assumes fully tapered and does not include the minimum allowance. The answer £4,000 does not halve the excess of £46,000 so the minimum allowance of £4,000 applies. The answer £27,500 ignores the property income and does not halve the excess. The answer £33,750 ignores the property income.

2 The correct answer is: £4,000

	£
Employment income (£290,000 – 10% × £290,000)	261,000
Property business income	33,500
Net income	294,500
Catherine's and employer's contribution to occupational pension (10% + 5%) × £290,000	43,500
Contribution to the personal pension scheme (not relevant)	0
Adjusted income	338,000

Then compute the reduced annual allowance:

	£
Adjusted income	338,000
Less threshold	(240,000)
Excess	98,000
Annual allowance	40,000
Less half excess £98,000 × ½	(49,000)
	(9,000)
Minimum allowance applies	4,000

The answer £nil does not apply the minimum allowance. The answer £12,750 ignores the contributions to the occupational scheme. The answer £7,750 ignores the joint income.

Activity 5: Annual allowance charge (2)

		Non-savings income
		£
Employment income		126,000
Personal allowance (W1)		(12,500)
Taxable income		113,500
Income tax		
	95,000 × 20% (W2)	19,000
	18,500 × 40%	7,400
Annual allowance charge	17,500 (W3) × 40%	7,000
Income tax liability		33,400

Workings

1 ***Personal allowance***

	£
Adjusted net income (ANI)	

Employment income	126,000
Less gross pension contribution	(57,500)
ANI	68,500

∴ Personal allowance is £12,500

2 ***BR band limit***

£37,500 + £57,500 = 95,000

3 ***Excess annual allowance***

Annual allowance charge	£
Gross pension contribution	
£46,000 × 100/80	57,500
Annual allowance	(40,000)
	17,500

6

Property income

Learning objectives

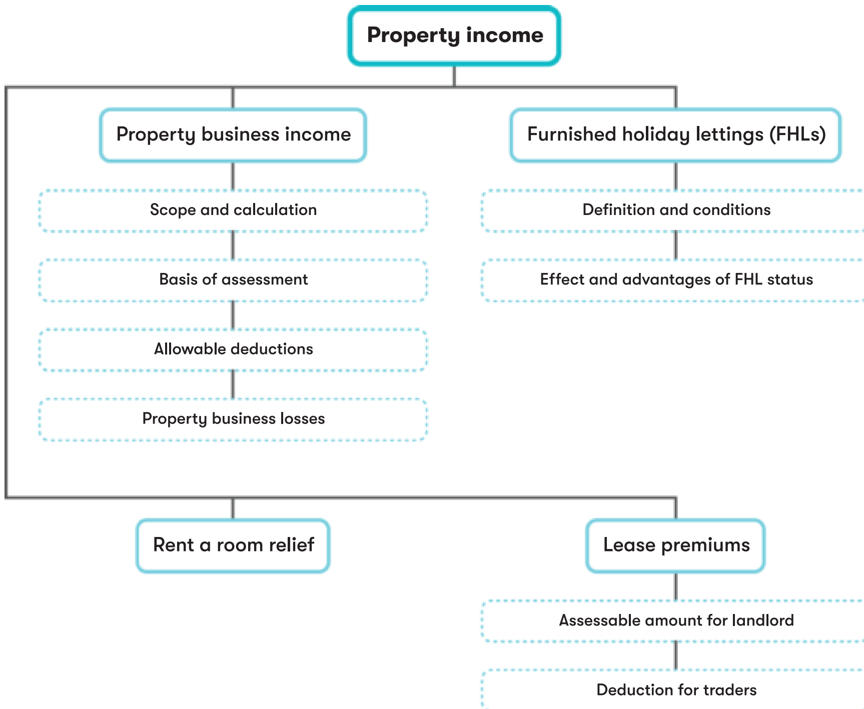
On completion of this chapter, you should be able to:

	Syllabus reference no.
Compute property business profits.	B4(a)
Explain the treatment of furnished holiday lettings.	B4(b)
Understand rent-a-room relief.	B4(c)
Compute the amount assessable when a premium is received for the grant of a short lease.	B4(d)
Understand and apply the restriction on property income finance costs.	B4(e)
Understand how relief for a property business loss is given.	B4(f)

Exam context

You are likely to be required to compute property income as part of a 10- or 15-mark question in Section C. You may find it tested in the context of income tax or corporation tax (see later in this Workbook). Specific aspects of property income such as lease premiums may be tested in Section A or Section B questions. Rent-a-room relief is an important relief for individuals (it does not apply to companies), and the special rules for furnished holiday lettings will only be examined in an income tax context. Remember that property income is non-savings income even though a property portfolio is usually regarded as an investment.

Chapter overview



1 Property business income

1.1 Scope and calculation

1.1.1 Scope of charge

Income from land and buildings in the UK is taxed as non-savings income. The profit or loss of the UK property business operated by an individual is computed for a tax year.

1.1.2 Computation of property business profit/loss

A taxpayer with UK rental income is treated as running a business, their 'UK property business'. All the receipts and expenses for all properties are pooled to give a single profit or loss.

The main taxable receipt for a property business is **rent paid by the tenant to the landlord taxpayer**, which is usually in the form of money. If the tenant is required to pay a security deposit to cover costs such as unpaid rent, cleaning or making good damage by the tenant at the end of the tenancy, this is not treated as a receipt unless and until the landlord becomes legally entitled to use it under the terms of the deposit.

	£
Rental income	X
Less allowable expenses including:	
Advertising	(X)
Agent's fees	(X)
Repairs/ replacement domestic items	(X)
Property income profit/(loss)	X/(X)

1.2 Basis of assessment

1.2.1 Cash basis

KEY TERM

Cash basis: A landlord who is an individual is by default assessed on rent received less expenses paid in the current tax year (cash basis).

Exam focus point

The examining team has stated that in any examination question involving property income for individuals and partnerships (since the individual partners are taxed on their share of the partnership property business income), it should be assumed that the cash basis is to be used unless specifically stated to the contrary.

1.2.2 Accruals basis

KEY TERM

Accruals basis: Property income can alternatively be assessed on rent receivable less expenses payable in the current tax year (accruals basis).

An individual **must** use the accruals basis if cash basis receipts for the tax year exceed £150,000 (reduced proportionately if the property business is not carried on for a full tax year).

An individual can **elect** to use the accruals basis. The election must be made by the 31 January which is 22 months from the end of the tax year.

Companies must use the accruals basis to compute property business income (see Chapter 19).

Activity 1: Assessable property income

Len owns a flat which he lets out from 1 March 2020. Rent is payable quarterly in advance. Payments are made by the tenant as follows:

Payment date	£
1 March 2020	3,000
1 June 2020	3,000
1 September 2020	3,000
1 December 2020	3,600
1 March 2021	3,600

All the payments were made on time apart from the 1 March 2021 payment which was not paid until 10 April 2021.

Required

1 What is the assessable property income for 2020/21?

£ ______

2 What is the assessable property income for 2020/21 if Len makes an election to use the accruals basis?

- O £10,800
- O £11,600
- O £12,800
- O £13,200

Solution

1.3 Allowable deductions

1.3.1 General conditions

The general rule is that all expenses incurred wholly and exclusively for the purpose of the letting business are allowable in computing the property business profit or loss. Deductible expenses include repairs to the property, agent's fees, insurance, and rent payable where a landlord is renting the property which they in turn let to others. Capital expenditure (for example mortgage capital repayments, construction of an extension or boundary wall) is not usually deductible.

A landlord can choose to use either actual motoring expenses incurred, or the approved mileage allowances (same as for employment income) for motoring expenses incurred in their property business.

1.3.2 Finance costs

Special rules apply to interest and other finance costs (including incidental costs incurred in obtaining loans such as fees or commission payments) for property businesses carried on by individuals (not companies). The effect of the rule is to restrict tax relief on these costs to the basic rate. The tax liability of basic rate taxpayers will not be affected by the rule but higher and additional rate taxpayers will have an increased tax liability.

The rule applies to **loans taken out for a residential property business**. It is not necessary for the loan to be for the purchase of the property, for example it could be taken out to pay for repairs to the property. Loans relating to commercial properties or for furnished holiday letting business (see later in this chapter) do not fall within the rule.

Instead of being given relief by deducting finance costs from property income, they are instead given as a tax reducer at 20% (ie, deductible from the individual's income tax liability).

Illustration 1: Finance costs tax reducer

Millicent bought a house on 6 April 2020 and let it out throughout the tax year 2020/21 at a monthly rental of £1,500 which she received in full by 5 April 2021. She bought the house with a mortgage loan and in 2020/21 she made capital repayments of £1,000 and paid interest of £4,000. Millicent had other property business expenses (all deductible) of £2,500 for 2020/21. Millicent had other taxable income (after deduction of her personal allowance) of £60,000 in 2020/21.

Required

Compute Millicent's income tax liability in respect of her property income for the tax year 2020/21.

Solution

	£
Rental income £1,500 × 12	18,000
Less deductible expenses	(2,500)
Property income 2020/21	15,500

Note that the mortgage capital repayments are not deductible.

Income tax on property income	£
£15,500 × 40% (higher rate taxpayer)	6,200
Less property business finance costs tax reducer	
£4,000 × 20%	(800)
Property income tax liability 2020/21	5,400

1.3.3 Replacement of furniture and other domestic items

No relief is given for the initial cost of providing furniture in a let property. Relief is however given if an item of furniture is replaced. This is known as 'Replacement of domestic items relief'.

This relief is for a range of domestic items including furniture, furnishings, household appliances and kitchenware, but does not apply to fixtures which become part of a property such as radiators.

The amount of the relief is the expenditure on the new replacement asset less any proceeds from selling the old asset which has been replaced plus any incidental costs of disposal of the old asset or acquisition of the new asset. If the new asset is not the same, or substantially the same, as the old asset, only the cost of an equivalent asset is given relief. For example, if a single bed is replaced with a double bed, only the cost of an equivalent single bed is given relief.

1.4 Property business losses

Generally, there is no difference between the treatment of a property business loss calculated under the cash basis or one calculated under the accruals basis.

If the result is a profit – taxable in the current tax year

If the result is a loss – carry forward to deduct from first available property profits in the future

Activity 2: Computation of property business profits

Fiona owns a property that she has let furnished on a short-term basis for a number of years. The following information relates to the tax year 2020/21:

(1) Fiona's total property income (after deduction of allowable expenses) amounted to £9,900. This was before taking account of her mortgage repayments which amounted to £2,500 (consisting of £2,000 of interest and £500 capital repayments).

(2) The property was let out at a monthly rental of £1,000 payable on the 6th of each month. The rent due on 6th March 2020 was not received until 6 April 2020.

(3) Fiona had received a security deposit of £500 from a tenant when she let the property in January 2020. That tenant left the property on 5 January 2021 at the end of the letting period. On that date, Fiona used £200 of the deposit to pay for cleaning the property and repaid the remaining £300 to the departing tenant. She then let the property again on 6 January 2021 and received a security deposit of £600 from the incoming tenant. This amount was still held as a deposit by Fiona at 5 April 2021.

(4) Fiona disposed of an old washing machine for £25 and replaced it with a new washer-dryer at a cost of £550. The cost of a new washing machine equivalent to the one she disposed of would have been £330.

(5) Fiona travelled 1,000 miles in her car in relation to letting the property.

Fiona wants to know what the income tax liability on her property income is for the tax year 2020/21 that is in addition to her income tax liability on her other income. Fiona has other taxable income (all non-savings) of £50,000.

For the tax year 2021/22, Fiona is considering using the accruals basis.

Fiona may incur substantial allowable expenditure on refurbishing the property in the tax year 2021/22 which could result in a property business loss. The property will then generate a profit in subsequent tax years. Fiona wants to know how the loss could be used.

Required

1 What is Fiona's additional income tax liability for 2020/21 on her property income?

- O £3,960
- O £3,460
- O £3,560
- O £3,160

2 What was the amount of income received when Fiona computed her property income for 2020/21?

£ [ ]

3 What was the total amount of expenditure paid in respect of the new washer-dryer in (4) and the use of Fiona's car in (5) that was deducted when Fiona computed her property income for 2020/21?

- O £555
- O £755

O £780

O £975

4 Which **TWO** of the following statements about the use of the accruals basis by Fiona in the tax year 2021/22 are correct?

☐ Under the accruals basis, Fiona will compute property income using rent receivable less expenses payable

☐ Under the accruals basis, Fiona will be able to deduct the whole of her finance costs from her property profit

☐ Fiona must use the accruals basis if her property income under the cash basis exceeds £150,000 in that tax year

☐ Fiona can elect to use the accruals basis and must so elect by 31 January 2023

5 Complete the following sentence about how Fiona could use a property business loss for 2021/22.

Fiona can use a property business loss for 2021/22 against ☐ (1) income in the tax year ☐ (2) .

Pull down list 1

- general
- property

Pull down list 2

- 2020/21
- 2021/22
- 2022/23

Solution

2 Furnished Holiday Lettings (FHLs)

2.1 Definition and conditions

Accommodation counts as a furnished holiday letting (FHL) if all of the following apply:

- It is available for commercial letting to the public for no less than 210 days each tax year.
- It is actually let for at least 105 days in each tax year. If a taxpayer owns more than one FHL, this condition can be satisfied based on the average number of days that each property is let.
- Tenants do not stay for a period of more than 31 days. However, the property can be let to the same tenant for periods longer than this provided these long lets do not take up more than 155 days per tax year.
- It is located in the European Economic Area.

Exam focus point

An FHL must be situated in the UK or in another state within the European Economic Area. However, only FHLs situated within the UK are within the Taxation (TX – UK) syllabus.

It is possible to make an election so that a rental property continues to qualify as an FHL for up to two years after the 105-day test ceases to be met. This election is **not examinable** in Taxation (TX – UK).

2.2 Effect and advantages of FHL status

FHL accommodation income is taxable as property income but it is treated as a business.

Landlord needs to keep details of income and expenses separate to other properties. This is so that the profits and losses can be identified for the special rules which apply to FHLs.

Losses can only be offset against future profits from FHLs.

The advantages of having an FHL are that:

- Finance costs are not restricted, ie they are fully deductible from FHL business income.

- Capital expenditure on furniture is deductible when incurred (or under the accruals basis, capital allowances are available), instead of on replacement basis.
- Income is treated as earned income and so qualifies as part of relevant earnings for pension contributions (see Chapter 5).
- Capital gains tax rollover relief, business asset disposal relief and gift relief are available on any subsequent sale of the property (see Chapter 15).

3 Rent-a-room relief

The first £7,500 each tax year collected from a tenant renting a room in the taxpayer's main residence is tax-free. This limit is halved if any other person (eg spouse/civil partner) also received income from renting accommodation in the property. The taxpayer can elect to ignore the exemption, for example to generate a loss by taking into account both rent and expenses.

If the rent received exceeds £7,500 the taxpayer is by default taxable on total rents received less normal rental expenses, but can elect to be taxed on the excess rentals over £7,500 with no deduction for expenses.

An election to ignore the exemption (if gross rents are below £7,500), or an election for the alternative basis (if gross rents exceed £7,500) must be made by the 31 January which is 22 months from the end of the tax year concerned.

Illustration 2: Rent a room relief

Sylvia owns and lives in a house near the sea in the UK. She has a spare bedroom and, during 2020/21, this was let to a lodger who paid her £148 per week which includes the cost of heating and electricity.

Sylvia estimates that her lodger costs her an extra £150 on gas, £125 on electricity, and £50 on buildings insurance each year.

Required

What is Sylvia's property income for 2020/21 assuming that she makes any beneficial election?

Solution

Sylvia's gross rents are above the rent-a-room limit. Therefore, she has the following choices:

(1) Under the normal method (no election needed), she can be taxed on her actual profit:

	£
Rental income £148 × 52	7,696
Less expenses (150 + 125 + 50)	(325)
	7,371

(2) Under the 'alternative basis' (elect for rent-a-room relief):

Total rental income of £7,696 exceeds £7,500 limit, so taxable income is £196 (ie £7,696 – £7,500) if rent-a-room relief claimed.

Sylvia should elect for rent-a-room relief and so be taxed on the 'alternative basis'.

4 Lease premiums

4.1 Assessable amount for landlord

A new tenant often pays both annual rental and a one-off premium. If the lease granted is for 50 years or less, part of the premium is treated as **rent received in advance** and increases the landlord's property income assessment for the year in which the premium falls due.

The property income assessment is calculated as:

	£
Premium	A
Less 2% × (n – 1) × A	(a)
	X
(Where n is the length of the lease)	

This treatment applies irrespective of whether the landlord uses the cash or accruals basis.

Illustration 3: Income element of a premium

Janet granted a lease to Jack on 1 March 2021 for a period of 40 years. Jack paid a premium of £16,000.

Required

How much of the premium received by Janet is taxed as property income?

Solution

	£
Premium received	16,000
Less 2% × (40 – 1) × £16,000	(12,480)
Taxable as property income	3,520

4.2 Deduction for traders

Where a trader has **paid** a premium for the granting of a short lease, they may deduct the following amount against their trading income, in addition to any rent paid:

Amount deductible (per annum) = Property income assessment on lessor/Life of lease (in years).

Activity 3: Lease premiums

Denise grants Timothy a lease to a shop on 30 June 2020.

Annual rental	£8,000 due on 1.7.20
Term	15 years
Premium	£60,000

Denise uses the accruals basis to calculate her property business profits.

Required

1 Calculate the property income assessment on Denise for 2020/21.

2 Timothy prepares accounts to 31 December every year.

Required

Show the relief available to Timothy for the premium paid for his year ended 31 December 2020.

Solution

Chapter summary

Property income

Property business income

Scope and calculation
- Profit/loss computed for tax year
- Results from all properties are pooled

Basis of assessment
- Cash basis: rent received less expenses paid in current tax year (use unless told otherwise in question)
- Accruals basis: rent receivable less expenses payable in current tax year (use if cash basis property business income exceeds £150,000 or if election made)

Allowable deductions
- Expenses incurred wholly and exclusively for letting business
- Finance costs relief given as tax reducer at 20%
- No relief for capital items, except
- Cost of replacement furniture and appliances

Property business losses
- Offset vs current and future property income

Furnished holiday lettings (FHLs)

Definition and conditions
- Available for letting for > 210 days per year
- Let for > 105 days
- Lets > 31 days add up to ≤ 155 days in total

Effect and advantages of FHL status
- Treated as a business
- Loss relief only against income from FHL business
- Advantages:
  - Finance costs are not restricted
  - Relevant earnings for pension contributions
  - Business asset for CGT so gift relief, business asset disposal relief and rollover relief available
  - Capital expenditure on furniture deductible when incurred

Rent a room relief

- First £7,500 pa tax free income from lodger

Lease premiums

Assessable amount for landlord

Premium	A
Less 2% × (n – 1) × A	(a)
Rental assessment	X

Deduction for traders
- Trader paying lease premium gets trading profit deduction for rental assessment, spread over lease term

Knowledge diagnostic

1. **Property business profits**

   Income for individuals is usually assessed on a cash basis.

   Revenue expenses are deductible (but finance costs are given relief via a tax reducer at 20%) and there is a deduction for the cost of replacement furniture.

   A loss on a property letting business is carried forward to set against future property business profits.

2. **Furnished holiday lettings (FHLs)**

   FHLs are seen as a business activity so attract certain advantages. Finance costs are offset against FHL income, purchase of furniture is deductible when incurred and income is relevant earnings for pension purposes. Carry forward loss relief is available against FHL income.

3. **Rent-a-room relief**

   £7,500 each tax year collected from renting a room in a main residence is tax-free. If the rent exceeds £7,500, full amount less expenses is taxable as property business profits. Taxpayer can elect for the excess over £7,500 to be taxable, but with no deduction for expenses.

4. **Lease premiums**

   Lease premiums on the grant of a short lease lead to an element of the premium being treated as rent received in advance. If the premium is paid by a trader, a deduction can be made in computing taxable trading profits.

Further study guidance

Question practice

Now try the following from the Further question practice bank (available in the digital edition of the Workbook):

Section A: Q24, Q25 and Q26

Section C: Q27 Rafe

Activity answers

Activity 1: Assessable property income

1 £ 9,600

	£
1.6.20	3,000
1.9.20	3,000
1.12.20	3,600
	9,600

The payment due on 1.3.21 paid on 10.4.21 will be taxed in 2021/22.

Use the cash basis unless specifically told otherwise in the question.

2 The correct answer is: £12,800

		£
1.3.20 payment:	3,000 × 2/3	2,000
1.6.20		3,000
1.9.20		3,000
1.12.20		3,600
1.3.21	3,600 × 1/3	1,200
		12,800

The answer £10,800 omits the accrual for April and May. The answer £11,600 omits the accrual for March – under the accruals basis it is not relevant that this is not received until April. The answer £13,200 is all the rent from June 2020 to March 2021.

Activity 2: Computation of property business profits

1 The correct answer is: £3,560

	£
Property income (no deduction for any mortgage repayments)	9,900
Tax	
£9,900 × 40%	3,960
Less: finance costs tax reducer £2,000 × 20%	(400)
Tax liability	3,560

Fiona's other taxable income uses up her basic rate band so the additional income tax is computed at the higher rate.

The answer £3,960 does not deduct the tax reducer. The answer £3,460 incorrectly includes capital repayments in the tax reducer. The answer £3,160 deducts the whole of the finance costs in computing the property income, ie gives relief on finance costs at 40% instead of 20%.

2 £ 13,200

	£
Rent received 2020/21 (including late paid rent due 6 March 2020) £1,000 × 13	13,000
Security deposit retained 5 January 2021	200
Tax liability	13,200

The security deposit paid by the incoming tenant is not treated as income unless and until Fiona becomes legally entitled to use it under the terms of the deposit.

3 The correct answer is: £755

	£
Washer-dryer (£330 – £25)	305
Landlord's mileage allowance 1,000 × 45p	450
Total deduction	755

Only the cost of an equivalent asset is allowable, less the proceeds from selling the old washing machine. The mileage allowance is computed using the approved mileage rates.

The answer £555 uses the 25p rate for the mileage allowance. The answer £780 does not deduct the disposal proceeds of the old washing machine. The answer £975 allows the full cost of the new washer-dryer.

4 The correct answers are:

- Under the accruals basis, Fiona will compute property income using rent receivable less expenses payable
- Fiona must use the accruals basis if her property income under the cash basis exceeds £150,000 in that tax year

Finance costs are not deductible from property income, irrespective of whether the cash or the accruals basis is used. Fiona can elect to use the accruals basis but must so elect by 31 January 2024 for the tax year 2021/22.

5 Fiona can use a property business loss for 2021/22 against [property] income in the tax year [2022/23] .

Property business losses cannot be carried back and cannot be set against general income.

Activity 3: Lease premiums

1

	£
Premium	60,000
Less 2% × (15 – 1) × 60,000	(16,800)
	43,200
Rent (9/12 × 8,000)	6,000
Property income assessment	49,200

2 Relief available = £43,200/15 = £2,880 for 12-month period of account.

Lease commenced 1 July 2020, so relief available in the year ended 31 December 2020: 6/12 × £2,880 = £1,440.

7 Computing trading income

Learning objectives

On completion of this chapter, you should be able to:

	Syllabus reference no.
Describe and apply the badges of trade.	B3(b)
Recognise the expenditure that is allowable in calculating the tax-adjusted trading profit.	B3(c)
Explain and compute the assessable profits using the cash basis for small businesses.	B3(d)
Recognise the relief that can be obtained for pre-trading expenditure.	B3(e)

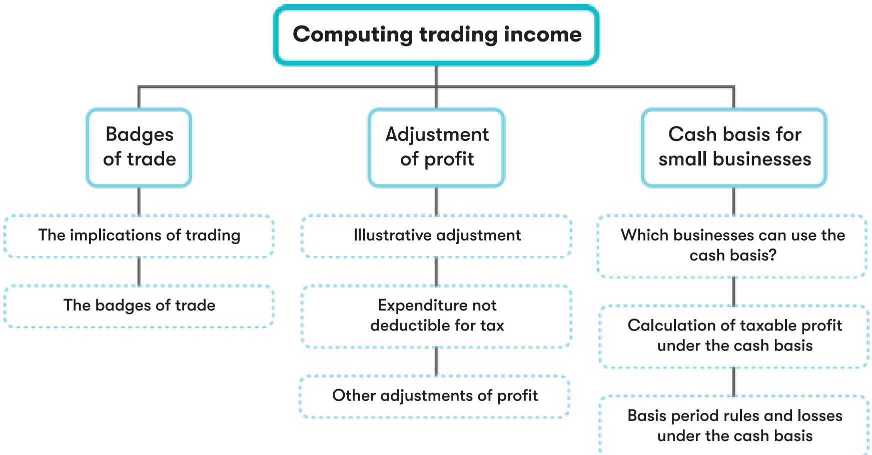
Exam context

The final figure to slot into the income tax computation is income from self-employment (trading income).

We are therefore going to look at the computation of profits of unincorporated businesses. We work out a business's profit as if it were a separate entity (the separate entity concept familiar to you from basic bookkeeping) but, as an unincorporated business has no legal existence apart from its trader, we cannot tax it separately. We have to feed its profit into the owner's personal tax computation.

Section A questions on computing taxable trading income may test two or three particular adjustments such as the restriction for motor cars with high carbon dioxide (CO_2) emissions. You may also be required to deal with a number of adjustments in a Section B question. You may be required to compute trading profits in a Section C question. The computation may be for an individual, a partnership or a company. In each case, the same principles are applied. You must however watch out for the adjustments which only apply to individuals, such as private use expenses. You may also be asked to explain the badges of trade in a Section C question. These topics may be tested as part of a 15-mark or a 10-mark question.

Chapter overview



1 The badges of trade

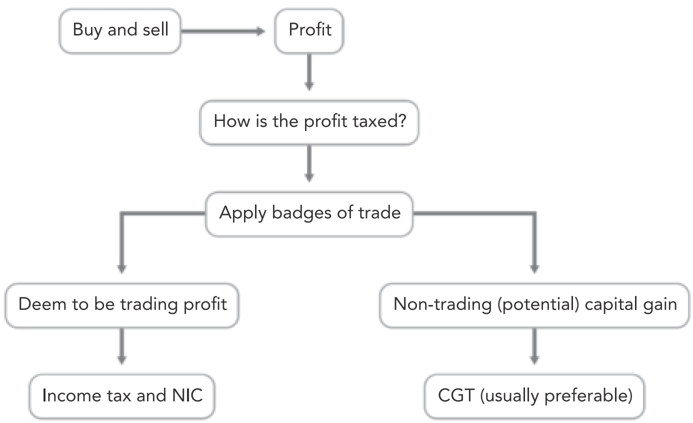
The badges of trade are used to decide whether or not a trade exists. If one does exist, the accounting profits need to be adjusted in order to establish the taxable trading profits.

A trade is defined by the Income Tax Act 2007 as any venture in the nature of trade. Further guidance about the scope of this definition is found in a number of cases which have been decided by the courts. This guidance is summarised in a collection of principles known as the 'badges of trade'. These are set out below. They apply to both corporate and unincorporated businesses.

KEY TERM

Badges of trade: A number of principles based on previous court decisions which indicate whether an activity is trading in nature

1.1 The implications of trading



1.2 The badges of trade

It is important to know when an individual's income should be assessed under the trading income rules. The following main tests are used:

1.2.1 Subject matter

Whether a person is trading or not may sometimes be decided by examining the subject matter of the transaction.

1.2.2 Frequency of transactions

Transactions which may, in isolation, be of a capital nature will be interpreted as trading transactions where their frequency indicates the carrying on of a trade.

1.2.3 Length of ownership

Although this is not always the case, the courts may infer adventures in the nature of trade where items purchased are sold soon afterwards.

1.2.4 Profit motive

The presence of a profit motive will be a strong indication that a person is trading.

1.2.5 Supplementary work and marketing

When work is done to make a property more marketable, or steps are taken to find purchasers, the courts will be more ready to ascribe the trading motive.

1.2.6 Manner in which assets were acquired

If acquired unintentionally (eg by inheritance) and then sold, it is unlikely that trading has taken place.

Essential reading

There are certain other relevant factors which may be considered, depending on the facts of the case. These include the existence of similar transactions, the source of finance used, and the organisation of the activity as a trade. These, along with facts relating to relevant case law supporting the above badges of trade, are examined in more detail in the Essential Reading section of your Workbook.

The Essential reading is available as an Appendix of the digital edition of the Workbook.

2 Adjustment of profit

Taxable trading profits are not the same as accounting profits. Accounting profits need to be adjusted to take account of tax legislation and to ensure only trading income and expenditure are included within the 'Trading income' figure.

2.1 Illustrative adjustment

The following proforma should be used to adjust a statement of profit or loss to arrive at the taxable trading profit or loss for the accounting period:

	£	£
Net profit in accounts		X
Add back:		
Expenditure not deductible for tax	X	
Any non-trading expenditure	X	
		X
Deduct:		
Income assessable under other categories	X	
Non-taxable income	X	
Deductible expenditure not shown in accounts	X	
		(X)
Adjusted profits		X
Less: capital allowances on plant and machinery		(X)
Adjusted trading income/(loss)		X

You may refer to deductible and non-deductible expenditure as allowable and disallowable expenditure respectively. The two sets of terms are interchangeable.

Exam focus point

An examination question requiring adjustment to profit will direct you to start the adjustment with the net profit of £X and to deal with all the items listed, indicating with a zero (0) any items which do not require adjustment. Marks will not be given for relevant items unless this approach is used. Therefore, students who attempt to rewrite the statement of profit or loss will be penalised.

2.2 Accounting policies

The fundamental concept is that the profits of the business must be calculated in accordance with generally accepted accounting principles using the accruals basis (but see later in this chapter for details of when the cash basis can be used). These profits are subject to any adjustment specifically required for income tax purposes.

2.3 Expenditure not deductible for tax

Disallowable (ie non-deductible) expenditure must be added back to the net profit in the computation of the taxable trading profit. Any item not incurred wholly and exclusively for trade purposes is disallowable expenditure. Certain other items, such as depreciation, are specifically disallowable.

2.3.1 Capital expenditure

Capital expenditure is not deductible. This means that depreciation is non-deductible, as are legal and professional fees in relation to capital acquisitions and disposals.

Profits and losses on the sale of non-current assets must be deducted or added back respectively.

Chargeable gains or allowable losses may be dealt with under capital gains tax for individuals or separately for corporation tax for companies (see later in this Workbook).

The most contentious items of expenditure will often be repairs (revenue expenditure) and improvements (capital expenditure).

Essential reading

Further detail in relation to the definition of repairs for tax purposes can be found in your Essential Reading.

The Essential reading is available as an Appendix of the digital edition of the Workbook.

There are exceptions to the 'capital rule'; the following three items are all deductible:

- Fees incurred in the renewal of short leases (less than 50 years) of land and buildings
- Incidental costs of obtaining loan finance
- Costs of registering patents and trademarks

2.3.2 Payments contrary to public policy and illegal payments

Fines and penalties are not deductible. However, HMRC usually allow employees' parking fines incurred in parking their employer's cars while on their employer's business. Fines relating to traders, however, are never allowed. A payment is not deductible if making it constitutes an offence by the payer. This covers protection money paid to terrorists, and also bribes. Statute also prevents any deduction for payments made in response to blackmail or extortion.

2.3.3 General provisions and bad debts (impairment losses)

Only impairment losses where the liability was incurred wholly and exclusively for the purposes of the trade are deductible for taxation purposes. For example, loans to employees written off are not deductible.

General provisions (ie those calculated as a percentage of total trade receivables, without reference to specific receivables) will now rarely be seen. In the event that they do arise, increases or decreases in a general provision are not allowable/taxable and an adjustment will need to be made.

2.3.4 Unpaid remuneration

If earnings for employees are charged in the accounts but are not paid within nine months of the end of the period of account, the cost is only deductible for the period of account in which the earnings are paid.

2.3.5 Entertaining and gifts

The general rule is that expenditure on entertaining and gifts is non-deductible. However, the following are allowable:

- Staff entertaining and gifts (note however that a charge to tax may arise on the employee under benefits legislation)
- Gifts to third parties which meet all of the following criteria:
  - Cost <£50 per recipient per annum
  - Bear a conspicuous company logo
  - Are not food, drink, tobacco or vouchers

2.3.6 Appropriations of profit

Private expenditure of the owner (including the private proportion of 'mixed' expenses such as rent, motor expenses and telephone bills) and appropriations of the trade profit (eg proprietor's salary, drawings or tax/NIC) are disallowed. A salary paid to a member of the trader's family is allowed as long as it is not excessive in respect of the work performed by that family member.

2.3.7 Subscriptions and donations

The general 'wholly and exclusively' rule determines the deductibility of expenses. Subscriptions and donations are not deductible unless the expenditure is for the benefit of the trade. Charitable and politicaldonations are disallowed (unless small donations to local charities).

2.3.8 Legal and professional fees

Legal and professional charges relating to capital or non-trading items are not deductible. These include charges incurred in acquiring new capital assets or legal rights, issuing shares, drawing up partnership agreements and litigating disputes over the terms of a partnership agreement.

Professional charges are deductible if they relate directly to trading. Deductible items include:

- Legal and professional charges incurred defending the taxpayer's title to non-current assets
- Charges connected with an action for breach of contract
- Expenses of the renewal (not the original grant) of a short lease for less than 50 years
- Charges for trade debt collection
- Normal charges for preparing accounts/assisting with the self-assessment of tax liabilities

Accountancy fees for tax appeals and assisting with enquiries are allowable provided no adjustments arise that relate to negligence or fraud by the taxpayer.

2.3.9 Leased cars

There is a restriction on the leasing costs of a car with CO_2 emissions exceeding 110g/km. 15% of the leasing costs will be disallowed in the adjustment of profits calculation.

2.3.10 Interest payable

Interest paid by an individual on borrowings for trade purposes is deductible as a trading expense on an accruals basis, so no adjustment to the accounts figure is needed. Individuals cannot deduct interest on overdue tax. Interest that qualifies for relief under the 'qualifying interest' rules seen in Chapter 3 must be disallowed if it has been charged as an expense in the statement of profit or loss (to prevent double relief).

2.3.11 Expenditure not wholly and exclusively for the purpose of the trade

Expenditure is not deductible if it is not for trade purposes (the remoteness test), or if it reflects more than one purpose (the duality test). The private proportion of payments for motoring expenses, rent, heat and light and telephone expenses of a trader is non-deductible. If an exact apportionment is possible, relief is given on the business element.

Essential reading

Further detail and case law relating to the remoteness test and the duality test can be found in your essential reading.

The Essential reading is available as an Appendix of the digital edition of the Workbook.

2.3.12 Other allowable and disallowable expenses

Essential reading

A table summarising other allowable and disallowable items can be found in your essential reading.

The Essential reading is available as an Appendix of the digital edition of the Workbook.

Activity 1: Disallowed expenses

Lulu has the following expenses in her statement of profit or loss.

Required

Indicate in the table below, which of these expenses must be added back to work out her tax-adjusted trading profit before capital allowances.

Expenses	Add back/Do not add back
Legal fees in connection with the acquisition of a freehold building	
Legal fees in connection with the renewal of a 15-year lease on some land	
Motor insurance on a van used in her trade	
The gift of 25 identical pens bearing Lulu's business to clients (total cost = £1,375)	

Solution

2.4 Other adjustments of profit

2.4.1 Trading income excluded from accounts

If any trading income is omitted from the accounts, it must be added back in the adjustment of profits in order for it to be taxed.

The usual example is when a trader takes goods for their own use.

In such circumstances, the selling price of the goods if sold in the open market (less any amount the trader actually paid for the goods) is added to the accounting profit. In other words, the trader is treated for tax purposes as having made a sale to themselves.

2.4.2 Accounting profits not taxable as trading income

There are three types of receipts which may be found in the accounting profits but which must be excluded from the taxable trading profit computation (and are therefore deducted from net profit as shown in the proforma). These are:

(a) Capital receipts (eg profit on disposal of fixed assets)

(b) Income taxed in another way (at source or as another type of income), eg bank interest received taxable as savings income for individuals or rental income is taxed as property income

(c) Income specifically exempt from tax

It is important that items deducted in this way are correctly taxed where necessary - for example, a capital receipt may require the calculation of a chargeable gain, or items such as rental income or interest will be included elsewhere in the trader's income tax computation.

Illustration 1: Adjustment of profits (1)

Here is the statement of profit or loss of Steven, a trader, for the year ended 5 April 2021.

	£	£
Gross profit		90,000
Other income		
Bank interest received		860
		90,860
Expenses		
Wages and salaries	59,000	
Rent and rates	8,000	
Depreciation	1,500	
Impairment losses (trade)	150	
Entertainment expenses for customers	750	
Patent royalties paid	3,200	
Legal expenses on acquisition of new factory	250	
		(72,850)
Finance costs		
Bank interest paid		(300)
Net profit		17,710

Salaries include £15,000 paid to Steven's wife, Melanie, who works full time in the business.

Required

Compute the adjusted taxable trade profit. You should start with the net profit figure of £17,710 and indicate by the use of zero (0) any items which do not require adjustment.

Solution

STEVEN

Adjusted taxable trading profit for the year ended 5 April 2021

	£	£
Net profit		17,710
Add: Wages and salaries (Melanie's salary not excessive for full-time work)	0	
Rent and rates	0	
Depreciation	1,500	
Impairment losses (trade)	0	
Entertainment expenses for customers	750	
Patent royalties	0	
Legal expenses (capital)	250	
Bank interest paid	0	
		2,500
		20,210
Less: Bank interest received		(860)
Profit adjusted for tax purposes		19,350

Bank interest will be taxed as savings income on Steven.

Activity 2: Adjustment of profits (2)

John's summarised statement of profit or loss for the year ended 31 December 2020 is as follows:

	£
Gross profit	30,000
Less: depreciation	(2,000)
entertaining (Additional information 1)	(3,000)
wages and salaries (Additional information 2)	(15,000)
car expenses (Additional information 3)	(1,500)
rent and rates	(1,000)
bank interest paid	(800)
Plus: bank interest received	500
profit on sale of assets	700
Net profit	7,900

Additional information

(1) Entertaining comprised £2,500 for customer entertaining and £500 for staff entertaining

(2) Wages and salaries comprised £10,000 for John and £5,000 for John's wife, Penny. Penny worked part-time in John's business and the same salary would have been payable to an unconnected employee.

(3) John uses the car 20% privately.

Required

Calculate John's adjusted trading profit.

Your computation should commence with net profit of £7,900 and should list all of the items referred to in the statement of profit or loss, indicating by the use of a zero (0) any items that do not require adjustment.

		£
Net profit		
Add:	depreciation	
	customer entertaining	
	John's salary	
	car private expenses	
	rent and rates	
	bank interest paid	
Less:	bank interest received	
	profit on sale	
Adjusted trading profit		

Solution

2.4.3 Deductible expenditure not charged in the accounts

Amounts not charged in the accounts that are deductible from trading profits must be deducted when computing the taxable trading income.

Examples of these are:

- Capital allowances (see next chapter)
- Annual sum which can be deducted by a trader that has paid a lease premium to a landlord who is taxable on the premium as property income (see chapter 6 on property income)
- Pre-trading expenditure (see below)

2.4.4 Pre-trading expenditure

Pre-trading expenditure is treated as a trading expense incurred on the first day of trading providing the following conditions are met:

- The expense was incurred in the seven years prior to the commencement of trading; and
- It would have been a deductible expense had the trade already started.

3 Cash basis for small businesses

An election can be made for an unincorporated business to calculate trading profits on the cash basis (instead of in accordance with generally accepted accounting principles) in certain circumstances.

> **Exam focus point**
>
> The detailed cash basis rules are quite complex. These more complex aspects are **not examinable** in Taxation (TX – UK). In any examination question involving an unincorporated business, it should be assumed that the cash basis is not relevant unless it is specifically mentioned.

3.1 Which businesses can use the cash basis?

If an unincorporated business has revenue which does not exceed £150,000 (given in tax rates and allowances in exam), it has the option to compute its trading profit using the cash basis. The cash basis will then apply to the current, and all subsequent eligible tax years.

The business would continue to use this basis until either:

- Its receipts in the previous tax year exceed £300,000 **and** receipts for the current year exceed £150,000; or
- Its 'commercial circumstances' change such that the cash basis is no longer appropriate and an election is made to use accruals accounting.

3.2 Calculation of taxable profits under the cash basis

The taxable trading profits under the cash basis are calculated as cash receipts less deductible business expenses actually paid in the period.

3.2.1 Cash receipts

This includes both cash and card receipts, including amounts received from the sale of plant and machinery (other than cars).

3.2.2 Deductible business expenses

Business expenses for the cash basis of accounting include capital expenditure on plant and machinery (except motor cars). Other capital expenses are not business expenses, eg purchase of land and buildings.

The majority of the specific tax rules covered earlier in this chapter concerning the deductibility of business expenses (for example, personal expenses of the owner) also apply when the cash basis is used.

Fixed rate expenses for private use of motor cars and business premises used for private purposes may be used instead (see further below).

3.2.3 Fixed rate expenses

When using the cash basis, certain expenses can be computed on a flat rate basis as follows:

(a) Use the statutory approved mileage allowance to compute the deduction for business miles (given in tax rates and allowances in exam).

(b) If a business premises are used partly for private purposes the private use adjustment can be made on the number of occupants (this will be given in an exam question).

Where a business elects to use the cash basis, for Taxation (TX – UK) purposes, it will be assumed to use fixed rate expenses rather than make deductions on the usual basis of actual expenditure incurred.

Essential reading

Further detail regarding fixed rate expenses and a numerical example of the cash basis can be found in your essential reading.

The Essential reading is available as an Appendix of the digital edition of the Workbook.

3.3 Basis period rules and losses under the cash basis

3.3.1 Basis period rules

A trader using the cash basis can, like any other trader, prepare their accounts to any date in the year. The basis of assessment rules which determine in which tax year the profits of an accounting period are taxed apply in the same way for accruals accounting and cash basis traders (see Chapter 9 of this Workbook).

3.3.2 Cash basis losses

If the cash basis produces a trading loss the only relief available is to carry the loss forward against future trading profits. The rules regarding loss relief for accruals basis traders are covered in Chapter 10 of this Workbook.

Chapter summary

Computing trading income

Badges of trade

The implications of trading

- Trading – profits liable to income tax and NIC. Losses used flexibly
- Not trading – could be capital gains tax or not taxable. Usually lower tax liabilities

The badges of trade

- Tests developed from case law to establish whether trading exists:
  - Subject matter
  - Frequency of transactions
  - Length of ownership
  - Profit motive
  - Supplementary work
  - Manner acquired/reason for sale

Adjustment of profit

Illustrative adjustment

	£
Net profit	X
Add back	
Disallowable expenditure	X
Deduct	
Income assessable elsewhere	(X)
Non taxable income	(X)
Deduct	
Capital allowances	(X)
Trading income	X

- In the exam, you will be asked to begin with net profit and to list all items including a zero if no adjustment is needed

Expenditure not deductible for tax

- Add back to net profit
- General rule = expenditure must be wholly and exclusively for trade
- Many disallowable items, eg capital items, third party entertaining and gifts

Other adjustments of profit

- Ensure any trading income omitted from accounts is taxed (add back)
- Deduct income that isn't taxable or is not taxed as trading income, eg interest
- Deduct any allowable expenses not recorded in accounts, including pre-trading expenditure in last seven years

Cash basis for small businesses

Which businesses can use the cash basis?

- Revenue <£150,000 to start using CB
- When revenue exceeds £300,000 in prior year must usually stop using CB (accruals must apply)

Calculation of taxable profit under the cash basis

- Cash receipts less deductible expenses paid
- Can use fixed rate expenses instead of actual, eg for business mileage

Basis period rules and losses under the cash basis

- Basis period rules = as per accruals accounting
- Losses can only be carried forward

Knowledge diagnostic

1. **Badges of trade**

   The badges of trade are used to decide whether or not a trade exists. If one does exist, the accounts profits need to be adjusted in order to establish the taxable profits.

2. **Adjustment of profits**

   The net profit in the statement of profit or loss must be adjusted to find the taxable trading profit.

   Disallowable (ie non-deductible) expenditure must be added back to the net profit in the computation of the taxable trading profit. Any item not incurred wholly and exclusively for trade purposes is disallowable expenditure. Certain other items, such as depreciation, are specifically disallowable.

   Receipts not taxable as trading profit must be deducted from the net profit. For example, rental income and interest received are not taxable as trading profit. The rental income is taxed instead as property business income, whilst the interest is taxed as savings income.

   Amounts not charged in the accounts that are deductible from trading profits must be deducted when computing the taxable trading income. An example is capital allowances. Amounts not charged in the accounts that are deductible from trading profits must be deducted when computing the taxable trading income. An example is capital allowances.

3. **The cash basis**

   An election can be made for an unincorporated business to calculate trading profits on the cash basis (instead of in accordance with generally accepted accounting principles) in certain circumstances.

   Fixed rate expenses can be used in relation to expenditure on motor cars and business premises partly used as the trader's home.

Further study guidance

Question practice

Now try the following from the Further question practice bank (available in the digital edition of the Workbook):

Section A: Q28, Q29, Q30

Section B: Q31 Margaret

Section C: Q32 Archie

Further reading

ACCA's article *Adjustment of profit*, written by a member of the Taxation (TX – UK) examining team, gives advice on attempting exam questions on adjustment of profit, with a working example of a question in a recent Taxation (TX – UK) exam.

ACCA's article *Motor cars*, written by a member of the Taxation (TX – UK) examining team, explains the implications of acquiring, running, or having the use of a motor car for income tax, corporation tax, value added tax (VAT) and national insurance contributions (NIC).

Activity answers

Activity 1: Disallowed expenses

Expenses	Add back/Do not add back
Legal fees in connection with the acquisition of a freehold building	Add back
Legal fees in connection with the renewal of a 15-year lease on some land	Do not add back
Motor insurance on a van used in her trade	Do not add back
The gift of 25 identical pens bearing Lulu's business to clients (total cost = £1,375)	Add back

Legal fees incurred on the acquisition of capital assets are not allowable, whereas those incurred on the renewal of a short lease are allowed. Motor insurance is a normal business expense incurred wholly and exclusively for the purpose of the trade. The pens are not allowed because, despite bearing a business logo and not being food, drink, tobacco or vouchers, the cost is in excess of £50 per recipient.

Activity 2: Adjustment of profits (2)

		£
Net profit		7,900
Add:	depreciation	2,000
	customer entertaining	2,500
	John's salary	10,000
	car private expenses 20% × 1,500	300
	rent and rates	0
	bank interest paid	0
Less:	bank interest received	(500)
	profit on sale	(700)
Adjusted trading profit		21,500

The bank interest received will be taxed on John as savings income and the profit on disposal is a capital, not a trading receipt.

8 Capital allowances

Learning objectives

On completion of this chapter, you should be able to:

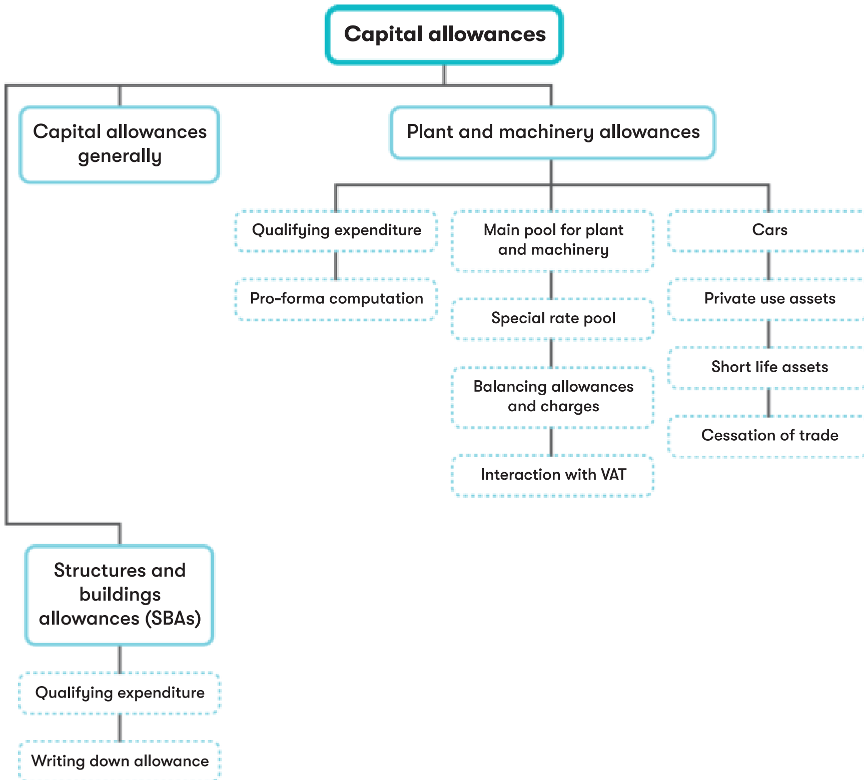
	Syllabus reference no.
Define plant and machinery for capital allowances purposes.	B3(h)(i)
Compute writing down allowances, first year allowances and the annual investment allowance.	B3(h)(ii)
Compute capital allowances for motor cars.	B3(h)(iii)
Compute balancing allowances and balancing charges.	B3(h)(iv)
Compute structures and buildings allowances	B3(h)(v)
Recognise the treatment of short life assets.	B3(h)(vi)
Recognise the treatment of assets included in the special rate pool.	B3(h)(vii)

Exam context

Section A questions on capital allowances may focus on one particular type of asset such as a motor car. You may also be asked to compute capital allowances on a variety of assets in a Section B question. In Section C, you may have to answer a whole question on capital allowances, or a capital allowances computation may be included as a working in a computation of taxable trading profits. This may be as part of a 15-mark question or a 10-mark question.

The computations may be for either income tax or corporation tax purposes; the principles are basically the same. Look out for private use assets; only restrict the capital allowances if there is private use by **traders**, never restrict capital allowances for private use by **employees**. This means that when you calculate capital allowances for a company there will never be any private use adjustments. Also watch out for the length of the period of account; you may need to scale writing down allowances (WDAs) and the annual investment allowance (AIA) up (income tax only) or down (income tax or corporation tax).

Chapter overview



1 Capital allowances generally

Allowances are given against adjusted trading profits in respect of the fall in value, due to business use, of qualifying assets. This replaces depreciation which is disallowed in the adjustment of profits.

Capital allowances are calculated for periods of account (or accounting periods for companies). They are treated as allowable trading expenses in arriving at trading income for the period of account. Balancing charges are treated as trading receipts.

Both unincorporated businesses (sole traders and partnerships) and companies are entitled to capital allowances. For completeness, in this chapter, we will look at the rules for companies alongside those for unincorporated businesses.

Essential reading

Information relating to the date expenditure is deemed to be incurred for capital allowances purposes can be found in your Essential reading.

The Essential reading is available as an Appendix of the digital edition of the Workbook.

PER alert

One of the competencies you require to fulfil Performance Objective 17 *Tax planning and advice* of the PER is to identify when to refer matters to someone with more specialist knowledge. You can apply the knowledge you obtain from this chapter to help to demonstrate this competence.

2 Plant and machinery allowances

2.1 Qualifying expenditure

Include all additions and disposals occurring in the relevant period of account. It does not matter at what point during the period the additions and disposals are made.

Plant and machinery allowances are only available for expenditure on plant and machinery which performs a function in the trade rather than provide a setting within which the trade is carried on. For that reason, capital allowances are available on cars, most factory and office machinery and equipment. They are not available to relieve expenditure on buildings or structures (including doors, floors, windows, bridges, waste disposal and drainage systems). Some integral features of structures, however, do qualify as plant and machinery (see later in this chapter).

Essential reading

Further information on the definition of plant and machinery, including relevant case law, can be found in your Essential reading.

The Essential reading is available as an Appendix of the digital edition of the Workbook.

2.2 Proforma plant and machinery allowances computation

The following format is recommended for use in the exams, for each period of account. As you work through this section of the chapter, you will learn how the content of each column is determined.

	AIA	FYA	Main pool	Special rate pool	Short life assets	Private used asset (40%)	Allowances
	£	£	£	£	£	£	£
TWDV b/fwd			X	X		X	
Additions	X	X	X	X	X		
Disposals (proceeds limited to cost)			(X)			(X)	
			X	X	X	X	
AIA	(X)						X
Tfr to MP/SRP	(X)		X	X	X		
			X	X	X		
FYA 100%		(X)					X
		–					
WDA 18%/6%			(X)	(X)	(X)	(X)	X (× 60% for private use asset)
TWDV c/fwd			X	X	X	X	X

2.3 Main pool for plant and machinery

2.3.1 Qualifying expenditure

Most expenditure on plant and machinery, including expenditure on cars with CO_2 emissions of 110g/km or less, is put into a pool of expenditure (the main pool) on which capital allowances may be claimed. An addition increases the pool whilst a disposal decreases it.

Exceptionally the following items are not put into the main pool:

- Assets dealt with in the special rate pool
- Assets with private use by the trader
- Short life assets where an election has been made

These exceptions are dealt with later in this chapter.

2.3.2 Writing down allowances (WDAs)

Allowances called writing down allowances (WDA) are given at a rate of 18% for a 12-month period of account on the tax written down value (TWDV) after adding the current period's additions and taking out the current period's disposals.

When plant is sold, **proceeds**, limited to a **maximum of the original cost**, are taken **out of the pool.**

2.3.3 Annual Investment Allowance (AIA)

An allowance of 100% is available for the first £1,000,000 of expenditure on plant and machinery for a 12-month period of account.

There is no AIA on purchase of cars.

AIA should be first allocated to additions qualifying for WDA at lower rate (see later in this chapter).

Exam focus point

The AIA limit changed from £1 million to £200,000 on 1 January 2021. However, for the purposes of the TX-UK examinations in June 2021, September 2021, December 2021 and March 2022, it will be assumed that the £1 million limit continues to apply. This will be the case regardless of the period covered by an exam question so, for example, the AIA limit for a year ended 31 March 2021 will be assumed to be £1 million.

Illustration 1: Plant and machinery main pool

Julia is a sole trader preparing accounts to 5 April each year. At 5 April 2020, the tax written down value on her main pool is £12,500.

In the year to 5 April 2021, Julia bought the following assets:

1 June 2020	Machinery	£990,000
12 November 2020	Van	£17,500
10 February 2021	Car for salesman (CO_2 emissions 100g/km)	£9,000

She disposed of plant on 15 December 2020 for £12,000 (original cost £16,000).

Required

Calculate the maximum capital allowances claim that Julia can make for the year ended 5 April 2021.

Solution

	AIA	Main pool	Allowances
	£	£	£
y/e 5 April 2021			
TWDV b/f		12,500	
Additions qualifying for AIA			
1.6.20 Machinery	990,000		
12.11.20 Van	17,500		
	1,007,500		
AIA	(1,000,000)		1,000,000
	7,500		
Transfer balance to pool	(7,500)	7,500	
Additions not qualifying for AIA			
10.2.21 Car		9,000	
Disposal			
15.12.20 Plant		(12,000)	
		17,000	

	AIA	Main pool	Allowances
	£	£	£
WDA @ 18%		(3,060)	3,060
TWDV c/f		13,940	
Maximum capital allowances			1,003,060

Activity 1: Main pool allowances

Mr Foxtrot, a sole trader, draws up accounts to 31 December and incurred the following transactions in the year ended 31 December 2020.

28 April – Bought factory equipment for £155,000

1 May – Sold machine (original cost £6,000) for £2,000

1 August – Bought some forklift trucks for £70,000

The TWDV of the main pool at 1 January 2020 was £28,000

Required

Calculate the allowances to be claimed for the year ended 31 December 2020.

Solution

2.3.4 Small balance on main pool

Where the balance of unrelieved expenditure on the main pool (after additions and disposals) is £1,000 or less, then this balance can all be claimed as a writing down allowance leaving the relevant pool with a nil balance.

2.3.5 Accounting periods longer or shorter than twelve months

The following are pro-rated in accounting periods that are longer or shorter than 12 months:

- Writing down allowances
- The AIA limit of £1 million
- The small pool threshold of £1,000

The allowances and limits are apportioned by multiplying by n/12, where n is the length of the accounting period in months.

Note that for companies, an accounting period can never be longer than 12 months for tax purposes (and therefore the allowances and limits could only ever be scaled down, and not up for a company). We will look at the rules governing long periods of account for companies in Chapter 19 of this Workbook.

2.4 Special rate pool

2.4.1 Qualifying expenditure

Certain items of expenditure are not dealt with in the main pool, but are required to be allocated to the special rate pool. These are:

- **Long life assets:** Assets with an expected working life of 25 years or more, where a business has incurred expenditure of more than £100,000 on such assets in a 12-month period. The £100,000 limit is pro-rated for period of accounts longer or shorter than 12 months. Plant and machinery in dwelling houses, retail shops, showrooms, hotels and offices, and cars, are not treated as long-life assets.
- **Cars** with CO_2 emissions of **over 110g/km**
- Expenditure on plant and machinery that is integral to a building **(integral features).** The following items are integral features:
  - Electrical and lighting systems
  - Cold water systems
  - Space or water heating systems
  - Powered systems of ventilation, cooling or air purification
  - Lifts or escalators

2.4.2 Writing down allowances

The WDA applicable to the SR pool is 6% for a 12-month period of account. This is pro-rated for accounting periods longer or shorter than 12 months.

A small balance on the special rate pool can be claimed as a writing down allowance in a similar way to the main pool.

2.4.3 Allocation of the AIA

The AIA can apply to expenditure on SR pool assets (except cars).

The taxpayer can decide how to allocate the AIA. It will be more tax efficient to set it against the SR pool expenditure rather than main pool expenditure where there is expenditure on assets in both pools in the period.

Activity 2: Special rate pool and AIA allocation

1 The TWDV in Enrique's main pool on 1 April 2020 was £80,000. In May 2020, he spent £1,020,000 on integral features and £5,800 on furniture.

Required

What is the maximum claim for capital allowances for the year ended 31 March 2021?

- O £1,019,044
- O £1,015,948
- O £1,025,800
- O £1,016,644

2 What are the maximum allowances that would have been available if Enrique's accounts had instead been prepared for the six months to 30 September 2020?

£ [ ]

Solution

Exam focus point

Note the tax planning opportunities available. If plant is bought just before an accounting date, allowances become available as soon as possible. Alternatively, it may be desirable to claim less than the maximum allowances to even out annual taxable profits and avoid a higher rate of tax in later years. In the exam, you should always claim the maximum available capital allowances unless you are told otherwise.

2.5 Balancing allowances and charges

When an asset that qualified for capital allowances is disposed of, the proceeds on disposal (limited to purchase cost) are deducted from the TWDV of the pool to which the asset was originally allocated.

If proceeds from the disposal > TWDV of any pool, a balancing charge arises. This is effectively a negative capital allowance and increases taxable profits.

A balancing allowance, where proceeds on disposal are less than the balance on a pool, can only arise on the main and special rate pools on cessation of trade. However, for assets in single pools (see later in this chapter), a balancing allowance may arise when that asset is sold.

2.6 Interaction with VAT

We deal with value added tax (VAT) in Chapters 24 and 25. You may want to make a note to re-read this section when you study VAT.

Qualifying expenditure includes irrecoverable VAT. The VAT may be irrecoverable because the trader is not VAT registered, or because it is the type of expenditure on which the VAT is not recoverable (eg the acquisition of a car not used wholly for business purposes).

If the trader is VAT registered and can reclaim VAT on a purchase, only the expenditure net of VAT will be qualifying expenditure. Similarly, on a disposal of an asset on which capital allowances have been claimed, if VAT is charged by the trader on the disposal, only the disposal proceeds net of VAT will be deducted.

Exam focus point

Not all capital allowances questions will require you to consider VAT. Take care, if the question mentions VAT inclusive or exclusive amounts or states that the trader is VAT-registered, that you make the appropriate VAT adjustments when performing capital allowances calculations

2.7 Cars

The treatment depends on the CO_2 emission of the car. There are three categories:

- Motor cars with CO_2 emissions of 50g/km or less receive 100% first year allowances (FYA). To qualify for FYA, the car must be new (ie unused and not second hand). FYAs are **not** pro-rated for non 12-month accounting periods.
- Motor cars with CO_2 emissions of between 51 and 110g/km (and second-hand low emission cars) go into main pool (no AIA) and receive WDA of 18% pa.
- Motor cars with CO_2 emissions of >110g/km go into SR pool (no AIA) and receive WDA of 6% pa.

Activity 3: Capital allowances on cars

Myles prepares accounts to 31 December each year and incurred the following transactions for the two years to 31 December 2021.

12.2.20 – Bought car for £26,000 with CO_2 emissions of 112g/km

15.2.20 – Sold a car with CO_2 emissions of 132g/km for £2,000 (original cost £12,000)

1.7.20 – Bought car for £19,000, CO_2 emissions of 100g/km

30.7.20 – Sold a car with CO_2 emissions of 84g/km for £1,000 (original cost £15,000)

1.10.21 – Bought car for £8,000, CO_2 emissions of 45g/km

Myles also bought some plant and machinery at a cost of £10,000 in each period of account.

On 1 January 2020, the TWDV of plant and machinery were as follows:

	£
Main pool	25,000
SR pool	8,000

Required

Calculate the capital allowances for the y/e 31 December 2020 and y/e 31 December 2021.

Note. Assume tax rates for the tax year 2020/21 apply throughout.

Solution

2.8 Private use assets

Special rules apply to any asset which is used partly for private purposes by a sole trader or a partner:

(a) Separate calculation for each asset, ie the asset is put into its own pool

(b) Deduct the whole WDA for the period from the TWDV of the asset

(c) Only claim the business proportion of the WDA, by copying only the business proportion into the allowances column

(d) This restriction applies to the AIA, FYAs, WDAs, balancing allowances and balancing charges.

(e) The restriction is not relevant for employee's private use – it applies to a proprietor's private use only. The employee may be taxed under the benefits code (see earlier in this Workbook) so the business receives capital allowances on the full cost of the asset.

Illustration 2: Private use assets

Jacinth has been in business as a sole trader for many years, preparing accounts to 31 March. On 1 November 2020, she bought computer equipment for £2,700 which she uses 75% in her business and 25% privately. She has already used the AIA against other expenditure in the year to 31 March 2021.

Required

Calculate the maximum capital allowance that Jacinth can claim in respect to the computer equipment in the year to 31 March 2021.

Solution

	Computer equipment		Allowances
	£		£
y/e 31 March 2021			
Acquisition	2,700		
WDA @ 18%	(486)	× 75%	365
TWDV c/f	2,214		
Maximum capital allowance on computer equipment			365

Activity 4: Private use assets and balancing adjustments

Felipe starts to trade on 1 April 2019 and prepares accounts to 31 March each year. Felipe buys two cars for his business on 30 June 2019.

Car 1 was bought for £18,000, has CO_2 emissions of 120g/km, and is used by Felipe privately 20% of the time.

Car 2 was bought for £15,000, has CO_2 emissions of 105g/km and is used privately by an employee, Juan Carlos, 50% of the time.

On 1 September 2020, both cars were sold for £10,000.

Required

Calculate his capital allowances for the years ending 31 March 2020 and 31 March 2021.

Note. Assume tax rates for the tax year 2020/21 apply throughout.

Solution

2.9 Short life assets

Short life assets are assets which normally go in the main pool and have an expected life of less than eight years.

As we have seen, balancing allowances cannot normally be claimed on assets in the main pool. However, plant and machinery (except cars) may be 'depooled' on election by the taxpayer. Any asset subject to this election is known as a **'short life asset' (SLA)**, and the election is known as a 'de-pooling election'.

Calculate allowances on each SLA in a separate column. If the SLA is sold **within eight years of the end of the accounting period** in which it was bought, a balancing allowance or charge arises on disposal.

Special treatment is lost on eighth anniversary of the end of the period of account in which the asset was acquired. The asset then automatically returns to the main pool at TWDV.

The election should therefore be made for assets likely to be sold for less than their tax written down values within eight years.

Activity 5: Capital allowance computation - main pool and short-life asset

Guy prepares accounts to 31 March each year. At 1 April 2020, the TWDV values of plant and machinery were as follows:

	£
Main pool	15,000
Short life asset	4,000

The following transactions took place during the year ended 31 March 2021:

15.4.20	Purchased equipment	123,000
31.8.20	Purchased motor car [1]. CO_2 emissions 49g/km	17,000
31.8.20	Purchased motor car [2], CO_2 emissions 112g/km	20,000

2.9.20	Sold a lorry (original cost £9,800)	(12,000)
1.2.21	Sold short life asset (original cost £8,000)	(800)

Required

Calculate Guy's capital allowances for year ended 31 March 2021.

Solution

3 Cessation of trade

When a business ceases to trade, no WDAs, FYAs or AIAs are given in the final period of account.

Additions in the relevant period are brought in and then the disposal proceeds (limited to purchase cost) are deducted from the balance of qualifying expenditure. If the assets are not sold (for example, a trader decides to keep certain items of plant and machinery), each such asset is deemed to be disposed of on the date the trade ceased (usually at the then market value).

Each pool must be 'closed', and so a balancing adjustment must arise on every pool. If the proceeds exceed the TWDV at disposal then a balancing charge arises. If proceeds are less, a balancing allowance is given.

Activity 6: Cessation of trade

Mezan ceased to trade on 31 December 2020 after several years in business. His last period of account was the nine-month period to 31 December 2020. On 1 April 2020 the TWDVs of plant and machinery are as follows:

	£
Main pool	12,000
SR pool (integral features)	18,000

The following transactions took place during the period ended 31 December 2020:

15.4.20	Purchased a van	5,000
31.8.20	Purchased motor car, CO_2 emissions 112g/km	22,000

2.9.20	Sold a van (original cost £18,000)	(9,800)

Mezan kept the car for himself when the market value was £17,500. He scrapped the integral features for no consideration and he sold the other assets for £10,000.

Required

Calculate Mezan's capital allowances for the period ended 31 December 2020.

Solution

4 Structures and buildings allowances

4.1 Qualifying expenditure

A structures and buildings allowance (SBA) is available for qualifying expenditure on **new commercial** structures and buildings for contracts entered into on/after 29 October 2018. For the purpose of the TX-UK exam, all expenditure will have been incurred on or after 6 April 2020 (or 1 April 2020 for companies).

Qualifying expenditure is expenditure on the construction of the building or structure itself (or the acquisition cost if bought from a developer), but **not** the cost of **land**, nor the cost of planning permission, fees and stamp taxes.

Where an existing building is renovated or converted, this expenditure may qualify (even if the underlying property was constructed prior to 29 October 2018).

Commercial structures and buildings include:

- Offices
- Retail and wholesale premises
- Factories
- Warehouses
- Walls
- Bridges
- Tunnels

Residential property or any part of a building which functions as a dwelling does not qualify for SBAs.

Exam focus point

You should assume that for any question involving the purchase (as opposed to a new construction) of a building, the SBA is not available unless stated otherwise.

4.2 Writing down allowance

The allowance is given at 3% **straight line**, over a 33 1/3 year period.

Each building or structure is treated separately, and enhancement expenditure is treated separately to the underlying building.

For SBAs to be claimed, the relevant asset must be in qualifying use, for example used in a trade or property letting business.

The allowance is pro-rated for accounting periods which are not 12 months in length, or where the structure or building is **brought into use or sold during the period**. This is in contrast to plant and machinery allowances which are given in full in the period of acquisition (with no WDA at all in the period of disposal).

There is no balancing adjustment on sale of an SBA asset; however, an adjustment is made to the chargeable gain or capital loss arising, by adding the SBA claimed to the seller's disposal proceeds. You will see chargeable gains for both individuals and companies later in this Workbook.

The new purchaser takes over the remaining allowances (based on the original cost) over the remainder of the 33 1/3 year period. The seller time apportions relief up to the date of the disposal.

Activity 7: SBAs

1 Dumpling Ltd purchases a newly-constructed office building from a developer for £2,050,000 on 1 July 2020 and brought it into use immediately. The purchase price of £2,050,000 includes £50,000 relating to solicitor's fees and other acquisition costs.

Dumpling Ltd prepares accounts to December each year.

Required

What are the maximum SBAs available to Dumpling Ltd in the year ended 31 December 2020?

- O £30,000
- O £30,750
- O £60,000
- O £61,500

2 Dumpling Ltd continued to use the office building for its trade until 30 June 2023, when it was sold to Suet plc for £2,500,000 (excluding land). Suet immediately started using the office for trading purposes.

Suet plc prepares its accounts to March each year.

Required

Which **TWO** of the following statements are correct regarding the implications of the disposal?

- ☐ Dumpling Ltd will not be entitled to any WDA on the building for its year ended 31 December 2023
- ☐ Dumpling Ltd's chargeable gain will increase by £180,000 due to the SBAs claimed
- ☐ Suet plc will claim £75,000 pa writing down allowances on the office
- ☐ Suet plc will time apportion its writing down allowance by 9/12ths in its year ended 31 March 2024

Solution

Chapter summary

Capital allowances

Capital allowances generally

- Relief against trading profits for the fall in value of qualifying assets
- Calculated for periods of account
- Available to all businesses

Structures and buildings allowances (SBAs)

Qualifying expenditure

- Construction/ acquisition from builder of qualifying assets
- Qualifying property includes offices, shops, factories, bridges
- Cost of land and acquisition expenses excluded
- Enhancing/renovating existing property can qualify

Writing down allowance

- 3% straight line
- Apportioned in periods of acquisition and disposal
- SBAs claimed are added to seller's sale proceeds in gain computation

Plant and machinery allowances

Qualifying expenditure

- Function ("with which") vs setting ("within which")
- If asset performs an active function for the trade, it is plant and machinery
- If part of setting, not P&M (may qualify for SBAs)

Pro-forma computation

- Column for each pool/ depooled asset
- Bring in additions, remove assets disposed of, then compute allowances
- Memorandum CA column to sum the allowances available for the AP

Main pool for plant and machinery

- 18% WDA
- AIA max £1m pa (not cars)
- If balance < £1k can claim 100% WDA
- Allowances pro-rated for non-12m APs

Special rate pool

- 6% WDA
- Expected working life > 25 years, P&M integral to a building, and cars with CO_2 emissions > 110g/km
- Allocate AIA to SRP assets in priority (not cars)
- If balance < £1k can claim 100% WDA

Balancing allowances and charges

- BC arises any time a pool is negative after disposals
- BA can only arise on a pool if trade ceases, but can arise at any time on a depooled asset

Interaction with VAT

- If VAT can be reclaimed, CAs are available on net (VAT-exclusive) cost
- If VAT irrecoverable, claim CAs on gross (VAT-inclusive) cost

Cars

- Low emission cars CO_2 of 50g/km or less = 100% FYA
- CO_2 emissions of between 51-110g/km = main pool = 18% WDA
- CO_2 emissions over 110g/km = special rate pool = 6% WDA

Private use assets

- Separate column for each asset
- Reduce TWDV by full WDA
- Only claim business use percentage of WDA
- Balancing adjustment on sale is business use percentage only

Short life assets

- Election on asset by asset basis (not cars)
- Separate column for each asset
- Allows balancing allowance on sale
- Once 8 × WDAs claimed reverts to main pool

Cessation of trade

- No WDA in final period
- Calculate balancing allowances and charges on everything
- Assets removed by trader deemed sale at MV

Knowledge diagnostic

1. **Capital allowances**

   These are deductible in computing trading income and are given to compensate for the wear and tear of qualifying assets.

2. **Writing down allowances**

   Most expenditure on plant and machinery qualifies for a WDA at 18% for a 12-month period. A WDA of 6% applies for special rate pool expenditure. Small pool balances up to £1,000 can be written off in full.

3. **Annual investment allowance**

   An annual investment allowance of 100% is available for the first £1,000,000 of expenditure on plant and machinery (not cars) for a 12-month period of account.

4. **Balancing allowances and charges**

   Balancing charges arise at any time when proceeds exceed TWDV of the pool. Balancing allowances on the main and special rate pools can only arise on cessation.

5. **Depooled assets**

   Assets with private use by the proprietor are not pooled. Only the business proportion of WDAs and balancing adjustments can be claimed.

   Short life assets can be 'depooled'. A balancing allowance may be claimed if proceeds from the disposal are less than the TWDV of the pool.

6. **Cessation of trade**

   When a business ceases to trade no WDAs, FYAs or AIAs are given in the final period of account. Assets removed by the trader are deemed to be sold at market value. Balancing adjustments will arise.

7. **Structures and buildings allowances**

   Qualifying buildings constructed since October 2018 are entitled to a 3% straight-line writing down allowance on cost.

Further study guidance

Question practice

Now try the following from the Further question practice bank (available in the digital edition of the Workbook):

Section A: Q33, Q34 and Q35

Section B: Q36 Sylvester

Section C: Q37 Tom

Further reading

ACCA's article *Motor cars*, written by a member of the Taxation (TX – UK) examining team, explains the implications of acquiring, running, or having the use of a motor car for income tax, corporation tax, value added tax (VAT) and national insurance contribution (NIC).

Activity answers

Activity 1: Main pool allowances

Year ended 31 December 2020			AIA	Main pool	Allowances
			£	£	£
TWDV b/fwd				28,000	
Additions:	28 April	– factory equipment	155,000		
	1 August	– forklift trucks	70,000		
Disposal:	1 May	– machinery		(2,000)	
			225,000	26,000	
AIA			(225,000)		225,000
				26,000	
WDA 18%				(4,680)	4,680
TWDV c/fwd				21,320	229,680

Activity 2: Special rate pool and AIA allocation

1 The correct answer is: £1,016,644

Year ended 31 March 2021	AIA	Main pool	Special rate pool	Allowances
	£	£	£	£
TWDV b/f		80,000		
Additions:				
Integral features	1,020,000			
Furniture		5,800		
		85,800		
AIA (best use)	(1,000,000)			1,000,000
Transferred to SR pool	(20,000)		20,000	
			20,000	
WDA 18%/6%		(15,444)	(1,200)	16,644
TWDV c/f		70,356	18,800	1,016,644

The answer £1,019,044 gives WDA @ 18% on the special rate pool. The answer £1,015,948 sets the AIA against the furniture and then the balance against the integral features. The answer £1,025,800 is 100% relief on the additions.

2 £ 523,322

Period ended 30 September 2020	AIA	Main pool	Special rate pool	Allowances
	£	£	£	£
TWDV b/f		80,000		
Additions:				
Integral features	1,020,000			
Furniture		5,800		
		85,800		
AIA (best use): £1m × 6/12	(500,000)			500,000
Transferred to SR pool	(520,000)		520,000	
			520,000	
WDA 18%/6% × 6/12		(7,722)	(15,600)	23,322
TWDV c/f		78,078	504,400	523,322

Note that both the limit of the AIA and the WDAs are time apportioned to take account of the short accounting period.

Activity 3: Capital allowances on cars

	AIA	FYA	Main pool	Special rate pool	Allowances
	£	£	£	£	£
Y/e 31.12.20					
TWDV b/f			25,000	8,000	
Additions	10,000		19,000	26,000	
Disposals			(1,000)	(2,000)	
			43,000	32,000	
AIA	(10,000)		-	-	10,000
WDA 18%/ 6%			(7,740)	(1,920)	9,660
c/f			35,260	30,080	19,660
Y/e 31.12.21					
TWDV b/f			35,260	30,080	
Additions	10,000	8,000			
AIA/FYA 100%	(10,000)	(8,000)	–	–	18,000
		–	35,260	30,080	
WDA 18%/6%			(6,347)	(1,805)	8,152
c/f			28,913	28,275	26,152

Activity 4: Private use assets and balancing adjustments

	Main pool	Privately used asset (80%)		Allowances
	£	£		£
Y/e 31.3.20				
Addition	15,000	18,000		
WDA 18%/6%	(2,700)	(1,080)	× 80%	3,564
Allowances				3,564
TWDV c/f	12,300	16,920		
Y/e 31.3.21				
TWDV b/f	12,300	16,920		
Disposal	(10,000)	(10,000)		
	2,300			
WDA 18%	(414)			414
Balancing allowance		6,920	× 80%	5,536
Allowances				5,950
TWDV c/f	1,886			

Remember, no balancing allowance is available on the main pool unless the business has ceased.

Activity 5: Capital allowance computation - main pool and short-life asset

	AIA	FYA	Main pool	Special Rate pool	SLA	Allowances
	£	£	£	£	£	£
Y/e 31.3.21						
TWDV b/fwd			15,000		4,000	
Addition – equipment	123,000					
– car [1]		17,000				
– car [2]				20,000		
Disposal						
– lorry (cost)			(9,800)			
– SLA					(800)	
	123,000					
AIA @ 100%	(123,000)					123,000
	–					
FYA @ 100%		(17,000)				17,000
		–	5,200	20,000	3,200	
WDA @ 18%/6%			(936)	(1,200)		2,136

	AIA	FYA	Main pool	Special Rate pool	SLA	Allowances
	£	£	£	£	£	£
Balancing allowance			–	–	(3,200)	3,200
TWDV c/fwd			4,264	18,800	–	
						145,336

Activity 6: Cessation of trade

	M pool	SR pool	Allowances
	£	£	£
9 m/e 31.12.20			
TWDV b/fwd	12,000	18,000	
Addition – van	5,000		
– car		22,000	
Disposal – van	(9,800)		
Cessation	(10,000)	(17,500)	
	(2,800)	22,500	
Balancing allowance	–	(22,500)	22,500
Balancing charge	2,800	–	(2,800)
	Nil	Nil	19,700

Activity 7: SBAs

1 The correct answer is: £30,000

£2,000,000 × 3% × 6/12 = £30,000

The cost of acquisition excludes acquisition fees. The SBA must be time-apportioned in the year of acquisition.

2 The correct answers are:

- Dumpling Ltd's chargeable gain will increase by £180,000 due to the SBAs claimed
- Suet plc will time apportion its writing down allowance by 9/12ths in its year ended 31 March 2024

Statement 1 is incorrect as the seller may claim a time-apportioned WDA in the year of disposal.

Statement 2 is correct, as Dumpling Ltd would have claimed (3 × 3% × £2,000,000) = £180,000 of SBAs at the date of disposal, which are added to the proceeds in its chargeable gain computation.

Statement 3 is incorrect, as SBAs are based on the original qualifying cost of £2 million.

Statement 4 is correct, as the building was brought into qualifying use by Suet plc on 1 July 2023, and therefore the WDA must be multiplied by 9/12.

9 Assessable trading income

Learning objectives

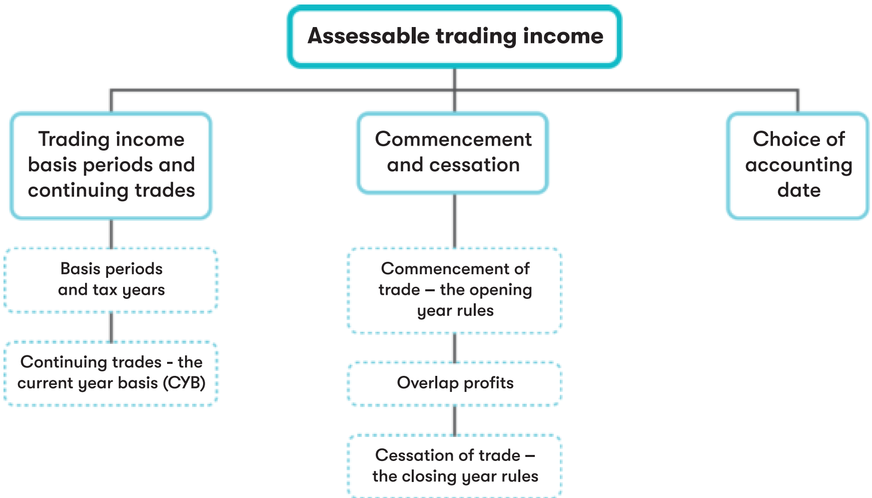
On completion of this chapter, you should be able to:

	Syllabus reference no.
Recognise the basis of assessment for self-employment income.	B3(a)
Compute the assessable profits on commencement and on cessation.	B3(f)
Recognise the factors that will influence the choice of accounting date.	B3(g)

Exam context

You are likely to have to deal with a tax computation for an unincorporated business in any of Sections A, B or C. It may be a simple computation for a continuing business, or you may have to deal with a business in its opening or closing years, including computing taxable trading profits and allocating them to tax years. You must be totally familiar with the rules and be able to apply them in the exam. These topics may be tested in a 15-mark question or a 10-mark question in Section C. A specific point, such as computing an amount of overlap profits, may be tested in Sections A or B.

Chapter overview



1 Trading income basis periods and continuing trades

1.1 Basis periods and tax years

A tax year runs from 6 April to 5 April, but most businesses do not have periods of account ending on 5 April. Thus, there must be a link between a period of account of a business and a tax year. The procedure is to find a period to act as the **basis period** for a tax year.

KEY TERM

Basis period: The profits for a basis period are taxed in the corresponding tax year.

If a basis period is not identical to a period of account, the profits of periods of account are time-apportioned as required (on a **monthly basis for exam purposes**) on the assumption that profits accrue evenly over a period of account.

1.2 Continuing trades - the current year basis (CYB)

The general rule is that the basis period is the year of account ending in the tax year. This is known as the **current year basis** of assessment. For example, if a trader prepares accounts to 31 December each year, the profits of the year to 31 December 2020 will be taxed in the tax year 2020/21.

Activity 1: Current year basis

A business which has been trading for many years has a year end of 31 March.

Recent adjusted profits are:

Year ended	£
31 March 2020	22,000
31 March 2021	18,000
31 March 2022	30,000

Required

1 What profits will be assessed in 2020/21?

2 What profits would be assessed if instead the year end was 30 April?

Solution

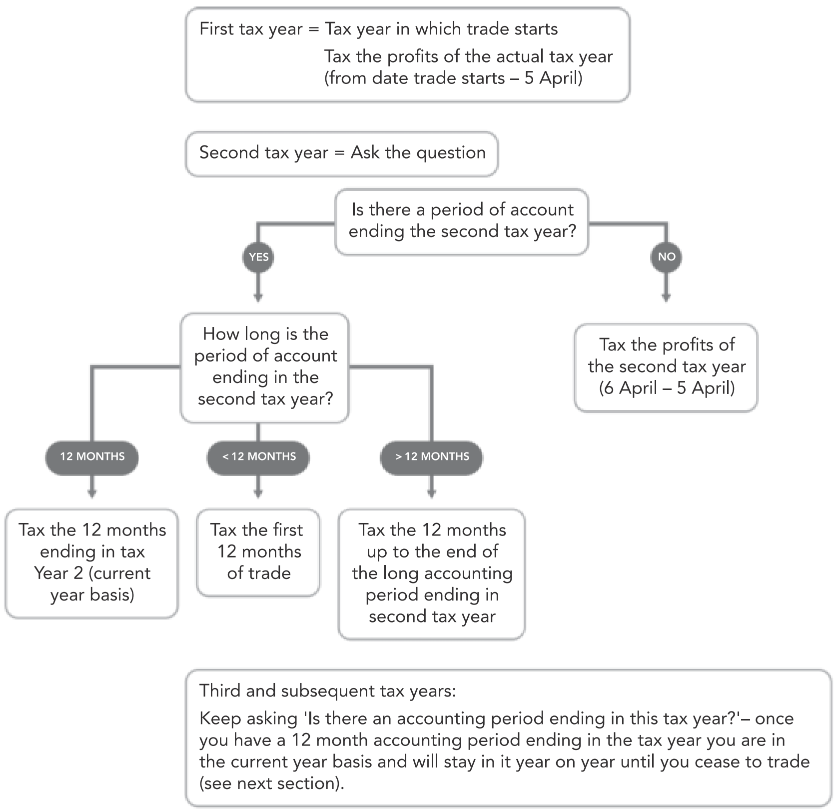
2 Commencement and cessation

The current year basis does not apply in the opening or closing years of a business. This is because in the first few years the business has not normally established a pattern of annual accounts, and very few businesses cease trading on the annual accounting date.

Apart from the first tax year of trade and the last tax year of trade, HM Revenue & Customs (HMRC) will expect to see 12 months of profits showing in the income tax computation each year. As the periods of account may not be 12 months long in the opening and closing years, special rules are needed to establish which 12 months should be allocated to which tax year.

2.1 Commencement of trade - the opening year rules

The following diagram shows the method of determining the basis period for the first three tax years of trading:



2.2 Overlap profits

KEY TERM

Overlap profits: Profits which have been taxed more than once are called **overlap profits**.

When a business starts, some profits may be taxed twice because the basis period for the second year includes some or all of the period of trading in the first year or because the basis period for the third year overlaps with that for the second year, or both.

Overlap profits are relieved when the trade ceases by being deducted from the final year's taxable profits.

Illustration 1: Opening year rules (1)

Jonathan commences business on 1 January 2019 and makes up his first accounts to 30 June 2019 and then 30 June annually thereafter. The tax-adjusted trade profits after capital allowances are as follows:

Period		
6 months	to 30 June 2019	£10,000
Year	to 30 June 2020	£18,000
Year	to 30 June 2021	£26,000

Required

Apply the opening year basis period rules to work out what profits are taxed in which tax years. Determine the date(s) and amount(s) of overlap profits.

Solution

1st tax year: 2018/19 – tax profits 1.1.19 – 5.4.19

2nd tax year: 2019/20

- Is there a period of account ending in 2019/20? (Yes, the period ended 30.6.19)
- How long is the period of account?
  - Less than 12 months, ie six months long.
- So, in 2019/20, tax the profits of the first 12 months of trade (1.1.19–31.12.19), ie:
  - pe 30.6.19 profits; plus
  - 6/12 of y/e 30.6.20 profits.

3rd tax year: 2020/21 - CYB, ie profits of year ended 30 June 2020

Overlap periods:

- The period 1.1.19 - 5.4.19 is taxed in both 2018/19 and 2019/20
- The period 1.7.19 - 31.12.19 is taxed in both 2019/20 and 2020/21

Tax year	Calculation		£
2018/19	Actual (1.1.19 – 5.4.19)		5,000
	First 12 months (1.1.19 – 31.12.19)		
	1.1.19 – 30.6.19	10,000	
	1.7.19 – 31.12.19 (6/12 × £18,000)	9,000	
2019/20			19,000
2020/21	CYB (year to 30.6.20)		18,000
2021/22	CYB (year to 30.6.21)		26,000
	1.1.19 – 5.4.19	5,000	
Overlap profits	1.7.19 – 31.12.19	9,000	14,000

Activity 2: Opening year rules (2)

Scott commences trading on 1 January 2019 and makes up his first accounts to 30 June 2020 and then 30 June annually thereafter.

	£
18 months to 30 June 2020	27,600
Year ended 30 June 2021	26,000

Required

What are his assessments based on these profits and what are his overlap profits?

Solution

Activity 3: Opening year rules (3)

Peter begins trading on 1 July 2019. He decides on a December year end but draws up his first accounts to 31 December 2020.

He made £18,000 profit in the 18 months to 31 December 2020 and £15,000 in the year ended 31 December 2021.

Required

What are his assessments based on these profits and what are his overlap profits?

Solution

Exam focus point

A business with a 31 March year end will have no overlap profits as its accounting year coincides with the tax year. A business with a 31 December year end, for example, will have three months of overlap profit as its accounting year ends three months before the end of the tax year. Use this rule of thumb to check your calculation of overlap profits.

2.3 Cessation of trade - the closing year rules

If the final year is the third year or a later year, the basis period runs from the end of the basis period for the previous year (which will have been assessed under the current year basis) to the date of cessation. This rule overrides the rules that normally apply in the third and later years.

Remember, overlap profits are deducted from the final tax year's taxable profits. Any deduction of overlap profits may create or increase a loss (see next chapter).

Essential reading

Your Essential reading contains details of the basis period rules where cessation happens in the first two tax years of trading.

The Essential reading is available as an Appendix of the digital edition of the Workbook.

Activity 4: Closing year rules

1 Albert, who has been trading for some years making up his accounts to 31 December, ceases to trade on 31 March 2021 with profits as follows:

	Adjusted profits
	£
Year to 31 December 2019	19,000
Year to 31 December 2020	22,000
3 months to 31 March 2021	12,000

The overlap profits arising in the opening years of his trade were £3,500.

Required

What is Albert's trading income assessment in the tax year 2019/20?

- O £19,000
- O £22,000
- O £19,750
- O £15,500

2 What is Albert's trading income assessment in the tax year 2020/21?

- O £18,500
- O £22,000
- O £30,500
- O £34,000

Solution

Essential reading

Your Essential reading contains an example illustrating the basis periods over the full life of a business, from commencement to cessation.

The Essential reading is available as an Appendix of the digital edition of the Workbook.

3 Choice of accounting date

The choice of an accounting date may affect when tax is payable on trading profits. It may also create overlap profits and help or hinder tax planning.

A new trader should consider which accounting date would be best. There are a number of factors to consider from the point of view of taxation.

- If profits are expected to rise, a date early in the tax year (such as 30 April) will delay the time when rising accounts profits feed through into rising taxable profits.
- An accounting date of 30 April gives the greatest time between earning the profits and paying the tax.
- Knowing profits well in advance of the end of the tax year makes tax planning easier.
- A 31 March/5 April year end is more straightforward and avoids overlap profits.
- The choice of an accounting date affects the profits shown in each set of accounts, and this may affect the taxable profits (especially for heavily seasonal businesses).

Essential reading

These points are examined in more detail in your Essential reading, along with a numerical example comparing the assessable profits with three different accounting date choices.

The Essential reading is available as an Appendix of the digital edition of the Workbook.

Chapter summary

Assessable trading income

Trading income basis periods and continuing trades

Basis periods and tax years
- Basis period rules are used to allocate profits and losses of accounting periods to tax years

Continuing trades - the current year basis (CYB)
- CYB rule – tax the 12m accounting period ending in the tax year

Commencement and cessation

Commencement of trade – the opening year rules
- First tax year = tax year in which trade starts
  Tax the profits of the actual tax year (from date trade starts – 5 April)
- Second tax year = Ask the question:

Is there a period of account ending the second tax year?

- YES → How long is the period of account ending in the second tax year?
  - 12 MONTHS → Tax the 12 months ending in tax year 2 (current year basis)
  - < 12 MONTHS → Tax the first 12 months of trade
  - > 12 MONTHS → Tax the 12 months up to the end of the long accounting period ending in second tax year
- NO → Tax the profits of the second tax year (6 April – 5 April)

- Third and subsequent tax years:
  Keep asking 'Is there an accounting period ending in this tax year?'– once you have a 12 month accounting period ending in the tax year you are in the current year basis and will stay in it year on year until you cease to trade

Overlap profits
- Profits taxed twice due to OYRs
- Relief given on cessation

Cessation of trade – the closing year rules
- Penultimate tax year: CYB
- Final tax year: all remaining profits less overlap relief

Choice of accounting date

- 30 April (ie early in tax year) delays time between profits being earned and taxed
- Dates earlier in tax year also give more time for tax planning
- 31 March/5 April avoids overlap profits

Knowledge diagnostic

1. **Current year basis**

   Trading income is assessed on a CYB, ie profits of a period of account ending in that tax year.

2. **Opening year rules**

   When a trade starts, special rules apply initially to get the trader onto the CYB. Overlap profits will arise unless a 31 March or 5 April year end is selected.

3. **Closing year rules**

   On cessation, special rules apply to make sure all the trade profits are taxed. Any overlap profits are relieved in the final tax year.

4. **Choice of accounting date**

   The choice of accounting date can affect when the tax is paid and the amount of any overlap profits.

Further study guidance

Question practice

Now try the following from the Further question practice bank (available in the digital edition of the Workbook):

Section A: Q38, Q39, Q40

Section C: Q41 Clive, Q42 Fiona

Activity answers

Activity 1: Current year basis

1 Profits assessed on a current year basis

2020/21 - year ended 31 March 2021: £18,000

2 2020/21 - year ended 30 April 2020: £22,000

Activity 2: Opening year rules (2)

Tax year	Calculation	£
	Actual (1.1.19 – 5.4.19)	
	3/18 × £27,600	
2018/19		4,600
	Actual (6.4.19 – 5.4.20)	
	12/18 × £27,600	
2019/20		18,400
	12m to a/c date (1.7.19 – 30.6.20)	
2020/21	12/18 × £27,600	18,400
2021/22	CYB (year to 30.6.21)	26,000
	1.7.19 – 5.4.20	
Overlap profits	9/18 × £27,600	13,800

Activity 3: Opening year rules (3)

Tax year	Calculation	£
	Actual (1.7.19 – 5.4.20)	
	9/18 × £18,000	
2019/20		9,000
	12 months to 31.12.20	
	12/18 × £18,000	
2020/21		12,000
2021/22	CYB (year to 31.12.21)	15,000
	1.1.20 – 5.4.20	
Overlap profits	3/18 × £18,000	3,000

Activity 4: Closing year rules

1 The correct answer is: £19,000

		£
2019/20	CYB (y/e 31.12.19)	19,000

The answer £22,000 is profit for the y/e 31.12.20. The answer £19,750 uses the actual basis for 2019/20. The answer £15,500 deducts the overlap profits.

2 The correct answer is: £30,500

		£
2020/21	Year ended 31.12.20	22,000
	3 months to 31.3.21	12,000
	Less 'overlap' relief	(3,500)
		30,500

The answer £18,500 is the profits for the year ended 31.12.20 less overlap profits. The answer £22,000 is the profits for the year ended 31.12.20. The answer £34,000 does not deduct the overlap profits.

10 Trading losses

Learning objectives

On completion of this chapter, you should be able to:

	Syllabus reference no.
Understand how trading losses can be carried forward	B3(i)(i)
Understand how trading losses can be claimed against total income and chargeable gains, and the restriction that can apply	B3(i)(ii)
Explain and compute the relief for trading losses in the early years of a trade	B3(i)(iii)
Explain and compute terminal loss relief	B3(i)(iv)
Recognise the factors that will influence the choice of loss relief claim	B3(i)(v)

Exam context

Section A questions on loss relief may deal with a specific aspect such as the cap on loss relief against general income. You may also have to deal with a number of aspects of loss relief in a Section B question. Section C could have a detailed computational question involving the carry back and carry forward of losses for a sole trader. Ensure you know the rules for ongoing trades and the additional relief in the early years of trading. On cessation, terminal loss relief may be used. Once you have established the reliefs available look to see which is most beneficial.

Business context

If a trader generates losses, it may well be that they are in financial difficulty (especially if they do not have significant other source of income). A tax adviser's role can then be important, to give appropriate advice as to the use of the loss to optimise the individual's cash flow position.

Chapter overview

- **Trading losses**
  - Trading losses and reliefs
    - Calculating a loss
    - Relieving the loss
  - Continuing trades
    - Loss relief against total income (TI)
      - Restrictions on relief against general income
    - Carry forward loss relief
      - Trading losses relieved against capital gains
  - Losses in opening years
    - Application of basis period rules
    - Loss relief options
    - Early trade loss relief
  - Terminal loss relief (TLR)
    - Loss relief options on cessation of trade
    - Terminal loss relief
  - Choice of loss relief and other planning
    - The choice between loss reliefs
    - Disclaiming capital allowances

1 Trading losses and reliefs

1.1 Calculating a loss

A tax loss is computed in exactly the same way as a taxable profit, making the same adjustments to the accounts profit or loss. The loss is the (negative) adjusted figure after capital allowances for an accounting period.

If there is a loss in a basis period, the taxable trade profits for the tax year based on that basis period are nil. Never put in a negative assessment.

1.2 Relieving the loss

The taxpayer will be able to claim relief for the loss by setting it against income in accordance with legislation. This will involve deducting the loss from either total income, chargeable gains, or future trading income, depending on which form of loss relief is used.

PER alert

One of the competencies you require to fulfil Performance Objective 17 *Tax planning and advice* of the PER is to mitigate and/or defer tax liabilities through the use of standard reliefs, exemptions and incentives. You can apply the knowledge you obtain from this chapter of the Workbook to help to demonstrate this competence.

2 Continuing trades

2.1 Loss relief against total income

A claim may be made by a taxpayer to offset a trading loss against their general income.

- The loss available for relief is the loss in the basis period for that tax year.
- Loss relief is against total income of:
  - The tax year in which the loss was suffered (known as a 'current year claim'); and/or
  - The preceding tax year (known as a 'carry back claim').
- If claims against both current and prior year income are made, the taxpayer can specify in which order the loss is used (ie current year and then prior year, or *vice versa*)
- The loss is offset against non-savings income as far as possible, and then against savings income and finally dividends.
- If a claim is made, the maximum possible loss must be set off (ie the loss may have to be set against income part of which would have been covered by the personal allowance or taxed at 0% in the savings income nil rate band or the dividend nil rate band).

Illustration 1: Loss relief against total income (1)

Janet has a loss in her period of account ending 31 December 2020 of £38,500. Her other income is dividend income of £31,500 a year, and she wishes to claim loss relief against general income for the year of loss and then for the preceding year. Her trading income in the previous year was £1,500.

Required

Show her taxable income for each year, and comment on the effectiveness of the loss relief. Assume that tax rates and allowances for 2020/21 have always applied.

Solution

The loss-making period ends in 2020/21, so the year of the loss is 2020/21.

	2019/20	2020/21
	£	£
Total income (£31,500 + £1,500)/£31,500	33,000	31,500
Less loss relief against general income	(7,000)	(31,500)
Net income	26,000	0
Less personal allowance	(12,500)	(12,500)
Taxable income	13,500	0

In 2020/21, (£2,000 + £12,500) = £14,500 of the loss has been wasted because that amount of income would have been covered by the personal allowance and the dividend nil rate band and the remainder of the loss will attract tax relief at the relatively low rate of 7.5%. If Janet claims loss relief against general income in that tax year, there is nothing she can do about this inefficient use of loss relief.

Activity 1: Relief against total income

Feng runs a market stall. Accounts for the year ended 30 June 2019 show a trading profit of £16,000. For the year ended 30 June 2020 there is a trading loss of £34,000. In the year ended 30 June 2021, he made a trading profit of £6,000. His only other income was property income of £15,000 each tax year.

Required

Show how the loss is relieved if he makes the earliest claim(s) to set his trading loss against total income.

Solution

2.2 Restrictions on relief against general income

There are two circumstances where loss relief against general income is either not permitted or is restricted.

2.2.1 Commercial basis

Relief cannot be claimed against general income unless the loss-making business is conducted on a commercial basis with a view to the realisation of profits throughout the basis period for the tax year.

2.2.2 Cap on income tax relief

If loss relief is claimed against total income the maximum that can be relieved is the **higher** of:

(a) £50,000

(b) 25% of person's total income (after deducting gross personal pension contributions)

The cap is applied separately to the total income for each year for which relief is claimed.

This restriction does not apply where a loss is relieved against profits of the same trade for the preceding tax year. The restriction only applies to the offset of losses against other income in that year.

Activity 2: Cap on income tax relief - high income

Paul has traded for many years. Recent results are as follows:

Year ended	£
30.6.19	40,000
30.6.20	(200,000)

He has other income of £100,000 per annum.

Required

Calculate Paul's taxable income for 2019/20 and 2020/21 assuming the largest and earliest claim against total income is made. Assume the personal allowance is £12,500 in both tax years.

Solution

2.3 Carry forward loss relief

If no claim is made to set loss against total income, or some of the loss is left after such a claim, then the balance will be carried forward indefinitely.

A carried forward loss is relieved against the first available future profits from the same trade.

Set-off is automatic and compulsory.

Activity 3: Carry forward loss relief

Bert Gown has traded for many years. Recent results are as follows:

	£
31.12.18	20,000

	£
31.12.19	(46,000)
31.12.20	(30,000)
31.12.21	8,000

He has other income of £13,000 per annum.

Required

Calculate the net income for 2018/19 to 2021/22 assuming that the largest and earliest possible claims against total income are made, and show the losses to be carried forward against future trading profits.

Solution

2.4 Trading losses relieved against capital gains

If a claim is made against total income, the taxpayer can make a further claim to offset any remaining loss against the chargeable gains for the year. Offset must be made against total income in that year first.

Essential reading

Further detail and an example of this relief is contained in your Essential reading. You will study chargeable gains later in this Workbook and we suggest that you come back to this section at that point.

The Essential reading is available as an Appendix of the digital edition of the Workbook.

3 Losses in opening years

3.1 Application of basis period rules

Under the rules determining the basis period for the first three tax years of trading, there may be periods where the basis periods overlap (as seen in Chapter 9). If profits arise in these periods, they are taxed twice but are relieved later, usually on cessation. However, a loss in an overlap period can only be relieved once. It must not be double counted.

Therefore If basis periods overlap, the opening year rules are modified such that a loss in the overlap period is treated as a loss for the earlier tax year only.

3.2 Loss relief options

The taxpayer has the following reliefs available:

- Loss relief against total income
- Carry forward relief
- Early trade loss relief

3.3 Early trade loss relief

This relief is available in respect of trading losses incurred in the first four tax years of trade.

The relief enables the loss to be carried back three tax years on a first in, first out basis (FIFO) ie applying the loss to the earliest year first. The loss is deducted from the taxpayer's total income.

A claim applies to all three carryback years automatically provided that the loss is large enough. The taxpayer cannot choose to relieve the loss against just one or two of the years, or to relieve only part of the loss.

The advantage of early trade losses relief is that it enables losses to be carried back for three years and so gives relief earlier than the other loss reliefs.

Activity 4: Early trade loss relief

Bob Fisher commenced trading on 1 July 2017. Results are as follows:

Year ended		£
30.6.18	Loss	(40,000)
30.6.19	Profit	24,000
30.6.20	Profit	30,000
30.6.21	Profit	36,000

Bob's total income prior to 2017/18 was £68,000 in each tax year. Bob has no other income.

Required

1. Determine Bob's trading income assessments based on the above results, and to which year(s) Bob's trading loss is attributed under the opening year rules.
2. Explain what loss reliefs are available to Bob for his trading losses of 2017/18 and 2018/19. Advise Bob on the best use of his losses.

Solution

Essential reading

A further illustration of the rules regarding overlapping losses can be found in the Essential reading.

The Essential reading is available as an Appendix of the digital edition of the Workbook.

4 Terminal loss relief (TLR)

4.1 Loss relief options on cessation of trade

Carry forward relief is no longer available when a trade has ceased. A loss arising in the final tax year of assessment (after closing year rules are applied) may be relieved by loss relief against general income in the normal way.

However, trade loss relief against general income will often be insufficient on its own to deal with a loss incurred in the last months of trading. For this reason there is a special relief, terminal trade loss relief, which allows a loss on cessation to be carried back for relief against taxable trading profits in previous years.

4.2 Terminal loss relief

4.2.1 Operation of the relief

Terminal loss relief (TLR) allows relief against **trading** profits of the tax year of cessation and the three preceding years, on a last in, first out (LIFO) basis

4.2.2 Calculation of the terminal loss

The loss of the last period of account is increased by any overlap profits.

The loss available for relief under TLR is the actual loss in the last 12 months of trading, constructed as follows:

(a) **Final tax year**

	£
Unrelieved trading loss from 6 April to date of cessation (increased by overlap profits)	X

(b) **Penultimatetax year**

Unrelieved trading loss (if any) arising from a date 12 months before cessation to 5 April	X
	X

If either (a) or (b) above yields a profit as opposed to a loss, the profit is regarded as zero for this purpose.

12m ← 6/4 → Cessation

Penultimate TY		Final TY	
Loss	X	Loss	X
Profit	(X)	Overlap profits	X
Ignore if profit	X		X

Terminal loss

Activity 5: Terminal loss relief

Ali commenced trading on 1 May 2011 making up accounts to 30 September each year. She ceased trading on 30 June 2020. The most recent results were:

Year 30 September 2016	£10,000 profit
Year 30 September 2017	£8,000 profit
Year 30 September 2018	£10,000 profit
Year 30 September 2019	£4,000 profit
Period to 30 June 2020	£27,000 loss

Ali had overlap profits from the commencement of trade of £3,000.

Required

1 What is Ali's maximum claim for terminal loss relief?

£ ____

2 Identify, by clicking on the relevant boxes in the table below, the amount of terminal loss relief that can be utilised in the tax years 2016/17 and 2017/18

2016/17: ____ (1)

2017/18: £ ____ (2)

Pull down list 1

- nil
- £10,000
- £7,000

Pull down list 2

- 8,000
- £4,000
- £nil

Solution

5 Choice of loss relief and other planning

5.1 The choice between loss reliefs

To decide on whether a loss should be relieved in the current year, carried back or carried forward will involve consideration of:

(a) Marginal rates of tax - offsetting a loss against income of a year where the taxpayer is being taxed at the higher rate is more tax-efficient than a year where the taxpayer pays basic rate tax

(b) Timing of tax payments/repayments: The carry back of a loss results in a refund of the relevant amount of income tax already paid

(c) The possibility of personal allowance, savings nil rate band and dividend nil rate band being wasted, due to the fact that a taxpayer cannot specify the amount of loss they wish to use

Illustration 2: Choice of loss relief

Felicity's trading results are as follows.

Year ended 30 September	Trading profit/(loss)
	£
2019	3,900
2020	(21,000)
2021	14,000

Her other income (all non-savings income) is as follows.

	£
2019/20	8,300
2020/21	35,000

	£
2021/22	19,500

Required

Show the most efficient use of Felicity's trading loss. Assume that the personal allowance has been £12,500 throughout.

Solution

Relief could be claimed against general income for 2020/21 and/or 2019/20, with any unused loss being carried forward. Relief in 2019/20 would be against general income of £(3,900 + 8,300) = £12,200, all of which would be covered by the personal allowance anyway, so this claim should not be made.

A claim against general income should be made for 2020/21 as this saves tax more quickly than carry forward loss relief would in 2021/22.

The final results will be as follows:

	2019/20	2020/21	2021/22
	£	£	£
Trading income	3,900	0	14,000
Less carry forward loss relief	(0)	(0)	(0)
	3,900	0	14,000
Other income	8,300	35,000	19,500
	12,200	35,000	33,500
Less loss relief against general income	(0)	(21,000)	(0)
Net income	12,200	14,000	33,500
Less personal allowance	(12,500)	(12,500)	(12,500)
Taxable income	0	1,500	21,000

5.2 Disclaiming capital allowances

Essential reading

Your Essential reading shows you another planning tool that can be used to minimise the wastage of a loss: adjusting a capital allowances claim.

The Essential reading is available as an Appendix of the digital edition of the Workbook.

Chapter summary

Trading losses

Trading losses and reliefs

Calculating a loss
- Follows the same principles as for calculating assessable profits

Relieving the loss
- Taxpayer claims relief in accordance with legislation

Continuing trades

Loss relief against total income (TI)
- Deduct loss from TI of year of the loss and/or preceding year
- All or nothing (must use maximum amount possible)

Restrictions on relief against general income
- Business must be conducted on commercial basis
- Maximum offset vs non-trade income higher of:
  - £50,000, or
  - 25% of total income after gross PPC

Carry forward loss relief
- Carry forward against trading profits of same trade
- Automatic (no claim required)

Trading losses relieved against capital gains
- Extension of loss relief against total income
- Offset against TI for year of gain must be done first
- Extra claim to use vs gains
- Max set off = net gains less capital losses b/f

Losses in opening years

Application of basis period rules
- Loss can only be relieved once (no overlap)

Loss relief options
- Relief against TI
- Carry forward relief
- Early trade loss relief

Early trade loss relief
- Losses in first four tax years
- Carry back against TI of three preceding tax years
- FIFO basis
- All or nothing, and one claim for all three preceding years

Terminal loss relief (TLR)

Loss relief options on cessation of trade
- Relief against TI
- No carry forward relief (trade ceased)
- Terminal loss relief

Terminal loss relief
- Loss of final 12 months (plus overlap)
- Offset against trading income in year of cessation and three preceding tax years
- LIFO basis

Choice of loss relief and other planning

The choice between loss reliefs
- Consider:
  - Marginal rates of tax
  - Timing of tax payments/repayments
  - Wastage of PA, SNRB, DNRB

Disclaiming capital allowances
- Consider reducing CA claim in order to preserve CA pools
- Could generate larger tax savings in future years

Knowledge diagnostic

1. **What to do with trading losses**

   Trading losses are computed in exactly the same way as trading income (although there are no overlap losses).

   It is then up to the taxpayer to decide how to relieve the loss.

2. **Continuing trades**

   Trading losses can be relieved against total income (and then subsequently gains) in the year of loss and/or preceding year. The amount being offset against non-trading income is restricted to the higher of £50,000 or 25% of an individual's total income.

   Any remaining loss is then carried forward against future trading income of the same trade.

3. **Losses in opening years**

   On commencement an additional loss relief is available allowing trading losses to be carried back against the total income of the preceding three tax years.

4. **Terminal loss relief**

   On cessation to compensate for no carry forward relief, traders can use TLR to carry back trading losses against the trading income of the three previous tax years.

5. **Choice of loss relief**

   It is important for a trader to choose the right loss relief, so as to save tax at the highest possible rate and so as to obtain relief reasonably quickly.

Further study guidance

Question practice

Now try the following from the Further question practice bank (available in the digital edition of the Workbook):

Section A: Q43, Q44, Q45

Section C: Q46 Morgan

Activity answers

Activity 1: Relief against total income

	2019/20	2020/21	2021/22
	£	£	£
Trading income	16,000	–	6,000
Other income	15,000	15,000	15,000
Total income	31,000	15,000	21,000
Loss relief against total income	(31,000) (i)	(3,000) (ii)	–
Net income	–	12,000	21,000

Loss memo:

		£
Y/e 30.6.20		34,000
	– 19/20	(31,000) (i)
	– 20/21	(3,000) (ii)
		–

Note. It is possible to claim relief in 2020/21 in priority to 2019/20; however here it is not beneficial as the carry back results in a refund of income tax paid.

Activity 2: Cap on income tax relief - high income

	2019/20	2020/21
	£	£
Trading profit	40,000	–
Other income	100,000	100,000
	140,000	100,000
Loss relief	(90,000)	(50,000)
	50,000	50,000
Less PA	(12,500)	(12,500)
Taxable income	37,500	37,500

Loss memo

		£
Y/e 30.6.20		200,000
Loss relief	– 19/20 (£40,000 + £50,000) (Note 1)	(90,000)
	– 20/21 (Note 2)	(50,000)
	Loss remaining	60,000

Notes.

1 In 2019/20 the relief against trading income of £40,000 is not capped. Relief against other income is capped at the higher of £50,000 or 25% × £140,000 = £35,000. So claim is £90,000 (£40,000 + £50,000).

2 In 2020/21, loss relief is capped at the higher of £50,000 or 25% × 100,000 = £25,000, ie £50,000.

Activity 3: Carry forward loss relief

	2018/19	2019/20	2020/21	2021/22
	£	£	£	£
Trading income	20,000	–	–	8,000
Carry forward relief	–	–	–	(8,000) (iv)
	20,000	–	–	–
Other income	13,000	13,000	13,000	13,000
Total income	33,000	13,000	13,000	13,000
Relief against total income	(33,000) (i)	(13,000) (ii)	(13,000) (iii)	–
Net income	–	–	–	13,000

Loss memo:

	£	£
Y/e 31.12.19	46,000	
Relief vs income – 2018/19	(33,000) (i)	
– 2019/20	(13,000) (ii)	
		–
Y/e 31.12.20	30,000	
Relief vs income – 2019/20	–	
– 2020/21	(13,000) (iii)	
c/fwd		17,000
		17,000
Automatic relief vs income – 2021/22		(8,000) (iv)
C/fwd		9,000

Activity 4: Early trade loss relief

1

Trading assessments		£
2017/18	Actual (1.7.17–5.4.18)	Nil
2018/19	12m to permanent accounting date (y/e 30.6.18)	Nil
2019/20	CYB (y/e 30.6.19)	24,000
2020/21	CYB (y/e 30.6.20)	30,000

Trading assessments		£
2021/22	CYB (y/e 30.6.21)	36,000

Bob's trading losses are attributed as follows:

		£
2017/18	9/12 × £40,000	30,000
2018/19	12m to permanent accounting date (y/e 30.6.18)	40,000
	Less used in 2017/18	(30,000)
		10,000

2 **2017/18 loss of £30,000:**

Relief available against total income of 2017/18 (£nil) and/or 2016/17 (£68,000) under normal loss relief against total income.

Relief against total income of 2014/15, 2015/16 and 2016/17 (£68,000 pa) in that order under early trade loss relief - the loss would be offset fully against 2014/15 income.

Carry forward relief against the first available trading profits of the same trade - £24,000 would be relieved in 2019/20 and the remainder in 2020/21.

2018/19 loss of £10,000:

Relief available against total income of 2018/19 (£nil) and/or 2017/18 (£nil) under normal loss relief against total income.

Relief against total income of 2015/16, 2016/17 and 2017/18 (£68,000 pa) in that order under early trade loss relief - the loss would be offset fully against 2015/16 income.

Carry forward relief against the first available trading profits of the same trade - depending on the relief used for the 2017/18 loss, relief would be obtained against 2019/20 or 2020/21 income.

Advice

Early years loss relief is the most beneficial claim for both losses - relief is obtained at the earliest point, generating repayments, and furthermore Bob was a higher rate taxpayer in the years prior to starting his trade and so relief for his losses will be mainly obtained at 40%.

Activity 5: Terminal loss relief

1 £ $\boxed{29,000}$

Calculation of the terminal loss: Final year 2020/21

			Losses
			£
(a)	6.4.20 – 30.6.20 = 3/9 × (27,000) =		(9,000)
(b)	Overlap profits		(3,000)
(c)	1.10.19 – 5.4.20		
	6/9 × (27,000) =	(18,000)	
	1.7.19 – 30.9.19		
	3/12 × £4,000 profit	1,000	
			(17,000)
Total terminal loss claim			(29,000)

2 2016/17: $\boxed{\text{nil}}$

2017/18: £ $\boxed{8,000}$

Response Option	Explanation
£7,000	This answer assumes the loss can be carried back further than three years
£10,000	This assumes that relief can be carried back further than three years, and either relief on a FIFO basis, or a larger terminal loss.
£nil	This answer ignores the possibility of terminal loss relief
£4,000	This is the amount relieved in 2019/20

Since there is no assessment for 2020/21 the £29,000 will be carried back and set against the assessments for:

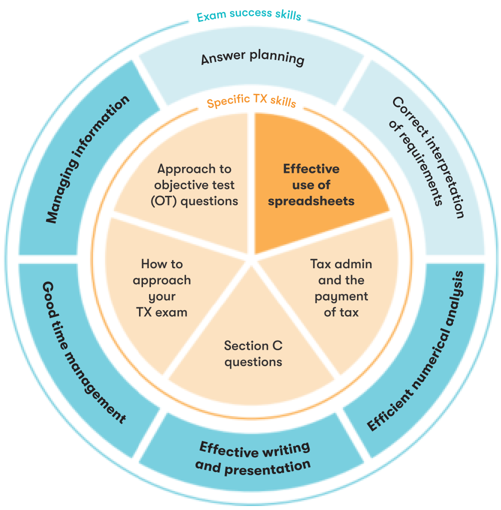
	£
Terminal loss	29,000
2019/20	(4,000)
2018/19	(10,000)
2017/18	(8,000)
Unrelieved terminal loss	7,000

This amount cannot be carried back any further (ie to 2016/17) and is lost.

Skills checkpoint 2

Effective use of spreadsheets

Chapter overview



Introduction

It is very likely that you will be required to use the spreadsheet response option in the constructed workspace for Section C questions. It is imperative that you know how to use the spreadsheet functions to prepare accurate and easy to follow calculations. Efficient use of the spreadsheets will save valuable time, which you can then use to address any difficult or discursive elements. Using spreadsheets correctly can also help to show the marker your calculations and reduce calculation errors.

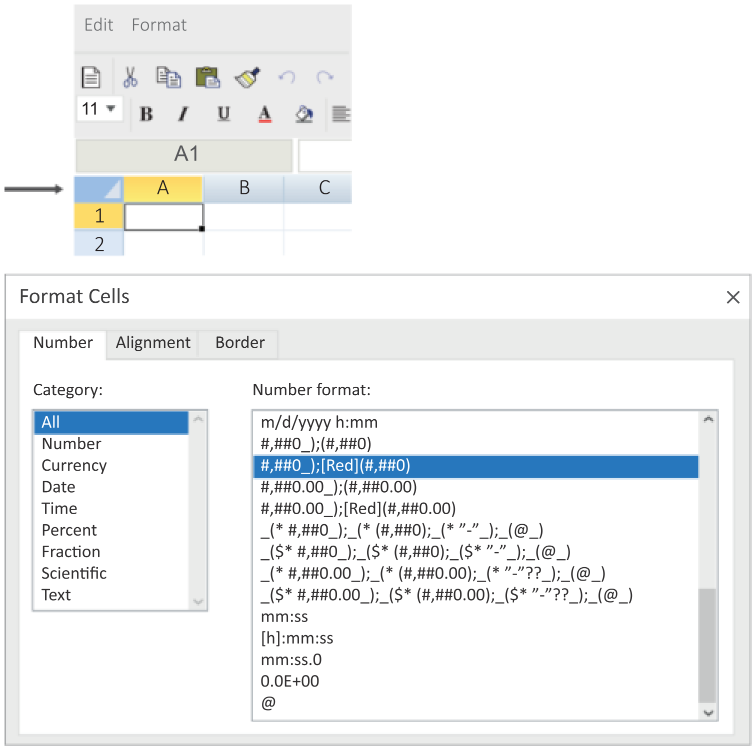
Effective use of spreadsheets

The key steps are outlined below and will be demonstrated in the following section as the question 'Florrie' is answered.

STEP 1 **Start by setting up the spreadsheet.**

The examining team would like to see negative numbers as negative numbers, in brackets and in a red font.

This is quick to do before you start to enter your answer. Click on the blue triangle left of the A cell, then right click, format cells, All, scroll down and click on #,##0_);[Red](#,##0), OK



Alternatively, you can click on the blue triangle, click on the 'format as currency' icon (left of the % icon) and select #,##0;[Red](#,##0)

Now, whenever you type a minus number, (eg -200), it will appear in brackets in red font.

B4 =-180*12

	A	B
1	**Taxable income**	
2	Employment income	74,400
3	Mileage allowance	345
4	Leasing costs	(2,160)

STEP 2 **Ensure the numbers are in a separate cell from the label.**

This makes the numbers easier to mark for the examiner as well as making it possible to use spreadsheet formulae for any necessary calculations.

	A	B
1	**Taxable income**	
2	Employment income	
3	Salary	74,400
4	Mileage allowance	345
5	Leasing costs	(2,160)

	A	B
1	**Taxable income**	
2	Employment income	
3	Salary 74400	
4	Mileage allowance 345	
5	Leasing costs (2160)	

STEP 3 **Always use formulae to perform calculations.**

Do not write out your working, eg 800-700+400=600 in a single cell because it wastes time and you may make a mistake. Use the spreadsheet functions instead! You can always double check your answer on your calculator. Remember to use * for multiplying and / for dividing. Percentages can be entered using a percentage symbol or as a fraction, eg 20% or 0.2.

	A	B
1	**Taxable income**	
2	Employment income	
3	Salary	=6200*12
4	Mileage allowance	=2300*(0.6-0.45)
5	Leasing costs	=-180*12

The leasing cost is showing as (21,600) and when the marker clicks on the cell B5, they can see the formula as shown above.

	A	B	C
1	**Taxable income**		
2	Employment income		
3	Salary = 6200x12=74400		
4	Mileage allowance 2300x15p=345		
5	Leasing costs 180x12=(21600)		

The student here has not used the spreadsheet formula and has wasted time typing 180x12. They have then made a mistake writing down the answer and have added an extra zero.

STEP 4 Make efficient use of the SUM function.

Remember, if some of the numbers in a list need to be deducted, enter a minus sign for these and then use the 'SUM' formula to add all of the numbers together. Type =sum(then select the cells you want to add together with your mouse and press return. This is quicker than entering = A1-A2+A3 and so on, and you are less likely to make a mistake.

	A	B
1	**Taxable income**	
2	Employment income	
3	Salary	=6200*12
4	Mileage allowance	=2300*(0.6-0.45)
5	Leasing costs	=-180*12
6		=SUM(B3:B5)

	A	B
1	**Taxable income**	
2	Employment income	
3	Salary	=6200*12
4	Mileage allowance	=2300*(0.6-0.45)
5	Leasing costs	=-180*12
6		=B3+B4-B5

Here, the student has wasted time trying to add and deduct each cell instead of using the SUM function. They have also made a mistake and deducted B5. Since B5 was already a negative number, it should have been added instead.

STEP 5 **Only use separate workings for longer calculations and cross reference any workings using '=' rather than re-typing the numbers**

Basic calculations, for example the salary, should be done within the cell (ie =6,200*12). Only longer workings, such as property income, should be shown separately.

	A	B
1	**Taxable income**	
2	Employment income	
3	Salary	74,400
4	Mileage allowance	345
5	Leasing costs	(2,160)
6	Property income	=B19
7		
8		
9	**Working**	
10	**Property income**	
11	Rent received	10,080
12	Mortgage interest	(2,100)
13	Replacement furniture relief	
14	Washing machine	(380)
15	Dishwasher	0
16	Other expenses	(1,110)
17		6,490
18	Furnished room	1,080
19		7,570

Here, the student has worked out the property income in a separate working. Then, instead of typing 7,570 into cell B6, they have used the spreadsheet function '=' to pick up the number. This ensures that the marker can see exactly where the number has come from, and also reduces the chances of making a mistake.

	A	B
1	**Taxable income**	
2	Employment income	
3	Salary	74,400
4	Mileage allowance	345
5	Leasing costs	(2,160)
6	Property income	7,550
7		
8		
9	**Working**	
10	**Property income**	
11	Rent received	10,080
12	Mortgage interest	(2,100)
13	Replacement furniture relief	
14	Washing machine	(380)
15	Dishwasher	0
16	Other expenses	(1,110)
17		6,490
18	Furnished room	1,080
19		7,570

Here, the student has typed property income into cell B6 and has made a mistake.

STEP 6 **Does your answer look reasonable?**

Take a moment to look at your answers and see whether any of the numbers look odd. If they do, re-check your calculations. You cannot insert or delete rows on the CBE spreadsheet software but you can copy and paste or cut and paste. For example, if you have left too many rows between a computation and the workings, you can cut and paste the workings so that they appear higher up. This sort of adjustment requires plenty of practice at using the CBE spreadsheet software. You need to feel confident using the software before you sit the exam.

Exam success skills

The following question is worth 15 marks.

For this question, we will also focus on the following exam success skills:

- **Managing information**. It is easy for the amount of information contained in a Section C question to feel overwhelming. Read the requirement first before you set up your spreadsheet and go through the detail in the scenario.

- **Efficient numerical analysis.** Use the spreadsheet functionality. Do not waste time doing calculations manually when the spreadsheet can do them for you. Cross reference your workings using '=' rather than re-typing the numbers.
- **Effective writing and presentation.** The markers want to see a clear layout with workings directly underneath. You can use the cut and paste functions to ensure that your answer looks neat.
- **Good time management.** Using the spreadsheet functions will save you time.

Skills activity

Florrie is employed by Shelford Ltd. The following information is available for the tax year 2020/21:

Employment

- Florrie was paid a gross annual salary of £63,730 by Shelford Ltd.
- In addition to her salary, Florrie received a bonus payment of £10,325 from Shelford Ltd. Florrie became entitled to this bonus on 31 March 2021 but it was not paid until 25 April 2021.
- Shelford Ltd has provided Florrie with living accommodation since 1 January 2018. The company had purchased the property in 2016 for £195,000, and it was valued at £210,000 on 1 January 2018. Improvements costing £10,000 were made to the property during June 2019. The annual value of the property is £8,570.
- In July 2020, Florrie paid a train fare of £150 for a business journey. This was reimbursed by Shelford Ltd in August 2020.
- In September 2020, Shelford Ltd gave each of its employees a one-day gym membership pass worth £45 as part of a healthy living promotion.
- During February 2021, Florrie spent four nights overseas on company business. Shelford Ltd paid Florrie a daily allowance of £20 to cover the cost of personal expenses such as telephone calls to her family.
- Income tax of £12,150 was deducted under PAYE.

Property income

- Florrie owns two houses which are let out.
- The first house was let from 6 May 2020 to 5 September 2020 at a monthly rent of £450, payable in advance.
- During March 2021, Florrie spent £1,130 repairing the roof of the house.
- The second house was purchased on 6 July 2020 and was let immediately to 5 April 2021 at a monthly rent of £750, payable in advance. The rent due on 6 March 2021 was not paid until 6 April 2021.
- During June 2020, Florrie spent £675 on advertising for tenants and she bought furniture at a cost of £3,500.
- Florrie bought a new three-seat sofa in March 2021 at a cost of £750. This replaced a two-seat sofa that she bought in June 2020. If Florrie had bought another two-seat sofa in March 2021 it would have cost £550. Florrie sold the original two-seat sofa for £170.
- Florrie had a property income loss of £2,100 brought forward from 2019/20.

Other information

- During the tax year 2020/21 Florrie received dividends of £2,850.
- During the tax year 2020/21 Florrie made Gift Aid donations totalling £2,000 (net) to national charities.

Required

Calculate the income tax payable by Florrie for the tax year 2020/21. You should indicate by the use of zero any items that are non-taxable/exempt from tax.

(15 marks)

STEP 1 **Start by setting up the spreadsheet.**

Note. The requirement asks you to calculate the income tax payable so once you have formatted the cells, you can start to draw up a proforma to calculate the taxable income, the tax liability and the income tax payable.

STEP 2 **Ensure the numbers are in a separate cell from the label.**

Note. Enter the labels into column A, enter a header for non-savings income in column B, dividend income on column C and a total in column D.

STEP 3 **Always use the formulae to perform calculations.**

Note. For example, use the SUM function to add up the living accommodation additional benefit, improvements and deduction of the £75,000 limit. Then use the spreadsheet to calculate the benefit at 2.25% (eg =B36*2.25%).

STEP 4 **Make efficient use of the SUM function.**

Note. For example, use the SUM function to add up the net income, the taxable income, the income tax liability, the income tax payable and the employment income.

STEP 5 **Only use separate workings for longer calculations and cross reference any workings using '=' rather than retyping the numbers.**

Note. For example, the basic rate tax on the non-savings income can be entered into cell B12 as =A52*20%.

STEP 6 **Does your answer look reasonable?**

Note. The figure should sound reasonable and the answer should be well presented.

This answer should look like this:

	A	B	C	D
1	**Florrie – income tax payable 2020/21**			
2		Non-savings income	Dividend income	Total
3		£	£	£
4	Employment income	85,630		
5	Property income	3,515		
6	Dividends		2,850	
7	Net income	89,145	2,850	91,995
8	Less PA	(12,500)		
9	Taxable income	76,645	2,850	79,495
10		£		
11	*Non savings income*			
12	Basic rate	8,000		
13	Higher rate	14,658		
14	*Dividend income*			
15	2,000@0%	0		
16	Higher rate	276		
17	Income tax liability	22,934		
18	Less PAYE	(12,150)		
19	Income tax payable	10,784		
20				
21	**Workings**			
22	**Employment income**	£		
23	Salary	63,730		
24	Bonus	10,325		
25	Living accommodation	11,495		
26	Reimbursed expenses	0		
27	Gym membership < £50	0		
28	Overseas allowance	80		
29	Employment income	85,630		
30				
31	**Living accommodation**	£	£	
32	Annual benefit		8,570	
33	Additional benefit	195,000		
34	Improvements	10,000		
35	Less limit	(75,000)		
36		130,000		
37	Benefit		2,925	
38			11,495	
39				
40	**Property income**	£	£	
41	Property 1 – rent received		1,800	
42	Property 2 – rent received, not March		6,000	
43	Repairs to roof	(1,130)		
44	Advertising	(675)		
45	Furniture – June 2020	0		
46	Replacement furniture	(380)	(2,185)	
47			5,615	
48	Less loss b/f 2019/20		(2,100)	
49			3,515	
50				
51	**Basic rate limit**			
52	40,000			

Exam success skills diagnostic

Every time you complete a question, use the diagnostic below to assess how effectively you demonstrated the exam success skills in answering the question. The table has been completed below for the 'Florrie' activity to give you an idea of how to complete the diagnostic.

Exam success skills	Your relections/observations
Managing information	Did you remember to extend the basic rate band because of the gift aid donation? Did you remember to deduct the PAYE?

Exam success skills	Your relections/observations
Efficient numerical analysis	Did you use the functions in the spreadsheet to help with numerical accuracy?
Effective writing and presentation	Did you present a neat set of figures with appropriate workings that would have been easy for a marker to follow?
Good time management	Did you manage your time to ensure you completed the question in the time available?
Most important action points to apply to your next question	

Summary

Section C of the TX exam is worth 40 marks, most of which will need to be answered using a spreadsheet.

The best way to score well in Section C questions is to practise them frequently using the CBE software. You need to know how to get the best out the spreadsheet functions. You therefore need to ensure that you:

- Always enter negative figures as negatives (best practice is in brackets in red font).
- Always use the spreadsheet functions to perform your calculations, eg the SUM function and calculations involving percentages.
- Only use separate workings for longer calculations and cross reference any workings using '=' rather than retyping the figures.