

ACCA

TX-UK

Taxation

Integrated Workbook

Finance Act 2020  
for June 2021 to March 2022  
examination sittings

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# Integrated Workbook Icons



Advantage



Choices



Deadline



Definition



Disadvantage



Ethics



Exam Technique Point

## Taxation



Important Calculation



Key Point



PER Performance Objectives

PER



Tax tables

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# Tax rates and allowances

The supplementary instructions and tax rates and allowances below will be reproduced in the TX examination in the period 1 June 2021 to 31 March 2022. In addition, other specific information necessary for candidates to answer individual questions will be given as part of the question.

- (1) **Calculations and workings need only to be made to the nearest £.**
- (2) **All apportionments should be made to the nearest month.**
- (3) **All workings should be shown in Section C.**

## INCOME TAX

		<b>Normal rates</b>	<b>Dividend Rates</b>
Basic rate	£1 – £37,500	20%	7.5%
Higher rate	£37,501 – £150,000	40%	32.5%
Additional rate	£150,001 and over	45%	38.1%
Savings income nil rate band	– Basic rate taxpayers		£1,000
	– Higher rate taxpayers		£500
Dividend nil rate band			£2,000

A starting rate of 0% applies to savings income where it falls within the first £5,000 of taxable income.

## Personal allowance

Personal allowance	£12,500
Transferable amount	£1,250
Income limit	£100,000

Where adjusted net income is £125,000 or more, the personal allowance is reduced to zero.

## Residence status

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

## Child benefit income tax charge

Where income is between £50,000 and £60,000, the charge is 1% of the amount of child benefit received for every £100 of income over £50,000.

## Car benefit percentage

The relevant base level of CO<sub>2</sub> emissions is 55 grams per kilometre.

The percentage rates applying to petrol-powered motor cars (and diesel-powered motor cars meeting the RDE2 standard) with CO<sub>2</sub> emissions up to this level are:

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

A 0% percentage applies to electric-powered motor cars with zero CO<sub>2</sub> emissions.

For hybrid-electric motor cars with CO<sub>2</sub> emissions between 1 and 50 grams per kilometre, the electric range of a motor car is relevant:

### 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%

## Car fuel benefit

The base figure for calculating the car fuel benefit is £24,500.

## Company van benefits

The company van benefit scale charge is £3,490, and the van fuel benefit is £666.

## Individual Savings Accounts (ISAs)

The overall investment limit is £20,000.



### Property income

Basic rate restriction applies to 100% of finance costs relating to residential properties.

### Pension scheme limits

Annual allowance	£40,000
Minimum allowance	£4,000
Income limit	£240,000

The maximum contribution which can qualify for tax relief without any earnings is £3,600.

### Approved mileage allowances: cars

Up to 10,000 miles	45p
Over 10,000 miles	25p

### Capital allowances: rates of allowance

#### Plant and machinery

Main pool	18%
Special rate pool	6%

#### Motor cars

New cars with CO <sub>2</sub> emissions up to 50 grams per kilometre	100%
CO <sub>2</sub> emissions between 51 and 110 grams per kilometre	18%
CO <sub>2</sub> emissions over 110 grams per kilometre	6%

#### Annual investment allowance

Rate of allowance	100%
Expenditure limit	£1,000,000

#### Commercial structures and buildings

Straight-line allowance	3%
-------------------------	----

### Cash basis accounting

Revenue limit	£150,000
---------------	----------

### Cap on income tax reliefs

Unless otherwise restricted, reliefs are capped at the higher of £50,000 or 25% of income.

## CORPORATION TAX

Rate of tax	– Financial year 2020	19%
	– Financial year 2019	19%
	– Financial year 2018	19%
Profit threshold		£1,500,000

## VALUE ADDED TAX

Standard rate	20%
Registration limit	£85,000
Deregistration limit	£83,000

## INHERITANCE TAX: tax rates

Nil rate band			£325,000
Residence nil rate band			£175,000
Rate of tax on excess	–	Lifetime rate	20%
	–	Death rate	40%

## Inheritance tax: taper relief

Years before death	Percentage reduction
More than 3 but less than 4 years	20%
More than 4 but less than 5 years	40%
More than 5 but less than 6 years	60%
More than 6 but less than 7 years	80%

## CAPITAL GAINS TAX

		Normal rates	Residential property
Rates of tax	– Lower rate	10%	18%
	– Higher rate	20%	28%
Annual exempt amount			£12,300

## Business asset disposal relief (formerly entrepreneurs' relief and investors' relief)

Lifetime limit	– business asset disposal relief	£1,000,000
	– investors' relief	£10,000,000
Rate of tax		10%

**NATIONAL INSURANCE CONTRIBUTIONS**

Class 1 Employee	£1 – £9,500 per year	Nil
	£9,501 – £50,000 per year	12%
	£50,001 and above per year	2%
Class 1 Employer	£1 – £8,788 per year	Nil
	£8,789 and above per year	13.8%
	Employment allowance	£4,000
Class 1A		13.8%
Class 2	£3.05 per week	
	Small profits threshold	£6,475
Class 4	£1 – £9,500 per year	Nil
	£9,501 – £50,000 per year	9%
	£50,001 and above per year	2%

**RATES OF INTEREST (assumed)**

Official rate of interest	2.25%
Rate of interest on underpaid tax	2.75%
Rate of interest on overpaid tax	0.50%

**STANDARD PENALTIES FOR ERRORS**

<b>Taxpayer behaviour</b>	<b>Maximum penalty</b>	<b>Minimum penalty – unprompted disclosure</b>	<b>Minimum penalty – prompted disclosure</b>
Deliberate and concealed	100%	30%	50%
Deliberate but not concealed	70%	20%	35%
Careless	30%	0%	15%



# Chapter 1

## The UK tax system



### Outcome

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Upon completion of this chapter you will be able to:

- describe the purpose (economic, social, etc.) of taxation in a modern economy
- explain the difference between direct and indirect taxation
- identify the different types of capital and revenue tax
- describe the overall structure of the UK tax system
- state the different sources of revenue law
- describe the organisation HM Revenue & Customs (HMRC) and its terms of reference
- explain the difference between tax avoidance and tax evasion, and the purposes of the General Anti-Abuse Rule (GAAR)
- appreciate the interaction of the UK tax system with that of other tax jurisdictions and the need for double taxation agreements
- explain the need for an ethical and professional approach

and answer questions relating to these areas.



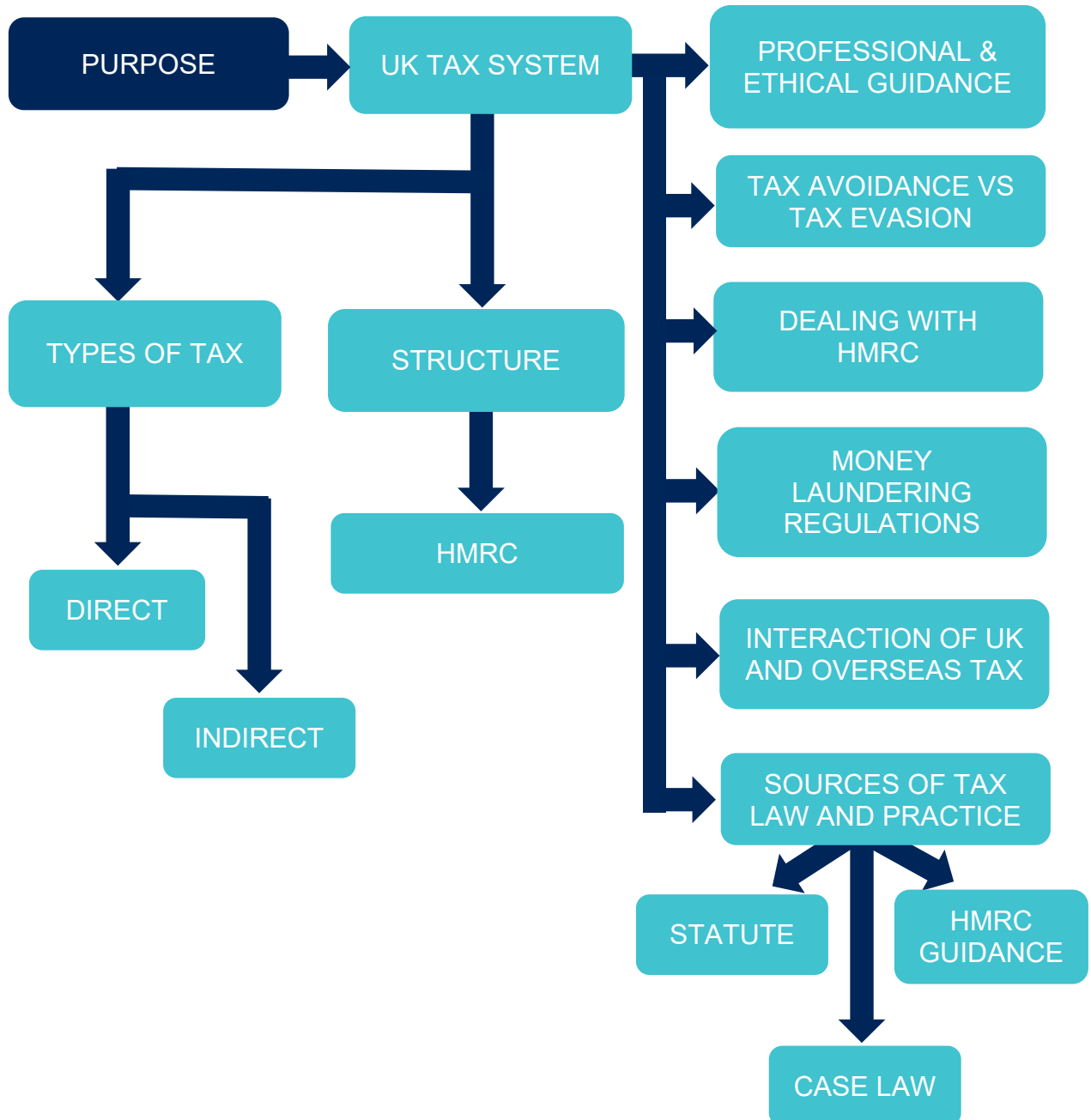
### PER

One of the PER performance objectives (PO1) is to always act in the wider public interest. You need to take into account all relevant information and use professional judgement, your personal values and scepticism to evaluate data and make decisions. You should identify right from wrong and escalate anything of concern. You also need to make sure that your skills, knowledge and behaviour are up-to-date and allow you to be effective in your role. Working through this chapter should help you understand how to demonstrate that objective.

The underpinning detail for this Chapter in your Integrated Workbook can be found in Chapter 1 of your Study Text.



## Overview



# 1 Objectives of taxation

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## 1.1 Economic

The system of taxation and spending by a government affects the economy of a country as a whole.

Taxation policies have been used to influence many economic factors such as inflation, employment levels, and imports/exports.

Tax is also used to direct the economic behaviour of businesses and individuals.

The current UK tax system encourages:

- individual saving habits by offering tax incentives on savings accounts such as ISAs
- charitable donations by offering tax relief through the gift aid scheme
- entrepreneurs and investors by offering tax relief/schemes.

Similarly, the current UK government discourages:

- motoring by imposing additional fuel duties
- smoking and drinking alcohol by imposing significant taxes on these items
- environmental pollution by imposing a variety of taxes.

As a government's objectives change, taxation policies are altered accordingly.

## Notes

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## 1.2 Social justice

The type of taxation structure imposed has a direct impact on the redistribution of wealth of a country.

The main taxation principles are listed below. The arguments for and against each of these is a matter for political debate.

### Direct v indirect principle



#### Direct taxes

These are paid by those who generate funds e.g. income tax, capital gains tax, corporation tax.



#### Indirect taxes

These relate to consumption e.g. value added tax. They are known as indirect taxes because they are collected by an intermediary such as a shop.

### Progressive v regressive principle



#### Progressive taxes

These increase with income e.g. income tax rates rise as income rises (see Chapter 2).



#### Regressive taxes

These decrease with income e.g. national insurance rates fall as income rises (see Chapter 11).

### Proportional v ad valorem principle



#### Proportional taxes

The proportion of tax remains the same, irrespective of the level of income on which it is based, e.g. 10% of all earnings regardless of the amount.



#### Ad valorem principle

A tax which is based on the value of the item, e.g. 20% VAT on most goods sold in the UK.

## Notes



# Types of UK tax

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### 2.1 The UK tax system

The UK tax system, governed by HM Revenue & Customs, comprises a number of different taxes. The following are the ones that are examinable within TX.

### 2.2 Income tax

Income tax is payable by individuals on their earnings, both from self-employment and employment.

PAYE is the system under which income tax is collected from employed workers.

### 2.3 National insurance contributions

National insurance contributions (NICs) are payable by individuals who are either employed or self-employed.

NICS are also payable by businesses (sole traders or companies) in relation to their employees.

### 2.4 Capital gains tax

Capital gains tax (CGT) is payable by individuals on the disposal of most capital assets.

Capital assets include land, buildings and shares but also could include smaller items such as antiques.

### 2.5 Corporation tax

Corporation tax is payable by companies on all their chargeable income and gains.

### 2.6 Inheritance tax

Inheritance tax (IHT) is payable on the value of someone's death estate but can also relate to certain gifts made by a person during his/her lifetime.

### 2.7 Value added tax

VAT is payable on most goods and services by the final consumer.

## Notes

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# Example 1

Match each tax with the correct statement.

Inheritance tax	Payable by companies on gains
Capital gains tax	Payable by businesses in relation to their staff
Corporation tax	Payable on assets left in your will
Income tax	Payable by individuals on gains
VAT	Payable by individuals on their earnings
NICs	Payable on goods and services

### Matching

Inheritance tax	Payable on assets left in your will
Capital gains tax	Payable by individuals on gains
Corporation tax	Payable by companies on gains
Income tax	Payable by individuals on their earnings
VAT	Payable on goods and services
NICs	Payable by businesses in relation to their staff Payable by individuals on their earnings

## Notes



## 3 HM Revenue and Customs (HMRC)

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### 3.1 Structure of HMRC

HM Revenue and Customs (HMRC) are the single body that controls and administers all areas of UK tax law. It is organised as follows:

#### Commissioners

These are appointed by the Queen. Their main duties are:

- To implement statute law
- To oversee the process of UK tax administration.

#### Officers of Revenue and Customs

These are appointed by the Commissioners to work in offices all over the UK, many of which have specialist functions. Their main duties are:

- To implement the day-to-day work of HMRC
- To act as a point of contact between HMRC and taxpayers.

With the move to online filing, many individuals will not have direct contact with their local HMRC office but will use the HMRC website or relevant helpline to resolve any outstanding issues or queries. All companies must file their returns and pay their tax electronically but individuals can still submit paper returns for most taxes if they wish.

## Notes

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### 3.2 Responsibilities of the taxpayer and HMRC

Under self-assessment, it is the responsibility of the taxpayer to ensure that the correct amount of income is reported to HMRC and the correct amount of tax is paid. Individual taxpayers can however request that Officers of Revenue and Customs do the calculations of tax payable based on the income they have reported.

Other responsibilities of HMRC include:

- Collecting and administering IT, CGT, NIC, CT and VAT
- Paying and administering universal credit, tax credits and child benefit
- Collecting the repayment of student loans
- Ensuring adherence to minimum wage rules
- Protecting society from tax fraud, smuggling and illegal importation of drugs.

## Notes

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## 4 Sources of tax law and practice

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### 4.1 Tax law

The basic rules of the UK tax system have been established from the following main areas.

#### **Tax legislation**

- Tax legislation/statutes are law and therefore adherence is mandatory.
- They are updated each year by the annual Finance Act, which follows from the proposals made by the Chancellor of the Exchequer in the Budget.
- They include Statutory Instruments, which are issued where detailed notes are required on an area of tax statute.

#### **Case law**

- Case law refers to the decisions made in tax cases brought before the courts.
- Often the case challenges current tax legislation or argues a certain interpretation of the tax law should be applied.
- Most of these rulings are binding and therefore provide guidance on the interpretation of tax statutes.

## Notes

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## 4.2 HMRC publications

As the tax legislation can be difficult to understand and open to misinterpretation, further guidance is issued by HMRC in order to:

- explain how to implement the law
- give their interpretation of the law.

The main sources of guidance are discussed below.

### Statements of practice

- Provide HMRC's interpretation of tax law and often provide clarification or detail of how it should be applied.

### Extra-statutory concessions

- Given to specific taxpayers to relax the tax legislation. They are often given where undue hardship or anomalies would otherwise occur.
- The legality of extra-statutory concessions was successfully challenged in 2005, so they are gradually being withdrawn or made law.

### Internal guidance manuals

- HMRC's own working manuals produced for their staff, but they are also available publicly.

### HMRC website, leaflets and booklets

- Aimed at the general public and provide an explanation of various tax issues in non-technical language.

### Detailed technical guidance

- HMRC issue Notices and Guidance Notes, aimed at tax agents and advisers, to explain tax issues in more technical detail than is normally required for the general public.
- HMRC Briefs provide detailed technical guidance on a specific tax issue that has arisen during the year.

## Notes





## Example 2



**Which of the following statements are true?**

- (1) Case law is written by HMRC and gives guidance and interpretation on difficult aspects of tax legislation.
  - (2) Extra-statutory concessions are given to specific taxpayers to relax tax law.
  - (3) Case law decisions can never be binding on future cases.
  - (4) Adherence to tax legislation/statutes is mandatory.
- (1) False: Statements of practice are written by HMRC and give guidance and interpretation on difficult aspects of tax legislation.
- (2) True.
- (3) False: Many case law decisions form a binding precedent for future cases.
- (4) True.

## Notes



# 5 Interaction of UK & overseas tax systems

## 5.1 Double taxation agreements

The laws of two countries may conflict which means a taxpayer can be paying tax on the same source of income in two different jurisdictions. In this situation, a double taxation agreement (also known as bilateral double taxation treaty) may be agreed between the two countries to resolve the issue by either exempting the income in one of the two states or providing relief in one for tax paid in another.

Even if a treaty doesn't exist between the relevant country and the UK, the UK still allows some measure of relief for overseas taxes which have already been paid on the relevant source of income.

## 5.2 Influence of the EU

The main external influence on UK taxation is currently the EU:

- One of the aims of the EU is to remove barriers and distortions due to different economic and political policies imposed in different member states.
- Although EU members do not have to align their tax systems, members can agree to jointly enact specific laws, known as Directives.
- To date the most important of these has been agreements regarding VAT. EU members have aligned their policies per European Legislation. They did not however need to align their rate of taxation.
- Many cases have been brought before the European Court of Justice regarding discrimination against non-residents in tax law, some of which have led to changes in UK tax law.
- Note that the Brexit transition period is due to end on 31 December 2020. However, for exams under FA20 you should assume that EU rules regarding VAT continue to apply.

## Notes



## Tax avoidance versus tax evasion

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### 6.1 Tax evasion



**Tax evasion** is illegally seeking to pay less tax than is due by deliberately misleading HMRC. It carries a risk of criminal prosecution (fines and/or imprisonment).

The main forms of tax evasion are:

- Suppressing information e.g. failing to declare taxable income to HMRC.
- Submitting false information e.g. claiming expenses that have not been incurred.

The proceeds from tax evasion are treated the same as proceeds from theft, drug trafficking and other criminal conduct. Therefore, failure to report tax evasion is also an offence under the money laundering regulations.

### 6.2 Tax avoidance



Tax avoidance is any legal method to reduce the tax burden, for example utilising tax shelters such as ISAs.

Tax avoidance measures, whilst legal, are not always effective:

- Promoters of tax avoidance schemes are now required to disclose details to HMRC, enabling HMRC to close loopholes quickly.
- The courts may disregard elements of transactions that have no commercial purpose, (i.e. were designed with the main aim of avoiding tax).
- A general anti-abuse rule (GAAR) enables HMRC to challenge abusive tax avoidance arrangements.

## Notes

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# 7 Professional and ethical guidance



## 7.1 Fundamental principles

The ACCA's 'Professional Code of Ethics and Conduct' sets out five fundamental principles by which members should abide.



### Objectivity

- Members should not allow prejudice, bias, or the influence of others to override objectivity.



### Professional competence and due care

- Members have an ongoing duty to maintain professional knowledge and skills.
- Members should be diligent and act in accordance with applicable technical and professional standards.



### Professional behaviour

- Members should refrain from any conduct that might bring discredit to the profession.



### Integrity

- Members should act in a straightforward and honest manner in performing their work.

## Notes





## Confidentiality

- Members should respect the confidentiality of information acquired as a result of professional and business relationships.
- Members should not disclose any such information to third parties unless:
  - they have proper and specific authority, or
  - there is a legal or professional right or duty to disclose e.g. money laundering.
- Confidential information acquired as a result of professional and business relationships should not be used for the personal advantage of members or third parties.

## 7.2 Advice on taxation issues

A member owes duties and responsibilities to both his/her client and HMRC. This entails the following:

- Ensuring that information provided to HMRC is accurate and complete.
- Not assisting a client to plan, or commit, an offence.

If, in the course of his/her work, any client errors come to light, a member should take the following action:

- Explain to the client the need to notify HMRC as soon as possible and the consequences of not doing so.
- If the client refuses to make a full and frank disclosure, the member should set out the consequences in writing and consider whether it is appropriate to continue to act for the client.
- If the client still refuses, the member should cease to act, should advise HMRC that he/she is no longer acting (without giving the reason why) and consider his/her position under the Money Laundering Regulations.

## Notes



### 7.3 Money Laundering Regulations

A person is engaged in money laundering where they:

- Conceal, disguise, convert, transfer, remove (from the UK) criminal property.
- Enter into/become concerned in an arrangement which they know or suspect facilitates the acquisition, retention, use or control of criminal property.
- Acquire, use or have possession of criminal property.

Criminal property includes the proceeds of tax evasion.

A business within the regulated sector must appoint a money laundering reporting officer (MLRO) within the firm. Suspicions of money laundering need to be reported to the MLRO who then decides whether a report should be made to the National Crime Agency (NCA).

A client should not be advised that a report has been made otherwise this would amount to the offence of tipping off.

### 7.4 Dishonest conduct of tax agents

- Civil penalty of up to £50,000.
- HMRC may publish details of the penalised tax agent in certain circumstances.
- HMRC may have rights of access to all working papers of a dishonest agent.

## Notes

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## Questions



You should now be able to answer Test your understanding (TYU) questions 1 to 6 from the Study Text Chapter 1.

For further reading, visit Chapter 1 of the Study Text.

# Notes

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# Chapter 2

## Basic income tax computation



### Outcome

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Upon completion of this Chapter you will be able to:

- explain how the residence of an individual is determined
- recognise the treatment of individual savings accounts (ISAs) and other tax exempt investments
- prepare a basic income tax computation involving different types of income
- calculate the amount of personal allowance available
- understand the impact of the transferable amount of personal allowance for spouses and civil partners
- compute the amount of income tax payable
- understand the treatment of interest paid for a qualifying purposes
- understand the treatment of gift aid donations and charitable giving
- explain and compute the child benefit charge
- understand the treatment of property owned jointly by a married couple, or by a couple in a civil partnership

and answer questions relating to these areas.



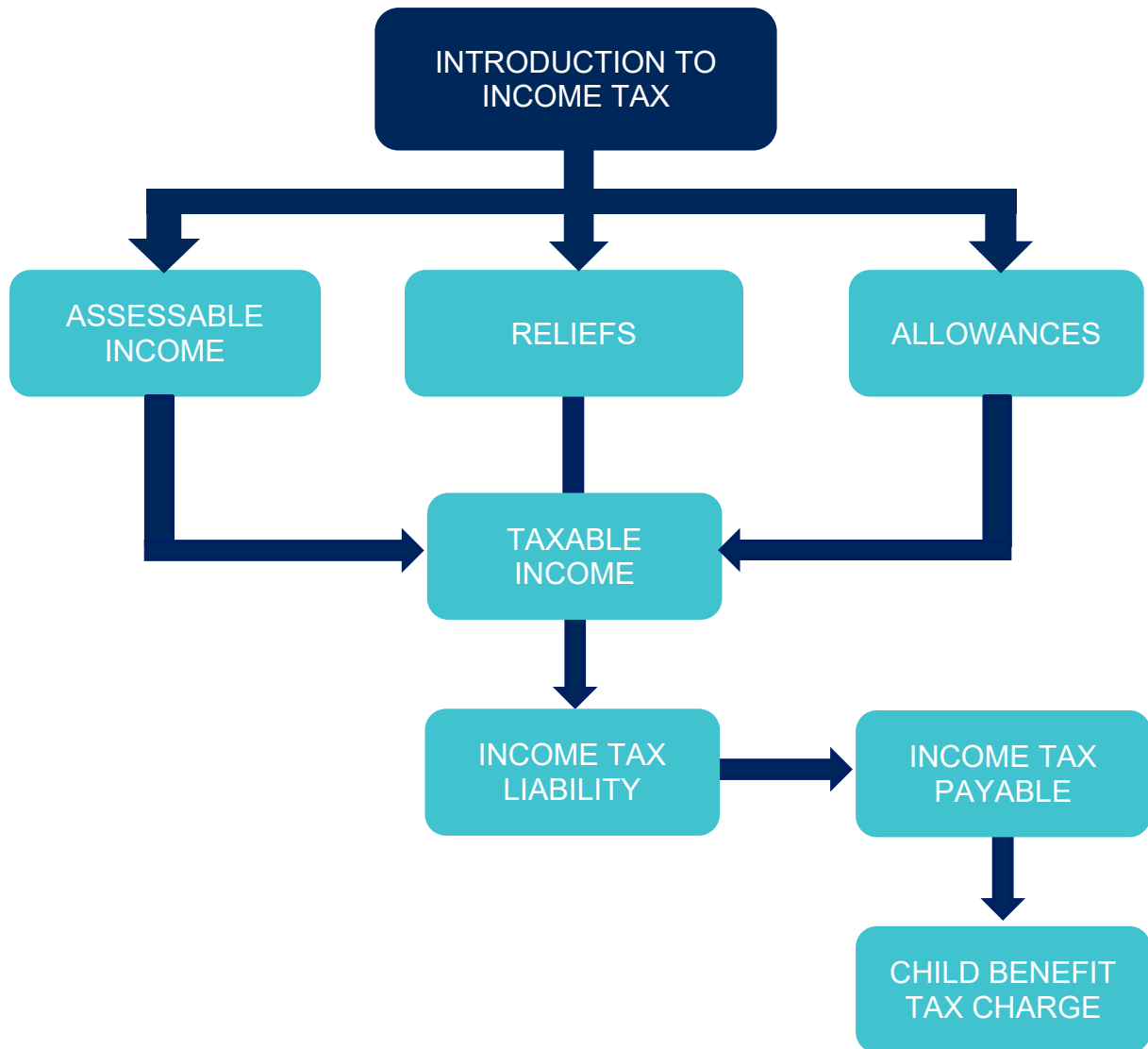
PER

One of the PER performance objectives (PO15) is to prepare computations of taxable amounts and tax liabilities according to legal requirements. Working through this chapter should help you understand how to demonstrate that objective.

The underpinning detail for this Chapter in your Integrated Workbook can be found in Chapter 2 of your Study Text.



### Overview



# 1 Introduction to income tax

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## 1.1 Scope of income tax

Income tax is calculated on taxable income earned in the **tax year**.

You will be examined on the income tax rules and rates relating to tax year 2020/21 (6 April 2020 to 5 April 2021).

- Income tax is payable by all individuals resident in the UK (see section 8).
- Each individual is separately liable.
- Married couples/civil partners split joint income 50:50, unless they elect to use their actual ownership percentage.

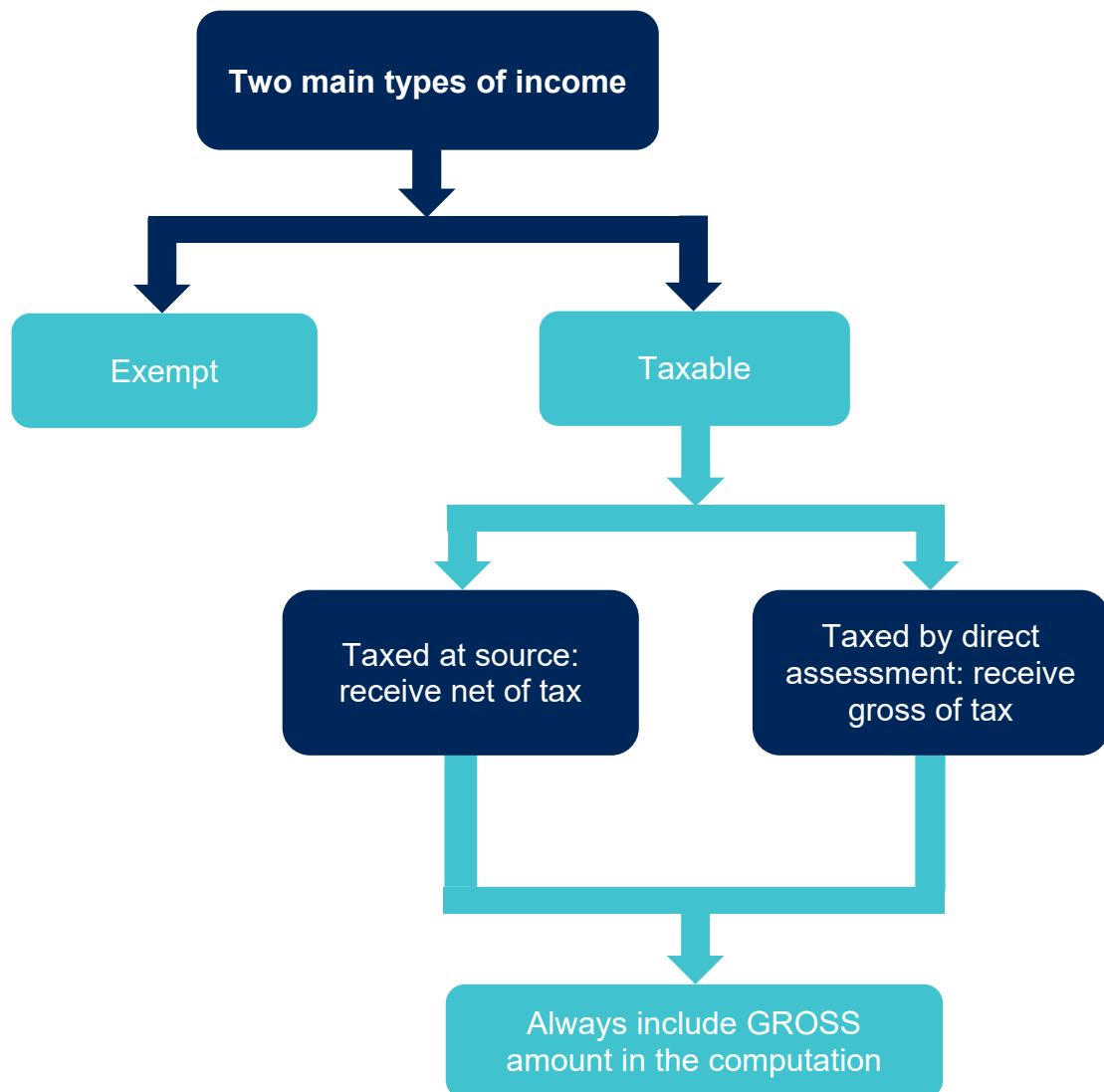
## Notes

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## 2 Chargeable and exempt income

### 2.1 Types of income



Notes



## Chapter 2

### 2.2 Exempt income

Examples of income that is exempt from income tax include:

- income from Individual Savings Accounts (ISAs)
- interest from NS&I Certificates
- winnings e.g. betting, lottery, premium bonds.

### 2.3 Non-savings income

Non-savings income comprises earned income and property income.

Earned income comprises:

- trading income
- employment income
- pension income.

Employment (and sometimes pension) income = received net of tax. Tax is deducted by the employer under PAYE (pay as you earn) scheme.

Always use **gross** figure in income tax computation (i.e. before tax is deducted). Salaries are always stated gross in examination questions.

### 2.4 Investment income

Investment income (see Chapter 3) comprises:

- savings income
- dividend income.

## Notes



## 3 Computation of taxable income

### 3.1 Net income



**Net income** is the total of all income less reliefs (see section 5) but before deducting the personal allowance.

### 3.2 Income tax computation – 2020/21

	Non-savings income	Savings income	Dividend income	Total income
	£	£	£	£
Trading income	X			X
Employment income	X			X
Property income	X			X
Pension income	X			X
Savings income		X		X
Dividends			X	X
	<hr/>	<hr/>	<hr/>	<hr/>
Total income	X	X	X	X
Less: Reliefs	(X)			(X)
	<hr/>	<hr/>	<hr/>	<hr/>
Net income	X	X	X	X
	<hr/>	<hr/>	<hr/>	<hr/>

## Notes



## Chapter 2

### 3.3 Taxable income



**Taxable income** = net income after the deduction of the tax-free personal allowance (PA).



For the tax year 2020/21 the **PA** is **£12,500**.

The PA is only available against income, not in the calculation of other taxes (e.g. capital gains tax).

In the TX exam, it should be deducted in the order non-savings income, savings income, then dividend income.

	Non-savings income	Savings income	Dividend income	Total income
	£	£	£	£
Net income	X	X	X	X
Less: Personal allowance (PA)	(X) <sup>1</sup>	(X) <sup>2</sup>	(X) <sup>3</sup>	(X)
	<hr/>	<hr/>	<hr/>	<hr/>
Taxable income	X	X	X	X
	<hr/>	<hr/>	<hr/>	<hr/>

## Notes





### 3.4 Withdrawal of personal allowance



PA is gradually withdrawn for individuals with income > £100,000.

- The withdrawal of PA is based on the taxpayer's **adjusted net income**.
- Adjusted net income (ANI)  
= net income – (gross gift aid donations + gross personal pension contributions)
- If ANI > £100,000, PA is reduced by:  
 $(ANI - £100,000) \times 50\%$

If resulting PA is not a whole number, round up to the nearest pound.



- A taxpayer with ANI ≥ £125,000 is not entitled to any PA (as excess above £100,000 ≥ twice the PA).
- Effective rate of tax on income between £100,000 and £125,000 is 60% = 40% higher rate tax + lost PA ( $\frac{1}{2} \times 40\% = 20\%$ ).

Taxpayers in this margin could consider making additional gift aid donations or personal pension contributions to reduce their ANI below £100,000.

## Notes





## Example 1

Markos received the following income in the tax year 2020/21:

- Trading income £91,000
- Building society interest £10,000
- Dividends £5,000
- Interest from NS&I Certificates £460

He also made personal pension contributions of £2,500 (gross).

**Compute Markos's taxable income for the tax year 2020/21.**

### Markos

	Non-Savings income	Savings income	Dividend income	Total
	£	£	£	£
Trading income	91,000			91,000
Building society interest		10,000		10,000
Dividends			5,000	5,000
NS&I interest (exempt)		0		0
Net income	91,000	10,000	5,000	106,000
Less: PA (W)	(10,750)			(10,750)
Taxable income	80,250	10,000	5,000	95,250

## Basic income tax computation

### Working:

	£	£
Basic PA		12,500
Net income	106,000	
Less: Gross PPCs	(2,500)	
	<hr/>	
Adjusted net income	103,500	
Less: Income limit	(100,000)	
	<hr/>	
	3,500	
	<hr/>	
Reduction of PA ( $£3,500 \times 50\%$ )		(1,750)
		<hr/>
Adjusted PA		10,750
		<hr/>

## Notes



# 4 Computing tax payable

## 4.1 Calculation of income tax liability on non-savings income



The income tax rates for tax year 2020/21 for non-savings income are as follows:

Basic rate band – first £37,500	20%
Higher rate band £37,501 – £150,000	40%
Additional rate band £150,001 +	45%

Different rates of tax apply to savings and dividend income – these are considered in Chapter 3.

### Example 2



Emily has employment income of £51,555 for the tax year 2020/21. She does not have any savings income or dividend income.

**What is Emily's income tax liability for the tax year 2020/21?**

## Notes



## Basic income tax computation

### Emily

			£
Employment income/Net income			51,555
Less: PA			(12,500)
			<hr/>
Taxable income			39,055
			<hr/>
Income tax:	£		£
Non-savings income – basic rate	37,500	× 20%	7,500
Non-savings income – higher rate	1,555	× 40%	622
	<hr/>		
	39,055		
	<hr/>		
Income tax liability			8,122
			<hr/>

## Notes





## Example 3

Leo receives the following income in the tax year 2020/21:

- Salary £83,850
- Trading income £19,100

**Compute Leo's income tax liability for the tax year 2020/21.**

**Leo**

			£
Salary			83,850
Trading income			19,100
			<hr/>
Net income			102,950
Less: PA (W)			(11,025)
			<hr/>
Taxable income			91,925
			<hr/>
Income tax:	£		£
Non-savings income – basic rate	37,500	× 20%	7,500
Non-savings income – higher rate	54,425	× 40%	21,770
	<hr/>		<hr/>
	91,925		
	<hr/>		<hr/>
Income tax liability			29,270
			<hr/>

**Working**

	£
Basic PA	12,500
Less: $(£102,950 - £100,000) = £2,950 \times \frac{1}{2}$	(1,475)
	<hr/>
Adjusted PA	11,025
	<hr/>

## 4.2 Computing income tax payable or repayable

- Employment income must not be taxed twice; therefore, PAYE is deducted from income tax liability to give income tax payable.
- If income tax already paid > income tax liability a repayment is generated.

### Example 4



In the tax year 2020/21 Thomas received employment income of £221,800 before the deduction of £82,300 of income tax under PAYE.

**Calculate Thomas' income tax payable/repayable for the tax year 2020/21.**

**Thomas**

			£
Employment income/Net income			221,800
Less: PA (Note)			(0)
			<hr/>
Taxable income			221,800
			<hr/>
Income tax:			
	£		£
Non-savings income – basic rate	37,500	× 20%	7,500
Non-savings income – higher rate	112,500	× 40%	45,000
	<hr/>		<hr/>
	150,000		
Non-savings income – additional rate	71,800	× 45%	32,310
	<hr/>		<hr/>
	221,800		
	<hr/>		<hr/>
Income tax liability			84,810
Less: PAYE			(82,300)
			<hr/>
Income tax payable			2,510
			<hr/>

### Notes

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### 4.3 Transferable marriage allowance



A spouse/civil partner can transfer a fixed amount of marriage allowance (MA) of **£1,250** of his/her PA to his/her spouse/civil partner:

- provided neither spouse is a higher or additional rate taxpayer.
- MA reduces the **PA** of the spouse making the transfer.
- MA reduces the recipient's **income tax liability** at the **basic rate**. It cannot be used to generate a tax repayment for the recipient.

The transferor must make an election if he/she wants to make this transfer.

### Example 5



Rasmus is on a career break to enable him to care for his young children full time. His husband Davit is a sole trader and has assessable trading profits in the tax year 2020/21.

Rasmus makes an election to transfer the marriage allowance to Davit.

**Calculate Davit and Rasmus' income tax liabilities for the tax year 2020/21 assuming that they have the following amounts of income.**

	Davit	Rasmus	
(a)	£28,350	£Nil	
(b)	£13,200	£Nil	
(c)	£28,350	£11,715	from a property which is let out

## Notes



## Chapter 2

### Davit

#### (a) Income tax liability

	Davit £	Rasmus £
Trading income	28,350	0
Property income	0	0
	<hr/>	<hr/>
Net income	28,350	0
Less: PA	(12,500)	0
	<hr/>	<hr/>
Taxable income	15,850	0
	<hr/>	<hr/>
Income tax:		
Non-savings income – basic rate	(£15,850 × 20%)	3,170
Less: Marriage allowance reduction	(£1,250 × 20%)	(250)
	<hr/>	<hr/>
Income tax liability	2,920	0
	<hr/>	<hr/>

All of Rasmus' PA is unused therefore maximum benefit of election = £250

#### (b) Income tax liability

	Davit £	Rasmus £
Trading income	13,200	0
Property income	0	0
	<hr/>	<hr/>
Net income	13,200	0
Less: PA	(12,500)	0
	<hr/>	<hr/>
Taxable income	700	0
	<hr/>	<hr/>
Income tax:		
Non-savings income – basic rate	(£700 × 20%)	140
Less: Marriage allowance reduction	(restricted)	(140)
	<hr/>	<hr/>
Income tax liability	0	0
	<hr/>	<hr/>

All of Rasmus' PA is unused but the maximum benefit of the election is restricted since Davit doesn't have sufficient income tax to offset the full benefit from (a).

## Davit

### (c) Income tax liability

	Davit £	Rasmus £
Trading income	28,350	0
Property income	0	11,715
	<hr/>	<hr/>
Net income	28,350	11,715
Less: PA (Note)	(12,500)	(11,250)
	<hr/>	<hr/>
Taxable income	15,850	465
	<hr/>	<hr/>
Income tax:		
Non-savings income – basic rate	(£15,850 × 20%) (£465 × 20%)	3,170 93
Less: Marriage allowance reduction	(£1,250 × 20%)	(250)
	<hr/>	<hr/>
Income tax liability	2,920	93
	<hr/>	<hr/>

## Note

Only £785 (£12,500 – £11,715) of Rasmus' PA is unused, however if the election is made, the fixed amount of £1,250 must be transferred.

## Notes



# 5 Reliefs against total income

In TX the only reliefs deductible from total income are certain qualifying interest payments and losses (covered in Chapter 15).

## 5.1 Qualifying interest payments

Qualifying interest payments are those made by an individual in respect of the following loans:

- to buy plant or machinery for use in a partnership in which the individual is a partner, or employment in which the individual is an employee
- to buy shares in an employee controlled trading company by a full-time employee
- to invest in a partnership or make a loan to a partnership in which the individual is a partner.

Relief is given by deducting the interest **paid** in the tax year from total income.

## Notes





## Example 6

Alison had the following income for the tax year 2020/21.

	£
Salary (PAYE deducted £3,230)	33,000
Property income	19,350

On 1 February 2021 Alison took out a loan for £5,000 to buy shares in Hubbington Ltd, a company which is controlled by its employees and for which Alison works on a full-time basis.

The interest incurred on the loan up to 5 April 2021 was £300.

**Calculate Alison's income tax payable for the tax year 2020/21.**

### Alison

			£
Salary			33,000
Property			19,350
			<hr/>
Total income			52,350
Less: Qualifying interest			(300)
			<hr/>
Net income			52,050
Less: PA			(12,500)
			<hr/>
Taxable income			39,550
			<hr/>
Income tax:	£		£
Non-savings income – basic rate	37,500	× 20%	7,500
Non-savings income – higher rate	2,050	× 40%	820
	<hr/>		<hr/>
	39,550		
	<hr/>		<hr/>
Income tax liability			8,320
Less: PAYE			(3,230)
			<hr/>
Income tax payable			5,090
			<hr/>

# 6 Charitable giving

## 6.1 Gifts to charity

There are two ways in which tax relief is obtained for charitable giving

- Payroll giving (see Chapter 5).
- Donations under the gift aid scheme (below).

## 6.2 Donations under the gift aid scheme

Gift aid is a tax efficient way of giving to charity:

- The donor gives a cash donation to charity and makes a gift aid declaration.
- The amount paid to the charity is deemed to have been made net of 20% tax.
- The individual is deemed to have paid 80% of the ultimate donation to the charity; the charity can claim the remaining 20% from HMRC.
- Gross amount of the gift = amount actually paid by individual  $\times \frac{100}{80}$ .

The way in which tax relief is obtained depends on the tax status of the donor.

- Basic rate tax payers:
  - Relief is given at time of donation by only giving 80%.
  - No further adjustment is needed in the income tax computation.
- Higher rate tax payers:
  - 20% tax relief at the time the payment is made, as above.
  - A maximum of 20% (40% – 20%) tax relief is given by increasing the higher rate threshold by the gross amount of the gift.
- Additional rate payers:
  - 20% tax relief is granted at the time the payment is made.
  - A maximum of 25% (45% – 20%) tax relief is given by increasing the higher and additional rate thresholds by the gross amount of the gift.

## Example 7



Philip earns £20,000 per annum, Natalie earns £60,000 per annum and Mary earns £180,000 per annum.

All make donations of £2,000 declaring them to be under the gift aid scheme.

**Calculate the income tax liability for each of them for the tax year 2020/21.**

**Philip, Natalie and Mary**

**Philip**

		£
Net income		20,000
Less: PA		(12,500)
		<hr/>
Taxable income		7,500
		<hr/>
Income tax:		
Non-savings income – basic rate	$£7,500 \times 20\%$	1,500
		<hr/>
Income tax liability		1,500
		<hr/>

## Notes



## Chapter 2

### Natalie

			£
Net income			60,000
Less: PA			(12,500)
			<u>47,500</u>
Taxable income			<u>47,500</u>
Income tax:	£		
Non-savings income – basic rate (W1)	40,000	× 20%	8,000
Non-savings income – higher rate	7,500	× 40%	3,000
	<u>47,500</u>		<u>11,000</u>
Income tax liability			<u>11,000</u>

### Mary

			£
Net income			180,000
Less: PA			(0)
			<u>180,000</u>
Taxable income			<u>180,000</u>
Income tax:			
Tax on non-savings income	£		
Non-savings income – basic rate (W1)	40,000	× 20%	8,000
Non-savings income – higher rate (W2)	112,500	× 40%	45,000
	<u>152,500</u>		
Non-savings income – additional rate	27,500	× 45%	12,375
	<u>180,000</u>		<u>65,375</u>
Income tax liability			<u>65,375</u>

### Workings

- Higher rate threshold:  $£37,500 + (£2,000 \times 100/80) = £40,000$
- Additional rate threshold:  $£150,000 + (£2,000 \times 100/80) = £152,500$



## 7 Child benefit tax charge

### 7.1 Child benefit tax charge

Child benefit is a tax free payment from the government that can be claimed in respect of children.

- An income tax charge applies if a taxpayer or his/her partner receives child benefit but one of them has adjusted net income (ANI) > £50,000.
- The charge is added to income tax liability of the partner with the higher ANI.



The charge is 1% of child benefit received for every £100 of ANI over £50,000

- If both partners have ANI ≤ £50,000 = no charge.
- If higher earner has ANI > £50,000 charge = child benefit received.

To avoid the charge being levied, the recipient can opt not to receive child benefit.

### Example 8



Malik and Onya have three children and receive child benefit of £2,545.

Malik is a stay at home civil partner with no income.

Onya runs her own events organisation business generating net income for the tax year 2020/21 of £58,000.

She made gross gift aid donations of £800 in the year.

**What is the child benefit tax charge on Onya for the tax year 2020/21?**

## Chapter 2

### Onya and Malik

	£	£
Child benefit received	2,545	
Adjusted net income (£58,000 – £800)	57,200	
Less: Threshold	(50,000)	
Excess	7,200	
Charge is 1% per £100 of £7,200 = 72%		
Child benefit charge $72\% \times £2,545$		1,832

### Note

At every stage of the calculation the figures are rounded down to the nearest whole number.

## Notes



# 8 Tax status of an individual

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## 8.1 Concept of residence

An individual who is **resident** in the UK for a particular tax year is assessed to UK tax on his/her worldwide income.

## 8.2 Definition of residence

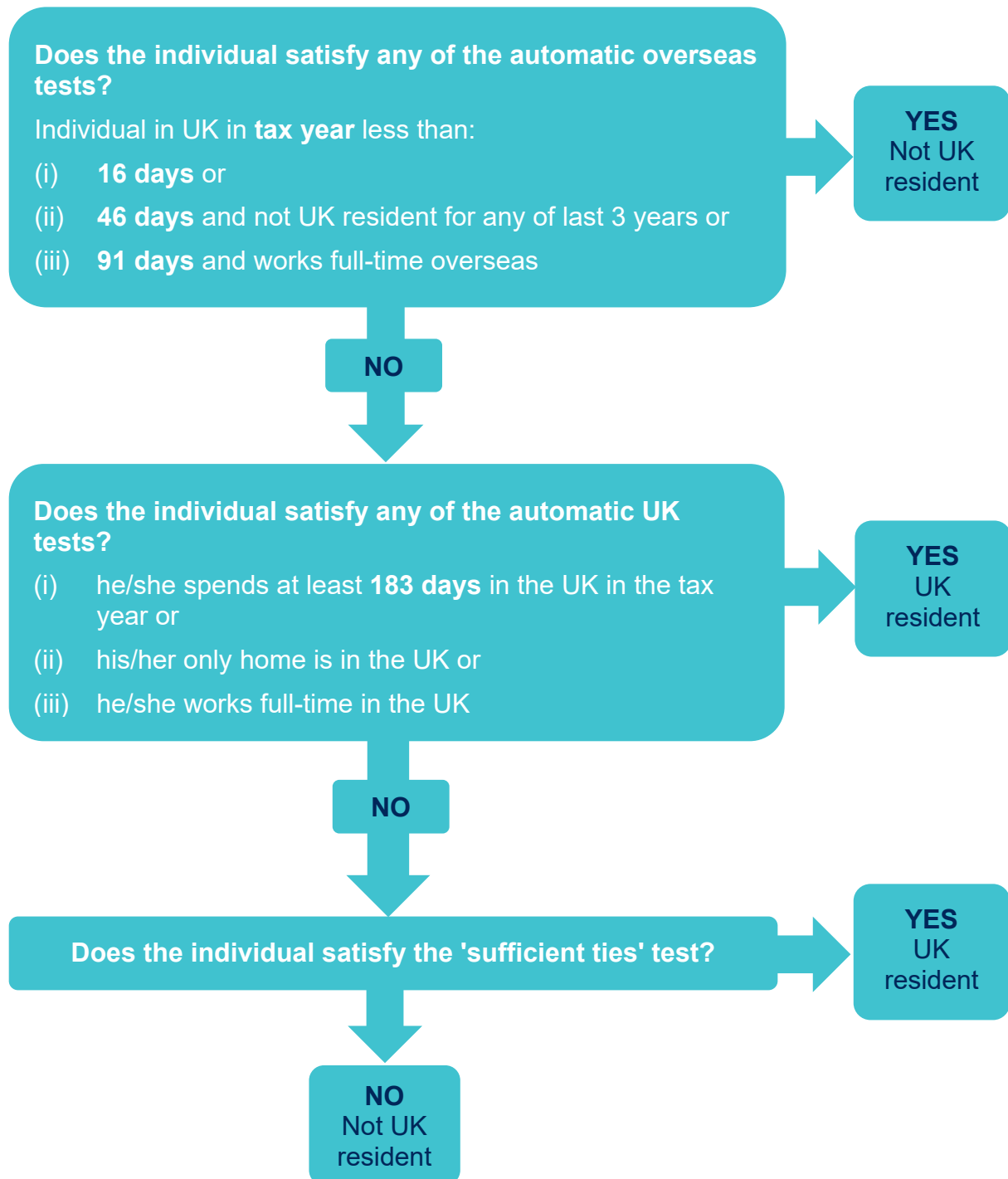
To determine if an individual is UK resident for a particular year, the following questions need to be addressed.

## Notes

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## Chapter 2



## Notes



For the purposes of the 'sufficient ties' test, the following are relevant ties:

- UK resident spouse/civil partner or child < 18 years old.
- Accommodation available in the UK, which is made use of during the year.
- Does substantive work in the UK.
- Spent > 90 days in the UK in either, or both, of the two preceding tax years.
- Spends more time in the UK than in any other country in the tax year.  
This 'country tie' is only applicable if individual has been resident in the UK in any of the three previous tax years.

Satisfaction of the sufficient ties test will depend on three factors:

- (i) whether the individual was resident in the UK in any of the three previous tax years
- (ii) number of days spent in the UK in the current tax year
- (iii) number of ties present.



### Sufficient ties required for residence:

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 ties (or more)	Resident if 2 UK ties (or more)
183 or more	Automatically resident	Automatically resident

## Notes



### Example 9



Harry is UK born and bred and has always been UK resident. In December 2019 he lost his job and decided to go travelling for an extended period. He does not intend to work while he is away.

Harry left the UK on 24 April 2020 and expects not to return to the UK until June 2021. His plans are vague but he began with a six week tour of Australia.

Harry lived with his mother until she sold the family home and moved into a nursing home in January 2020. His mother is his only surviving close relative (he is unmarried) so he stayed with friends before he went travelling.

**Explain Harry's residence in the tax years 2020/21 and 2021/22.**

### Notes



### Harry

#### 2020/21

The automatic overseas tests are not met as Harry

- was UK resident in the tax year 2019/20
- is present in the UK for more than 16 days in 2020/21
- is not working while he is overseas.

The automatic UK tests are also not met as Harry

- is not in the UK for more than 183 days in 2020/21
- does not have a UK home
- is not working in the UK.

It is therefore necessary to consider whether the sufficient UK ties tests are met. Harry has **one UK tie** for the year because he has spent more than 90 days in the UK in each of the two previous tax years. He does not have a spouse or child, does not have a house in the UK, is not working in the UK in 2020/21 and will spend more days in Australia than in the UK in the tax year, so none of the other ties are present.

As Harry is only in the UK for 18 days, he needs at least four ties to be UK resident. Harry is therefore **not UK resident** for 2020/21.

#### 2021/22

The automatic overseas tests are not met despite Harry's non-UK resident status in 2020/21 as Harry

- has been resident in at least one of the three preceding years
- will be present in the UK for more than 16 days in 2021/22, and
- will not be working full time overseas.

However, he is likely to meet the automatic UK tests and therefore be resident for the tax year. If he returns in June and stays in the UK for most of the rest of the tax year, he is likely to be present in the UK for at least 183 days.

### Questions



You should now be able to answer TYU questions 1 to 16 from the Study Text Chapter 2.

For further reading, visit Chapter 2 of the Study Text.



# Chapter 3

## Investment income



### Outcome

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Upon completion of this Chapter you will be able to:

- compute the tax payable on savings and dividends income
- recognise the treatment of individual savings accounts (ISAs) and other tax exempt investments
- understand how the accrued income scheme applies to UK Government securities (gilts)
- prepare a basic income tax computation involving different types of income
- understand how a married couple or couple in a civil partnership can minimise their tax liabilities
- suggest basic tax planning

and answer questions relating to these areas.



PER

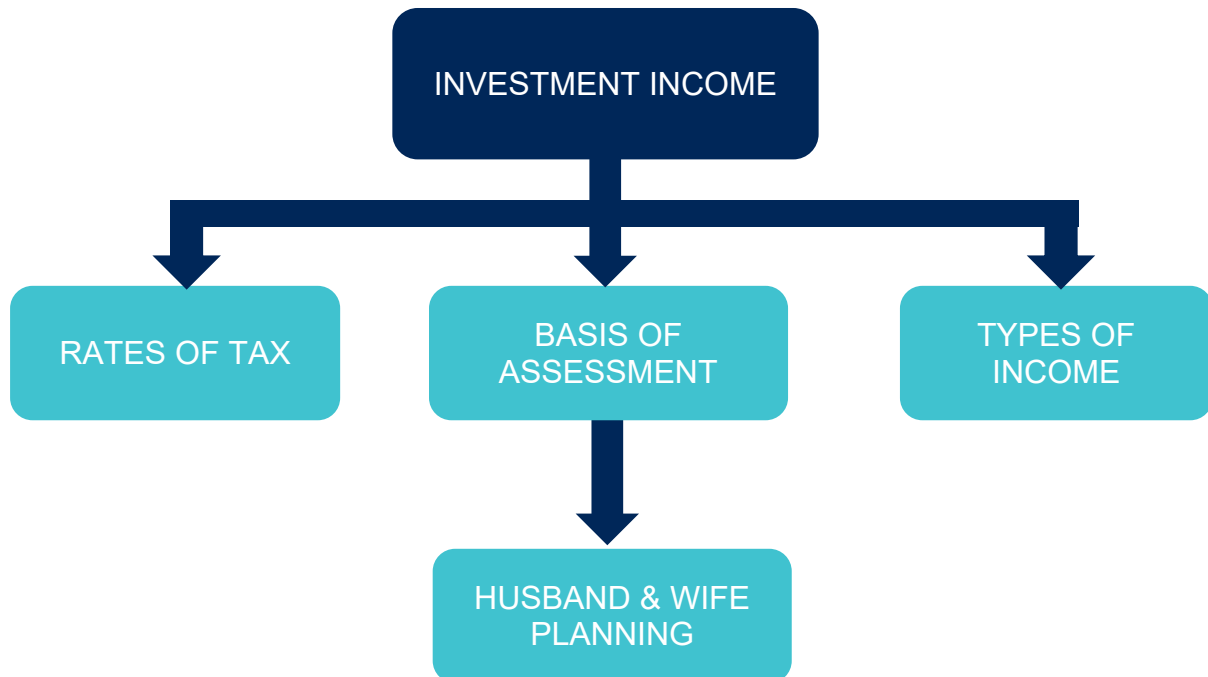
One of the PER performance objectives (PO15) is to prepare computations of taxable amounts and tax liabilities according to legal requirements. Another objective (PO17) is to advise on mitigating and deferring liabilities through legitimate tax planning measures. Working through this chapter should help you understand how to demonstrate those objectives.

The underpinning detail for this Chapter in your Integrated Workbook can be found in Chapter 3 of your Study Text.



## Overview

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# 1 Savings income

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## 1.1 Types of savings income

Examples of the main types of savings income are as follows:

- bank and building society interest
- interest from National Savings and Investments (NS&I accounts)
- interest from gilt-edged securities e.g. treasury stock, exchequer stock
- interest from quoted company loan stock.

**N.B.** Interest from ISAs and from NS&I **certificates** is exempt from income tax.

An individual is taxed on the interest **received** in a tax year.

## Notes

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## 1.2 Rates of tax on savings income



Savings income is taxed after non-savings income at the following rates:

		%
Starting rate band*	£1 – £5,000	0
Basic rate band	£1 – £37,500	20
Higher rate band	£37,501 – £150,000	40
Additional rate band	£150,001 +	45

\* The starting rate of 0% only applies if savings income falls into the first £5,000 of taxable income. This £5,000 band may be reduced, or fully eliminated by, non-savings income since this is taxed before savings income.

## Notes





## Example 1

Theo receives the following income in the tax year 2020/21:

- Salary £15,000
- Bank interest £2,000
- Interest on NS&I Certificates £360

**Compute Theo's income tax liability for the tax year 2020/21.**

**Theo**

	Non-savings income	Savings income	Total
	£	£	£
Salary	15,000		15,000
Bank interest		2,000	2,000
NS&I certificates – exempt			0
Net income	15,000	2,000	17,000
Less: PA	(12,500)		(12,500)
Taxable income	2,500	2,000	4,500
Income tax:	£		£
Non-savings income – basic rate	2,500 × 20%		500
Savings income – starting rate	2,000 × 0%		0
	4,500		
Income tax liability			500

**Notes:**

- Non-savings income is taxed first.
- The savings income falls within the first £5,000 of taxable income and is taxed at 0%.

### 1.3 Savings income nil rate band



**Savings income nil rate band (NRB)** = 0% rate for basic and higher rate taxpayers with savings income above the starting rate band. The savings NRB reduces the remaining basic or higher rate bands.



The **savings income NRB** = £1,000 for basic rate taxpayers  
£500 for higher rate taxpayers.

## Example 2



Androulla receives the following income in the tax year 2020/21:

- Salary £24,500
- Bank interest £2,500
- Lottery winnings £100

**Compute Androulla's income tax liability for the tax year 2020/21.**

## Notes



## Chapter 3

### Androulla

	Non-savings income	Savings income	Total
	£	£	£
Salary	24,500		24,500
Bank interest		2,500	2,500
Winnings – exempt			0
Net income	24,500	2,500	27,000
Less: PA	(12,500)		(12,500)
Taxable income	12,000	2,500	14,500
Income tax:	£		£
Non-savings income – basic rate	12,000	× 20%	2,400
Savings income – nil rate	1,000	× 0%	0
Savings income – basic rate	1,500	× 20%	300
	14,500		
Income tax liability			2,700

### Notes:

- The SRB is not available as the savings income does not fall within the first £5,000 of taxable income.
- As taxable income is less than £37,500 the £1,000 savings income nil rate band is available.
- The remaining savings income of £1,500 falls into the basic rate band and is taxed at 20%.





## Example 3

Donald receives the following income in the tax year 2020/21:

- Property income £49,850
- Bank interest £1,750
- Premium bond winnings £150

**Compute Donald's income tax liability for the tax year 2020/21.**

**Donald**

	Non-savings income	Savings income	Total
	£	£	£
Property income	49,850		49,850
Bank interest		1,750	1,750
Premium bond – exempt			0
Net income	49,850	1,750	51,600
Less: PA	(12,500)		(12,500)
Taxable income	37,350	1,750	39,100
Income tax:	£		£
Non-savings income – basic rate	37,350	× 20%	7,470
Savings income – nil rate	500	× 0%	0
Savings income – higher rate	1,250	× 40%	500
	39,100		
Income tax liability			7,970

**Notes:**

- The SRB is not available as the savings income does not fall within the first £5,000 of taxable income.
- As taxable income is over £37,500 but below £150,000, the £500 savings income nil rate band is available.
- The remaining savings income falls into the higher rate band and is taxed at 40%.

# 2 Dividend income

## 2.1 Rates of tax on dividend income



Dividend income is taxed after non-savings income and savings income at the following rates:

Basic rate band £1 – £37,500	7.5%
Higher rate band £37,501 – £150,000	32.5%
Additional rate band £150,001 +	38.1%

## 2.2 Dividend nil rate band



**Dividend nil rate band (NRB)** = 0% rate for all taxpayers on first £2,000 of dividend income. The dividend NRB reduces the remaining basic and higher rate bands.

Any remaining dividend income is taxed at the rates shown above.

**N.B.** When offsetting the PA and other reliefs, remember to deduct them in the following order:

- (1) Non-savings income
- (2) Savings income
- (3) Dividend income

Using a columnar approach to lay out your income tax computation will ensure that you deal with this in the right order.

## Notes



## Example 4



Ronnie receives the following income in the tax year 2020/21:

- Property income £19,500
- Bank interest £2,000
- Dividends £9,000

**Compute Ronnie's income tax liability for the tax year 2020/21.**

## Notes



## Chapter 3

### Ronnie

	Non-savings income	Savings income	Dividend income	Total
	£	£	£	£
Property income	19,500			19,500
Bank interest		2,000		2,000
Dividends			9,000	9,000
Net income	19,500	2,000	9,000	30,500
Less: PA	(12,500)			(12,500)
Taxable income	7,000	2,000	9,000	18,000
Income tax:	£			
Non-savings income – basic rate	7,000	× 20%		1,400
Savings income – nil rate	1,000	× 0%		0
Savings income – basic rate	1,000	× 20%		200
Dividend income – nil rate	2,000	× 0%		0
Dividend income – basic rate	7,000	× 7.5%		525
	18,000			
Income tax liability				2,125

### Notes:

- The dividend nil rate band of £2,000 is available to all taxpayers.
- The remaining dividend income falls into the basic rate band and is taxed at 7.5%.

## Example 5



Charis receives the following income in the tax year 2020/21:

- Salary £13,500
- Bank interest £8,000
- Dividends £39,000

**Compute Charis's income tax liability for the tax year 2020/21.**

## Notes



## Chapter 3

### Charis

	Non-savings £	Savings income £	Dividend income £	Total £
Salary	13,500			13,500
Bank interest		8,000		8,000
Dividends			39,000	39,000
Net income	13,500	8,000	39,000	60,500
Less: PA	(12,500)			(12,500)
Taxable income	1,000	8,000	39,000	48,000
Income tax:		£		£
Non-savings – basic rate		1,000	× 20%	200
Savings income – starting rate		4,000	× 0%	0
		5,000		
Savings income – nil rate		500	× 0%	0
Savings income – basic rate		3,500	× 20%	700
Dividend income – nil rate		2,000	× 0%	0
Dividend income – basic rate		26,500	× 7.5%	1,987
		37,500		
Dividend income – higher rate		10,500	× 32.5%	3,412
		48,000		
Income tax liability				6,299

## Example 6



In the tax year 2020/21 Eduardo received employment income of £220,550 before the deduction of £71,300 of income tax under PAYE. During the tax year he also received bank interest of £13,600 and dividends of £9,200.

Eduardo also paid interest of £3,000 on a loan to buy shares in his employer's company, which qualifies as a UK employee controlled unquoted trading company.

**Calculate Eduardo's income tax payable/repayable for the tax year 2020/21.**

## Notes



## Chapter 3

### Eduardo

	Non-savings income	Savings income	Dividend income	Total
	£	£	£	£
Employment income	220,550			220,550
Bank interest		13,600		13,600
Dividends			9,200	9,200
Total income	220,550	13,600	9,200	243,350
Less: Qualifying interest	(3,000)			(3,000)
Net income	217,550	13,600	9,200	240,350
Less: PA (ANI > £125,000)	(0)			(0)
Taxable income	217,550	13,600	9,200	240,350

### Income Tax

	£		£
Non-savings income – basic rate	37,500	× 20%	7,500
Non-savings income – higher rate	112,500	× 40%	45,000
	150,000		
Non-savings income – additional rate	67,550	× 45%	30,397
	217,550		
Savings income – additional rate	13,600	× 45%	6,120
Dividend income – nil rate	2,000	× 0%	0
Dividend income – additional rate	7,200	× 38.1%	2,743
	240,350		
Income tax liability			91,760
Less: PAYE			(71,300)
Income tax payable			20,460



### 3 Reminder of the income tax computation

#### Income tax computation – 2020/21

	Non-savings	Savings	Dividends	Total
	£	£	£	£
Trading profits	X			X
Employment income	X			X
Pension income	X			X
Furnished holiday lettings	X			X
Interest income		X		X
Property income	X		X	X
Dividends				X
Total income	X	X	X	X
Less: Reliefs				
Qualifying loan interest	(X) <sup>1</sup>	(X) <sup>2</sup>	(X) <sup>3</sup>	(X)
Net income	X	X	X	X
Less: Personal allowance (PA)	(X) <sup>1</sup>	(X) <sup>2</sup>	(X) <sup>3</sup>	(X)
Taxable income	X	X	X	X
Income tax at appropriate rates				X
Less: Marriage allowance (Max £250)				(X)
Income tax liability				X
Less: Tax deducted under PAYE				(X)
Income tax payable/(repayable)				X

## Notes



# 4 Individual savings accounts

### 4.1 Annual subscription limit



The maximum an individual can invest in an ISA for the tax year 2020/21 is £20,000.

Spouses and civil partners each have their own limits.

### 4.2 Types of ISA

There are two key types of ISA

- Cash ISA
- Stocks and shares ISA.

An individual can invest the overall limit of £20,000 in a mix of different types of ISAs.

### 4.3 Investor conditions

- Aged 16 or over (but 16 and 17 year olds can only invest in cash ISAs).
- Must be UK resident.

### 4.4 Tax reliefs

- All income (interest and dividends) received from an ISA is exempt from income tax.
- Disposals of investments held within an ISA are exempt from capital gains tax.

## Notes



## 5 Accrued income scheme

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Aim is to stop individuals selling securities just before the interest payment date to avoid having to pay tax on the accrued income (most securities are exempt from capital gains tax, but the interest income would be liable to income tax).

- Disposal price is adjusted to take into account accrued income element up to the date of the disposal.
- Income element is assessed to income tax as savings income.
- Rules only apply if nominal value of securities held by individual > £5,000.
- Rules do not apply to securities that are transferred on death.

### Notes

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### Example 7

Serena sells £40,000 8% loan stock cum interest on 30 September 2020 for proceeds of £64,000. She originally acquired the loan stock on 1 June 2017. Interest is paid on 31 January and 31 July each year

**Calculate the amount assessed on Serena as interest income in the tax year 2020/21.**

**Serena**

	£
Interest received 31 July 2020 (£40,000 × 8% × 6/12)	1,600
Accrued interest included in the selling price of loan stock (from 1 August until 30 September 2020) (£40,000 × 8% × 2/12)	533
	<hr/>
Total interest assessable to tax	2,133
	<hr/>

The disposal proceeds are reduced by £533 to take into account the amount which has been charged to income tax. However, most disposals of loan stock are exempt for capital gains purposes.

## 6 Married couples – planning opportunities

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Consider the following:

- Use of marriage allowance (MA) election to transfer fixed amount of PA between the couple.
- Transfer income generating assets to the individual with lowest net income in order to save tax (transfers of assets between spouses or civil partners are neutral for capital gains purposes).
- Joint ownership of shares to maximise dividend nil rate bands.
- Joint ownership of deposit accounts to maximise savings income nil rate bands.
- Making an election to split joint income according to actual ownership if the spouse with the higher actual ownership is the lower taxpayer.

### Notes

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# Questions



You should now be able to answer TYU questions 1 – 8 from the Study Text Chapter 3.

For further reading, visit Chapter 3 of the Study Text.

# Chapter 4

## Property income



### Outcome

Upon completion of this chapter you will be able to:

- compute property business profits
- explain the treatment of furnished holiday lettings
- understand rent-a-room relief
- compute the amount assessable when a premium is received for the grant of a short lease
- understand and apply the restriction on property income finance costs
- understand how relief for a property business loss is given

and answer questions relating to these areas.



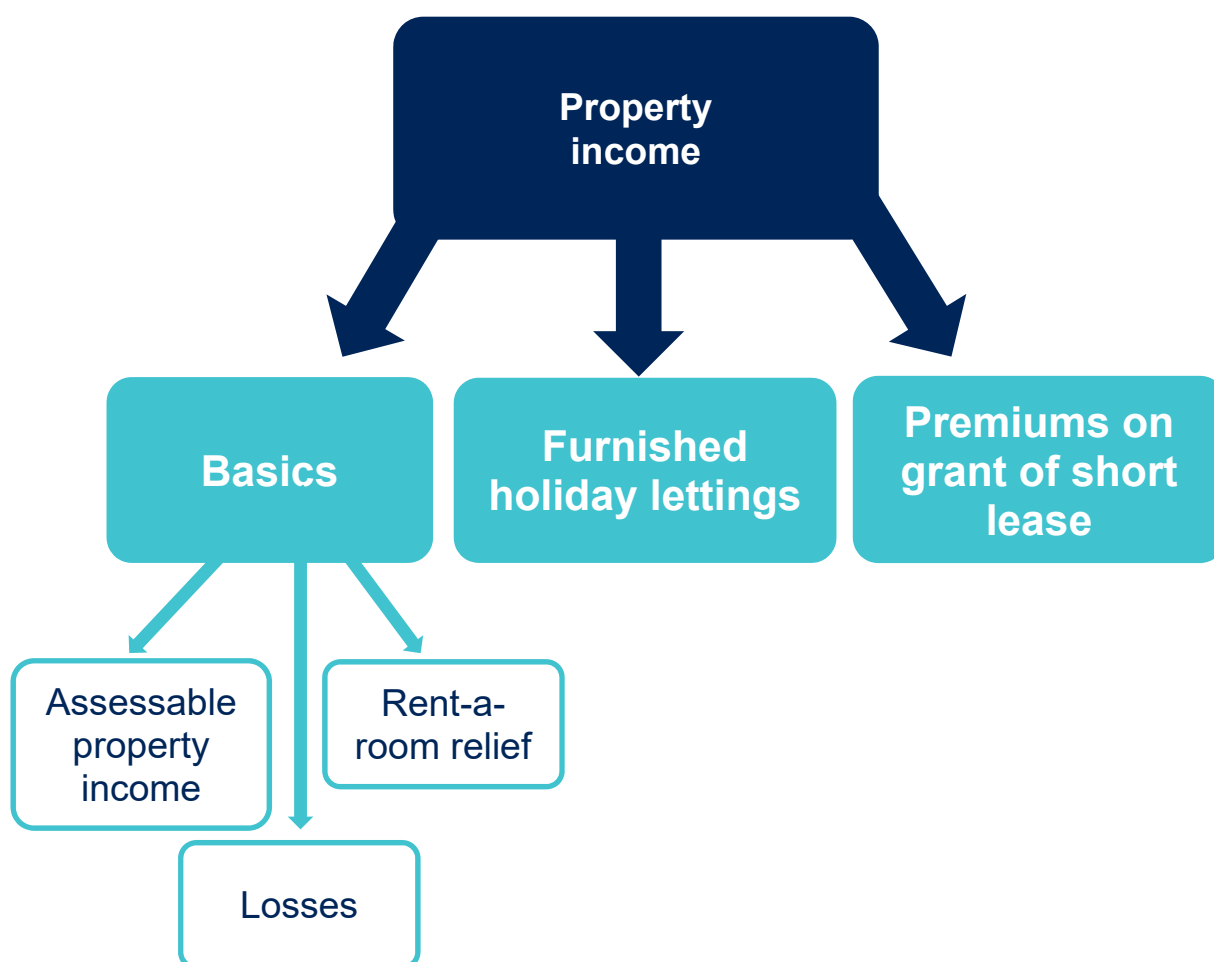
PER

One of the PER performance objectives (PO15) is to prepare computations of taxable amounts and tax liabilities according to legal requirements. Working through this chapter should help you understand how to demonstrate that objective.

The underpinning detail for this Chapter in your Integrated Workbook can be found in Chapter 4 of the Study Text.



### Overview





# 1 Property income – basic calculation

## 1.1 Basis of assessment

- The property income assessed for an individual or partnership in a tax year is the **income less expenses actually arising in the tax year**, i.e. for the tax year 2020/21 the net income arising in the period 6 April 2020 to 5 April 2021.
- The **cash basis** is the **default** basis for **individuals and partnerships** to calculate assessable income from land and buildings each tax year.
- Income and expenses from different properties are pooled together in a single working:

	£
Rental income <b>received</b>	X
Less: Related expenses <b>paid</b>	(X)
	—
<b>Property income assessment</b>	<b>X</b>
	—

## 1.2 Allowable deductions

To be allowable expenses must have been incurred **wholly and exclusively** for the purposes of the **property business**. Examples of allowable deductions include:

- insurance
- interest on a loan to buy a non-residential property (see below for residential)
- legal and professional costs, e.g. agent's fees
- rates and taxes paid by landlord, e.g. council tax, water rates
- ancillary services provided by landlord, e.g. cleaning, gardening
- repairs and maintenance, e.g. painting and decorating

If the owner occupies the property for part of the year, any expenses relating to the private use will not be allowed as a deduction.

## Notes



## Chapter 4

### 1.3 Interest in relation to residential lettings



Tax relief for the costs of **financing residential rental property**

= restricted to the basic rate of tax.

- Finance costs are **not** deducted from property income.
- Relief is given as a basic rate tax deduction from the individual's income tax liability instead.



Basic rate restriction applies to 100% of finance costs relating to residential properties.

- These special rules **apply to** interest and associated incidental costs (e.g. arrangement fees) on loans to:
  - acquire, improve or repair a residential let property, and
  - acquire equipment or assets used for the residential letting business.

Note that these rules **do not apply** to companies, commercial properties or qualifying furnished holiday accommodation (section 2).

## Notes



## Example 1



Ning owns a residential property which was let for the first time on 1 July 2019.

The rent for the year ended 30 June 2020 was £15,000 and was paid quarterly in arrears. On 1 July 2020 the rent was increased to £17,000 per annum.

Ning paid allowable expenses of £2,000 in the tax year 2020/21. In addition, he paid insurance quarterly in advance of £1,000 for the year ended 31 December 2020 and £1,400 for the year ended 31 December 2021. He had also taken out a loan to buy the property and the interest incurred on this loan for the tax year 2020/21 amounted to £1,980.

**Calculate Ning's taxable property income for the tax year 2020/21.**

## Notes



## Chapter 4

### Ning

	£	£
Rent received		
30 June 2020 (£15,000/4)		3,750
30 September 2020 (£17,000/4)		4,250
31 December 2020		4,250
31 March 2021		4,250
		<u>16,500</u>
Less:		
Allowable expenses paid	2,000	
Insurance paid		
1 July 2020 (£1,000/4)	250	
1 October 2020	250	
1 January 2021 (£1,400/4)	350	
1 April 2021	350	
Interest (Note)	0	
	<u>0</u>	
		(3,200)
Taxable property income		<u>13,300</u>

### Note

Since the property is residential, none of the interest qualifies for relief when calculating the property income assessment.

The interest cost of £1,980 will qualify for basic rate relief only, and this will be given as a reduction to his income tax liability. This will give rise to a maximum tax saving of £396 ( $£1,980 \times 20\%$ ).

## Notes



## 1.4 Capital expenditure

Under the cash basis there is generally no distinction between capital and revenue expenditure for tax purposes.

- Expenditure on plant and machinery used in a property business is an **allowable deduction** from income when paid.
- However, this general rule does not apply to:
  - cars
  - assets provided for use in a residential property, e.g. furniture, TV (but see replacement domestic items relief below).
- Also, capital expenditure on land and buildings is not an allowable deduction, but must distinguish between:
  - improvements (capital expenditure) = not allowable, and
  - repairs (revenue expenditure) = allowable.
- **Replacement domestic items relief**
  - The cost of **replacing** furnishings in a residential property (e.g. beds, televisions, fridges, freezers, carpets, floor coverings, curtains, crockery and cutlery) is allowable.
  - The relief available is reduced by any proceeds from the sale of the asset being replaced, but increased by any costs of disposal of the old item.
  - Relief is only available for a like-for-like replacement: no deduction is available for any costs that represent an improvement.
- **Cars**
  - Capital allowances (see Chapter 8) are available on the cost of cars and the actual motoring costs (e.g. petrol, insurance, etc.) are also deductible.
  - Alternatively, HMRC's approved mileage allowances can be claimed instead of capital allowances and actual motoring costs.

HMRC's approved mileage allowances are:



First 10,000 miles p.a.	45p
Over 10,000 miles p.a.	25p

These approved mileage allowances are the same as those used by employees and traders re: motoring costs (see Chapters 5 and 7).

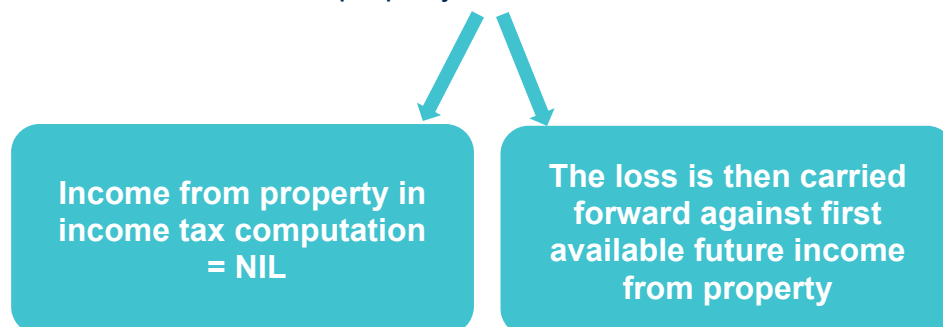
## Chapter 4

### 1.5 Accruals basis

- This basis should only be used in TX if the question specifies to do so. This will be the case if the taxpayer opts to use it or property income receipts exceed £150,000.
- The main difference is that rental income and related expenses are assessable/deductible on an accruals basis, i.e. the **rent receivable** and the **expenses payable** in respect of the tax year.
- If a tenant leaves without paying outstanding rent, the amount owed is a deductible expense. This is referred to as an 'impairment loss'.
- Expenditure on plant and machinery used in a property business is not an allowable deduction, but capital allowances (Chapter 8) are available instead.
- Other rules, including replacement domestic items relief and the treatment of finance costs for residential properties, operate in the same way as for the cash basis.

### 1.6 Losses

If total expenses > total income = property income loss.



## Notes



## Example 2



Sam has three properties that she lets out.

Her income received and allowable expenses paid for the tax years 2019/20 and 2020/21 were as follows:

	Property A £	Property B £	Property C £
<b>Income received</b>			
2019/20	4,600	2,200	11,000
2020/21	5,600	7,100	12,200
<b>Expenses paid</b>			
2019/20	9,600	1,800	10,300
2020/21	1,400	1,900	12,600

**Calculate Sam's property income or loss for the tax years 2019/20 and 2020/21 (assuming the current rules applied throughout).**

## Notes



## Chapter 4

### Sam

#### Property income

Property	A £	B £	C £	Total £
<b>2019/20</b>				
Income received	4,600	2,200	11,000	17,800
Less: Expenses paid	(9,600)	(1,800)	(10,300)	(21,700)
Profit/(loss)	(5,000)	400	700	(3,900)
Property income assessment				0
Loss c/f				(3,900)
<b>2020/21</b>				
Income received	5,600	7,100	12,200	24,900
Less: Expenses paid	(1,400)	(1,900)	(12,600)	(15,900)
Profit/(loss)	4,200	5,200	(400)	9,000
Loss b/f				(3,900)
Property income assessment				5,100

## Notes





## 1.7 Rent-a-room relief



If a taxpayer has a lodger renting a room in his, or her, main residence and the gross rent received is not more than the **rent-a-room** limit the property income from the lodger is exempt.

For the tax year 2020/21 the **rent-a-room limit** is £7,500 p.a.

- If gross rent received  $\leq$  £7,500, the taxpayer can elect not to take the exemption for a particular year (for example, if the normal calculation results in a loss).
- If gross rent received  $>$  £7,500, the individual can choose the lower of:

### Rent-a-room relief

Rent received	X
Rent-a-room relief	(7,500)
Property income	<u>X</u>

### or Normal calculation (cash basis = default)

Rent received	X
Less: expenses paid	(X)
Property income	<u>X</u>

Where two or more people share a home each has rent-a-room relief of £3,750 (£7,500/2), even if there are three or more co-owners.

Where the individual elects to use the accruals basis the gross rent received in the tax year should be based on rent receivable.

## Example 3



Montana lets out a room in her house at a rent of £150 per week received in advance. Her allowable expenses paid were £7,550 for the tax year 2020/21.

**Show whether Montana should elect to use the rent-a-room rules.**

## Notes



## Chapter 4

### Montana

Normal property income rules:

	£
Rent received ( $£150 \times 52$ )	7,800
Less: Expenses paid	(7,550)
	<hr/>
Taxable property income	250
	<hr/>

Rent-a-room rules:

	£
Rent received	7,800
Less: Rent-a-room limit	(7,500)
	<hr/>
Taxable property income	300
	<hr/>

Montana should not make the rent-a-room election as her taxable property income is lower under the normal rules.

## Notes



## 2 Furnished Holiday Lettings

### 2.1 Conditions

In order to qualify for the tax advantages of being classified as Furnished Holiday Accommodation (FHA) a property must meet the following conditions:

- The property is let **furnished**.
- Let on a **commercial basis** with a view to the realisation of profits.
- **Available** for commercial letting, to the public generally, as holiday accommodation for not less than **210 days** a tax year.
- **Actually let** for at least **105 days** a tax year.
- **Not** let for periods of '**long term occupation**' in excess of 155 days in a tax year. Long term occupation is defined as a period of more than 31 consecutive days when the property is let to the same person.

### 2.2 Implications

Profits from furnished holiday accommodation are assessable as property income.

The **cash basis** is the **default** basis when calculating the property income assessable for the tax year.

Losses can only be offset against income from the same FHA business.

However, the following benefits and reliefs are available:

- The profits are relevant earnings for the purposes of personal pension scheme contributions (see Chapter 6).
- Plant & Machinery
  - Cash basis** – a deduction is available on a **paid basis** for **plant and machinery** acquired.
  - Accruals basis** – **capital allowances** are available in respect of **plant and machinery** including furniture and furnishings.
  - Cash or accruals – replacement domestic items relief is not available to FHAs.
- Treated as a business asset for capital gains tax reliefs.

### Notes

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## 3 Premiums on grant of a short lease

### 3.1 Basic principles



A **lease** is the right to use property for a specified amount of time.



A **premium** is an upfront payment from the tenant to the landlord in consideration for granting a lease.

### 3.2 Amount taxed as property income on landlord

Where the premium is in respect of a short lease ( $\leq 50$  years), part of the premium is taxed as property income on the landlord in the year the lease is granted.

The property income element of the premium is calculated as:

Premium  $\times \frac{51 - n}{50}$  where  $n$  = length of lease granted (ignore parts of years).

An alternative way of calculating this amount is as follows:

	£
Premium received	X
Less: Premium $\times 2\% \times (n-1)$	(X)
	<hr/>
Property income	X
	<hr/>

## Notes





## Example 4

Calder grants a 40 year lease of business premises to Matt for a premium of £35,000.

**Calculate the amount of the premium which is taxable as property income.**

**Calder**

**Amount taxable on Calder as property income:**

	£
Taxable property income $\text{£}35,000 \times (51 - 40)/50$	7,700
	<hr/>

**Alternative method of calculating:**

	£
Premium	35,000
Less: $2\% \times (40 - 1) \times \text{£}35,000$	(27,300)
	<hr/>
	7,700
	<hr/>

## Notes





## Example 5

Anna grants a 38 year lease of business premises to Bana for a premium of £19,600.

**Calculate the amount of the premium which is taxable as property income.**

**Anna**

**Property income**

Taxable property income on the grant of a short lease:

$$= £19,600 \times (51 - 38)/50$$

£5,096

**Alternative method of calculating:**

Premium

£

19,600

Less:  $2\% \times (38 - 1) \times £19,600$

(14,504)

5,096

## Notes



### Questions



You should now be able to answer TYU questions 1 – 6 from the Study Text Chapter 4 as well as the question 'Amos' from Chapter 27.

For further reading, visit Chapter 4 of the Study Text.



# Chapter 5

## Employment income



### Outcome

Upon completion of this chapter you will be able to:

- recognise the factors that determine whether an engagement is treated as employment or self-employment
- recognise the basis of assessment for employment income
- recognise the income assessable
- recognise the allowable deductions including travelling expenses
- discuss the use of the statutory approved mileage allowances
- explain and compute the amount of benefits assessable

and answer questions relating to these areas.



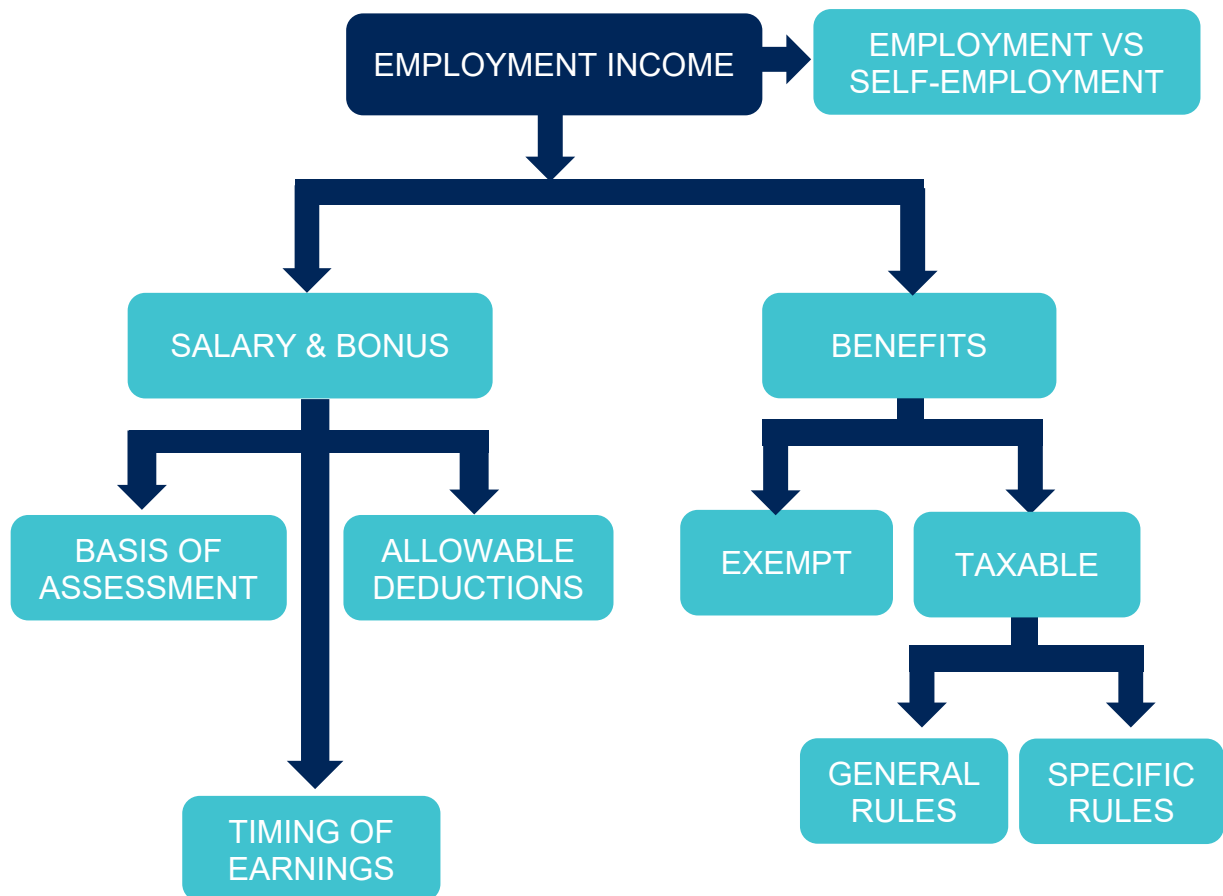
PER

One of the PER performance objectives (PO15) is to prepare computations of taxable amounts and tax liabilities according to legal requirements. Working through this chapter should help you understand how to demonstrate that objective.

The underpinning detail for this Chapter in your Integrated Workbook can be found in Chapter 5 of your Study Text.



### Overview



# 1 Employment vs self-employment

## 1.1 Contract of service vs contract for service



The distinction between employment and self-employment is fundamental for tax purposes.

- Employees = a **contract of service**  
taxed using employment income rules.
- Self-employed = a **contract for services**  
taxed using business income tax rules.

To determine whether an employment contract exists, consider the following factors:

- **Hours** – employee committed to work specified hours at fixed times and places and the contract is usually for a long period.
- **Integration** – employees normally carry out activities that are integral to the business rather than just an accessory to it.
- **Source of work** – employees typically receive their income from a single source, rather than multiple sources.
- **Control** – the employer controls how the work is carried out.
- **Holidays** – employees are entitled to paid holidays and sickness benefits.
- **Obligation** – employer to offer work and employee to carry it out.
- **Risk/Reward** – employees do not take any financial risk and cannot profit from sound management.
- **Equipment** – employees do not usually provide their own.
- **Substitutes** – employees must perform work themselves; someone else cannot perform their duties.

No single factor is conclusive.

You can use the mnemonic HIS CHORES to help you remember the above (as indicated by the letters in bold).

# 2 Employment income calculation

## 2.1 Employment income pro forma

	£
Salary	X
Bonus/commission	X
Benefits	X
Reimbursed expenses	X
Cash vouchers	X
	<hr/>
	X
Less: Allowable deductions	
Expenses incurred wholly, exclusively and necessarily	(X)
Contributions to employer's occupational pension scheme	(X)
Subscriptions to professional bodies	(X)
Charitable donations: payroll deduction scheme	(X)
Travel and subsistence expenses	(X)
Use of own car – mileage allowance	(X)
	<hr/>
Employment income	X
	<hr/>

## 2.2 Basis of assessment

The basis of assessment for employment income is the **receipts** basis.

Most earnings are deemed to be received on the earlier of:

- the actual payment date
- the date on which the individual became entitled to the payment.

## Notes



In the case of directors (who can manipulate the timing of payments), there are extra rules. They are deemed to receive earnings on the earliest of:

- the actual payment date
- the date on which the director became entitled to the payment
- the date on which the earnings are credited in the accounts
- if the earnings are determined:
  - before the end of the period  
= the last day of the period of account
  - after the end of the accounting period  
= the date on which the earnings are determined.

## Notes

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# 3 Deductibility of expenses

## 3.1 Allowable deductions

Expenses incurred by an employee are **allowable deductions** if:



the expense is incurred **wholly, exclusively** and **necessarily** in the **performance of duties** of the employment.

Examples of deductible expenses incurred by the employee include:

- Professional subscription fees
- Charitable donations under the payroll deduction scheme
- Contributions into an occupational pension scheme
- Travel (see below) and other business related expenses
- Capital allowances for plant and machinery necessarily provided for use in the employment duties.

## 3.2 Reimbursed expenses

Where an employee is reimbursed expenses by the employer, the amount received is taxable income.

However, an exemption applies if the employee would be able to treat business-related expenses as tax deductible under the above rules, e.g. business travel.

Where an expense is partly allowable and partly disallowable, then the exemption can be applied to the allowable part.

## Notes



### 3.3 Travel expenses

Travel and subsistence expenses may be deducted if they are:

- necessarily incurred in the performance of the employment duties, or
- for the necessary attendance at any place in the performance of the duties.

Travel between home and a permanent workplace and any private travel are not allowable expenses, with some exceptions. If the employee:

- has no normal place of work = home to work travel is allowable
- normally works at home = travel from home to other work locations is allowable
- has a temporary workplace ( $\leq 24$  months) = home to work travel is allowable.

## Notes

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## Example 1

Shilpa (not a director) receives a monthly salary of £3,500 from her employer, Larimar Ltd, where she is employed as a tax adviser. In addition, she received the following bonuses:

Received:	Relates to:	Bonus:
31 May 2020	Larimar's profits for y/e 30 November 2019	£3,750
31 May 2021	Larimar's profits for y/e 30 November 2020	£4,375

Shilpa made the following payments in respect of her employment for the tax year 2020/21:

	£
Subscription to golf club solely for the use of entertaining clients	1,200
Fees to CIOT (Chartered Institute of Tax)	450
Train ticket from home to normal place of work	20
New suit for office	250
Home telephone bill (£40 business calls; £140 private; £20 line rental)	200

**Calculate Shilpa's taxable employment income for the tax year 2020/21.**

## Notes





## Shilpa

	£	£
Salary ( $\text{£}3,500 \times 12$ )		42,000
Bonus (received May 2020)		3,750
		<hr/>
		45,750
Less: Allowable expenses (see notes)		
Professional subscription	450	
Business calls	40	
	<hr/>	
		(490)
		<hr/>
Employment income		45,260
		<hr/>

## Notes

- Golf membership fee – no deduction (not 'necessary' for performance of duties) but any actual expenses reimbursed (e.g. a meal at the clubhouse) would be exempt.
- Train ticket – no deduction for ordinary commuting.
- New suit – no deduction – not wholly, exclusively and necessarily for performance of duties.
- Phone bill – £40 for the business calls is deductible, the £140 for private calls and £20 for the line rental are not deductible.

## Notes



# 4 Approved mileage allowance payments (AMAPs)

## 4.1 Statutory rates



**Approved mileage allowance payments (AMAPs)** apply to employees using their own car for business travel and receiving mileage allowance/payments for business travel from their employers.



HMRC set **statutory rates** for tax allowable amounts as follows:

### Rate per mile

45p first 10,000 miles

25p thereafter

If payments received from the employer:

- = AMAP – no benefit or deduction
- > AMAP – excess is taxable benefit
- < AMAP – shortfall is allowable deduction.

## Notes





## Example 2

Holly Ltd employs Stacey and Nessa.

In the tax year 2020/21 they receive the following payments for business mileage that they do in their own cars:

Employee	Mileage allowance	Business miles
Stacey	47p	14,000
Nessa	34p	6,000

Show the employment income consequences for each employee.

### Stacey and Nessa

	Stacey £	Nessa £
Amount reimbursed ( $14,000 \times 47p$ )	6,580	
( $6,000 \times 34p$ )		2,040
Less: Allowable deduction		
First 10,000 miles ( $10,000 \times 45p$ )	(4,500)	(2,700)
Above 10,000 miles ( $4,000 \times 25p$ )	(1,000)	
	<hr/>	<hr/>
Taxable benefit – add to employment income	1,080	
Allowable deduction – treat as employment income expense		(660)
	<hr/>	<hr/>

## Notes



# 5 Benefits

### 5.1 Basic principle

The term earnings includes non-cash benefits received by the employee or provided to a member of his or her family (unless they are specifically exempt).

### 5.2 Exempt benefits

Certain benefits provided by an employer are exempt from income tax. The most common are:

- Trivial benefits provided by employers to employees. A benefit is trivial if it:
  - cost ≤ £50, and
  - is not cash, or a cash voucher, and
  - is not provided in recognition of services provided by the employee.
- Employer's contributions into a registered pension scheme.
- Use of free/subsidised on-site canteen available to all employees.
- Provision of a car parking space at/near place of work.
- Mobile phone (one per employee for private use).
- Up to £150 p.a. per head for social events.
- Non-cash gifts from third parties (up to £250 p.a. per donor).
- Workplace nurseries/childcare.
- Work buses and subsidies to use public bus services.
- Use of bicycles (and cycling safety equipment) if available to all employees.
- Relocation and removal expenses up to £8,000.
- Work related training courses.
- Personal incidental expenses when working away from home up to £5 per night in the UK and £10 when working abroad. If the limit is exceeded the whole payment is taxable.

- Payments towards costs of working from home (need supporting documents if > £6 per week).
- Up to £500 p.a. for recommended medical treatment to help the employee return to work.
- Loans with a beneficial interest rate, provided the loan is ≤ £10,000 throughout the tax year.
- Provision of job-related accommodation (see section 5.10).

Other exempt benefits include:

- Entertainment provided by a third party.
- Non-cash long service awards for ≥ 20 years' service, maximum £50 per year of service.
- Provision of travel, accommodation and subsistence during public transport disruption caused by industrial action.
- Sports facilities available to employees but not general public.
- Pension advice provided to all employees up to £500 per year.
- Glasses and eye tests for employees who use VDUs.
- Awards made under a staff suggestion scheme.

## Notes

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### 5.3 Taxable benefits

#### General rules

- Subject to any specific rules for calculating a particular benefit (see below), the value of the benefit for tax purposes is the '**cost of providing**' the benefit, which is generally the additional or **marginal cost** to the employer.
- The taxable benefit is normally **reduced by any contributions** made by the employee towards its cost.
- The taxable benefit will be **time apportioned** if it was only available to the employee for part of the year.

After the end of the tax year, an employer must provide HMRC with details of the benefits provided to each employee during the tax year using form P11D.

Some benefits can be dealt with through PAYE (like cash earnings). They don't have to be included on the P11D or the employee's tax return.

## Notes

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### 5.4 Vouchers and credit tokens

- Vouchers provided by the employer, e.g. department store vouchers, are a taxable benefit. The value of the benefit is the cost to the employer of providing the voucher.
- If an employee is provided with a 'credit token', e.g. a company credit card, the taxable benefit is the cost of any private goods and services acquired on the card.

## Notes

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## Chapter 5

### 5.5 Company cars provided for private use

- Benefit = **manufacturer's list price × CO<sub>2</sub> emissions %**.

#### List price

- **List price of the car when first registered (not the price paid)**
- **Plus all optional extras**
- **Less any capital contribution made by the employee (max £5,000).**

#### CO<sub>2</sub> emissions %



The appropriate percentage to use depends on the CO<sub>2</sub> emissions and, for hybrid-electric cars, the electric range:

- The following rules apply to cars first registered on or after 6 April 2020. The ACCA have confirmed that the rules for cars first registered before that date are not examinable. In the examination you should assume that all company cars are registered after 6 April 2020.

#### Petrol and diesel-powered cars

- The percentage for cars with CO<sub>2</sub> emissions of 51-54g/km is 13%.
- The percentage for cars with CO<sub>2</sub> emissions of 55g/km is 14%.
- For cars with emissions over 55g/km the percentage is calculated as 14% plus 1% for every complete 5g/km over 55 grams.
- To calculate the additional percentage
  - **Round emissions down to nearest 5 g/km**
  - **Deduct 55g**
  - **Maximum = 37%.**
- **Add a 4% supplement for diesel cars that do not meet the real driving emissions 2 (RDE2) standard.**

#### Electric-powered cars

- The percentage for cars with zero CO<sub>2</sub> emissions is 0%.



### Hybrid-electric cars

- The percentage for hybrid cars with CO<sub>2</sub> emissions of 1-50g/km depends on the electric range of the car.

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

### Additional points

- If car was unavailable for a period of **≥ 30 consecutive days**:
  - **time apportion** the benefit.
- There is no car benefit for genuine pool cars.
- The benefit covers the running costs (insurance, maintenance, road tax, etc.), but there is a separate benefit for private fuel (below) or a chauffeur (at cost).

## Notes

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## Example 3

Calculate the relevant taxable benefits for the following cars provided to employees in 2020/21. The cars were all first registered on 6 April 2020.

Employee	CO <sub>2</sub> emissions	List price	Fuel type
Bi	53g	£43,200	Diesel (meets RDE2)
Cai	128g	£18,700	Petrol
Klea	42g	£9,000	Electric hybrid (driving range of 120 miles)
Juliette	216g	£12,890	Petrol
Tui	157g	£8,900	Diesel (does not meet RDE2)

### Bi

CO<sub>2</sub> emissions are 53g/km

Relevant % = 13%

**Annual benefit in 2020/21 = (13% × £43,200) = £5,616**

Note there is no 4% diesel supplement for cars meeting RDE2.

### Cai

CO<sub>2</sub> emissions are 128g/km rounded down to 125g/km

Relevant % = 14% +  $\frac{1}{5} \times (125 - 55) = 28\%$

**Annual benefit in 2020/21 = (28% × £18,700) = £5,236**

### Klea

CO<sub>2</sub> emissions are 42g/km with a driving range of 120 miles

Relevant % = 3

**Annual benefit in 2020/21 = (3% × £9,000) = £270**

### Juliette

CO<sub>2</sub> emissions are 216g/km rounded down to 215g/km

Relevant % =  $14\% + \frac{1}{5} \times (215 - 55) = 46\%$  – restricted to maximum of 37%

**Annual benefit in 2020/21 =  $(37\% \times \text{£}12,890) = \text{£}4,769$**

### Tui

CO<sub>2</sub> emissions are 157g/km rounded down to 155g/km

Relevant % =  $14\% + \frac{1}{5} \times (155 - 55) = 34\% + 4\% \text{ (diesel)} = 38\%$  – restricted to maximum of 37%

**Annual benefit in 2020/21 =  $(37\% \times \text{£}8,900) = \text{£}3,293$**

## Notes





### Example 4

Mateo is provided with a diesel car from 6 October 2020, list price £50,000 although his employers were able to get a discount and only paid £48,000. The car was first registered on 6 April 2020 and does not meet the RDE2 standard.

CO<sub>2</sub> emissions are 168g/km. Mateo uses the car both privately and for his employment duties. His employers pay all costs (except diesel fuel) totalling £5,100 for the tax year 2020/21.

**Calculate the taxable benefit for the tax year 2020/21.**

#### **Mateo**

CO<sub>2</sub> emissions are 168 g/km rounded down to 165 g/km

Relevant % =  $14\% + \frac{1}{5} \times (165 - 55) + 4\%$  (for diesel) = 40%  
restricted to maximum of 37%

Annual benefit =  $(37\% \times £50,000) = £18,500$

Available for 6 months in tax year 2020/21:

**Benefit in 2020/21 =  $(£18,500 \times 6/12) = £9,250$**

## Notes



## 5.6 Private fuel benefit



Benefit = £24,500 × CO<sub>2</sub> emissions % (**as per car benefit**).

- £24,500 is a flat rate regardless of how much private fuel is paid for by the employer.
- **Time apportion** if the fuel was first made available or ceased during the year, but not for a temporary cessation.
- **No deduction for employee contributions** towards part of the cost of the fuel, (but if the employee reimburses all private fuel then there is no benefit).

### Example 5



Zeynab was provided with a car (list price £22,000) throughout 2020/21. Her employers only paid £21,000 for the car after discounts. The car has a diesel engine and CO<sub>2</sub> emissions of 118g/km. It was first registered on 6 April 2020 and does meet the RDE2 standard.

Zeynab's employer paid £6,200 for diesel during the tax year, 30% of which was for private journeys.

Zeynab contributed £5,400 towards the capital cost of the car. In addition, she contributes £30 per month for its private use and £50 per month for private diesel.

- (a) Calculate Zeynab's taxable benefit in respect of the car.
- (b) Calculate Zeynab's taxable benefit in respect of the fuel used in the car.

### Zeynab

CO<sub>2</sub> emissions = 118 g/km rounded down to 115 g/km

Relevant %:  $(115 - 55) \times 1/5 = 12\% + 14\% + 0\%$  (meets RDE2) = 26%

#### (a) Car benefit

List price (£22,000 – £5,000 (max)) = £17,000 (Note 1)

	£
Benefit (£17,000 × 26%)	4,420
Less: Employee contribution for use: (£30 × 12)	(360)
	<hr/>
Taxable benefit	4,060
	<hr/>

#### (b) Fuel benefit

Benefit (£24,500 × 26%)	6,370
Less: Employee contributions (Note 2)	(0)
	<hr/>
Taxable benefit	6,370
	<hr/>

#### Notes:

- (1) The price paid by the employer for the car is irrelevant.
- (2) There is no deduction for Zeynab's contributions towards the fuel as she has not reimbursed her employer for the cost of all her private fuel.

## Notes



### 5.7 Company vans



Benefit for the **private use of company vans** = £3,490.

- If van was unavailable for a period of **≥ 30 consecutive days**:
  - **time apportion** the benefit.
- **No benefit** where the private use is insignificant.
- If employees share private use:
  - apportion the benefit on a just and reasonable basis.



Benefit on **fuel provided for private use in company vans** = £666.

- **No reduction** for employee contributions towards private fuel costs.

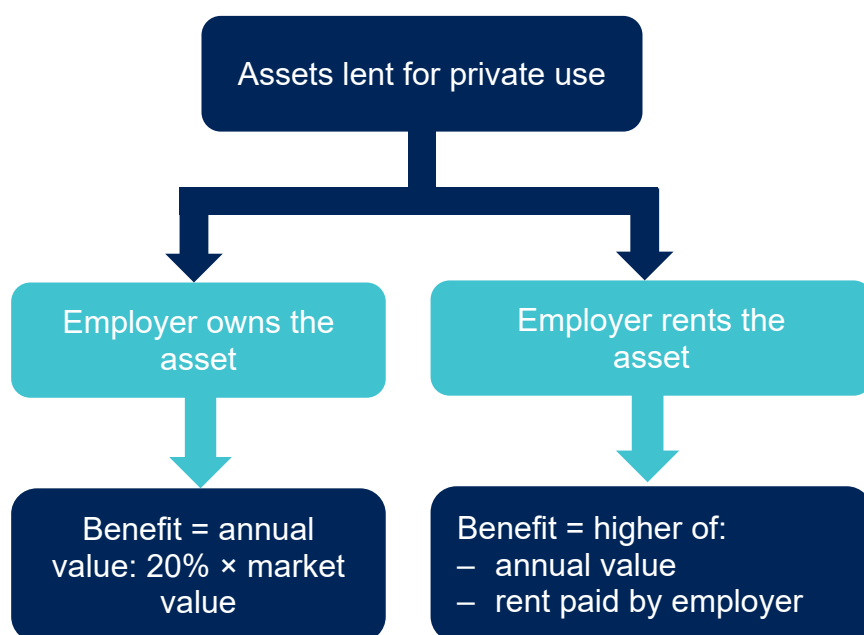
## Notes



### 5.8 Assets provided to employees

Where an employer lends an employee an asset, other than a car or van, for the employee's private use:

- Benefit = depends on whether the employer owns or rents the asset:



- **No benefit** if the private use is insignificant (e.g. using a work laptop for the odd private email).
- One mobile phone and bicycles = exempt (see section 5.2).

## Notes







## Example 6

Molly is provided with the following assets for private use:

Asset	First provided	Cost	Contribution by employee
Van (no fuel)	23 May 2018	£15,000	£100 per month
Machinery	5 June 2013	£1,000	£15 per month
Computer	30 Sept 2018	£1,750	None
Television	1 June 2020	£900	None

Calculate the taxable benefit for the private use of the above assets for the tax year 2020/21, assuming the van has CO<sub>2</sub> emissions of 163g/km and the private use of the computer is insignificant.

### Molly

	£
<b>Van</b>	3,490
Less: employee contribution (12 × £100)	(1,200)
	<hr/>
Taxable benefit	2,290
	<hr/>

<b>Machinery</b>	
Annual value (20% × £1,000)	200
Less: employee contribution (12 × £15)	(180)
	<hr/>
Taxable benefit	20
	<hr/>

<b>Computer</b>	
Insignificant private use therefore no taxable benefit	0
	<hr/>

<b>Television</b>	
Annual value (20% × £900)	180
	<hr/>
Available for 10 months of the tax year (£180 × 10/12)	
Taxable benefit	150
	<hr/>

## Chapter 5

### 5.9 Gifts of assets to employee

- If an employer purchases an asset and gifts it to the employee immediately, the taxable benefit is the cost to the employer of the asset.
- If an employer initially lends an asset to an employee and then subsequently gifts it to the employee, the taxable benefit when the asset is gifted is the greater of:

(1) Market value when gifted	X
	—
(2) Market value when first provided	X
Less: Benefit already taxed under private use rules	(X)
	—
	X
	—

Where the asset being given to an employee is a car, van or bike, the benefit is always the current MV.

## Notes





## Example 7

Joseph's employer lent him a boat on 1 January 2018 costing £2,300.

On 1 January 2021 Joseph bought the boat from his employer for £150. The market value of the boat on that date was £670.

**Calculate the taxable benefit assessable on Joseph in 2020/21 in respect of his use of the boat, and the subsequent gift to him.**

**Joseph**

**2020/21**

Benefit for use of asset:

First 9 months of the year

(£2,300 × 20% × 9/12 )

£

345

Gift of the boat = Greater of:

(1) **Market value** when gifted

670

(2) Original market value

2,300

Less: Amounts already taxed under the 20% rule

2017/18: (3/12 × 20% × £2,300)

(115)

2018/19: (20% × £2,300)

(460)

2019/20: (20% × £2,300)

(460)

2020/21: As above

(345)

920

Greater of £670 and £920

920

Less: Amount paid by Joseph

(150)

**Total taxable benefit – 2020/21**

**1,115**

## Chapter 5

### 5.10 Living accommodation

#### Overview

Benefit:	Not job-related accommodation	Job-related accommodation
Basic charge	✓	X
Extra charge	✓	X
Living expenses	✓	Subject to maximum amount (see section 5.11)
Use of furniture	✓	
Less: Employee contributions	✓	✓

#### Job-related accommodation

The provision of living accommodation is not taxable if it is job-related.



**Job-related accommodation** must be:

- **necessary** for performance of duties e.g. caretaker, or
- to enable **better performance** of the duties and **customary** to be provided, e.g. police officers, or
- provided for **security** reasons, e.g. soldier barracks.

#### Not job-related accommodation

If the accommodation is **not job-related** the taxable benefit depends on whether the employer owns, or rents, the property:

Employer	OWNS the property	RENTS the property
Benefit	<ul style="list-style-type: none"><li>➤ Annual value (given) and</li><li>➤ Extra charge if the original cost of the house including improvements &gt; £75,000</li></ul>	Higher of <ul style="list-style-type: none"><li>➤ Annual value (given) and</li><li>➤ Rent paid by employer</li></ul>

## Notes



## Extra charge

Charged if original cost plus capital improvements up to start of tax year > £75,000.

= ('Cost' – £75,000) × official rate of interest at start of tax year (2.25% for 2020/21).

- The 'cost' is generally:
  - the **original value** when the property was purchased
  - plus
  - any subsequent **capital improvements** up to the start of the tax year.
- If the employer owned the property for more than **six years** before the employee moved in:
  - use the **market value** at the date the employee moved in instead of cost
  - plus
  - any subsequent **capital improvements** up to the start of the tax year.

## Example 8



William is provided with a flat to live in by his employer throughout the tax year. The accommodation is not job-related.

The flat has an annual value of £4,000 and the employer pays rent of £400 per month. William contributes £100 per month.

**What is William's taxable benefit for a full year?**

**William**

Benefit = Higher of:	£	£
(a) Annual value	4,000	
	<hr/>	
(b) Rent paid by employer (£400 × 12)	4,800	4,800
	<hr/>	
Less: Employee contributions (£100 × 12)		(1,200)
		<hr/>
Taxable benefit		3,600
		<hr/>



## Example 9

Adam's employer bought a house in May 2011 for £140,000. The house was made available to Adam in April 2019 when its market value was £230,000.

£40,000 was spent on improvements in June 2019, and in May 2020 Adam's employer spent £60,000 on an extension to the house. The house has an annual value of £6,000 per annum.

**What is Adam's taxable benefit for the tax year 2020/21?**

**Adam**

	£
Basic charge = Annual value	6,000
Expensive accommodation benefit: (£230,000 + £40,000 – £75,000) × 2.25%	4,388
Total taxable benefit	10,388

**Note:** Since Adam's employer bought the house more than 6 years before Adam moved in, the cost of the house is replaced by its market value as at April 2019 when Adam moved in.

The cost of the improvements in June 2019 are included because they were incurred prior to 6 April 2020. However, the extension in May 2020 will not be included until the following year.

## Notes



### 5.11 Living expenses for accommodation

- A further benefit arises for **related living expenses** paid for by the employer (e.g. heat and lighting, cleaning, repairs and decoration).

**Benefit** = Cost to employer less employee contributions.

- If the employer **provides furniture** in the property:

**Benefit** = 20% × cost of the furniture when first provided.

Benefit arises each year the employee has use of the furniture.

- If the accommodation is **job-related**, the taxable benefit for living expenses and furniture is restricted:

**Maximum benefit** = 10% of the employee's net earnings.

Net earnings = Taxable employment income – living accommodation benefits.

## Notes



## Chapter 5

### 5.12 Beneficial loans

There is a taxable benefit on loans made by an employer to an employee below the official rate of interest (ORI) of 2.25%.

There are two methods of calculating the benefit:

#### The average method (default method in absence of an election)

- Uses the average of the loan outstanding at the beginning and end of the tax year.
- If the loan starts or ends during the tax year that date is used instead of the beginning or end of the tax year and the benefit is time apportioned.

#### The strict method (HMRC or taxpayer may elect to use)

- Calculates the benefit based on the monthly balance actually outstanding.

The taxable benefit is given by:

Loan amount (under strict/average method) × ORI	X
Less: Interest actually paid in the tax year	(X)
	<hr/>
Assessable benefit	X
	<hr/>

There is no taxable benefit where:

- Total loans to an employee ≤ £10,000 throughout the tax year, or
- The interest paid on the loan would qualify for tax relief (e.g. if it is a loan to buy plant and machinery for employment) – see Chapter 2.

If all, or part, of a loan to an employee is written off in the year, the amount written off is treated as a benefit and charged to income tax.

## Notes







## Example 10

Celia was granted a loan of £48,000 by her employer on 31 March 2018 to help finance the purchase of her house. Interest is payable on the loan at 0.7% p.a.

On 1 November 2020 Celia repaid £8,000 and on 1 January 2021 she repaid a further £12,000. The remaining £28,000 was still outstanding on 5 April 2021.

**Calculate the assessable benefit for the tax year 2020/21 under:**

- (a) the average method, and
- (b) the strict method.

**Celia**

### (a) Average method

Balance at start of year £48,000

Balance at end of year (£48,000 – £8,000 – £12,000) = £28,000

Average loan  $(£48,000 + £28,000) \times 1/2 \times 2.25\%$

£  
855

Less: Interest paid

6 Apr 2020 – 31 Oct 2020	$(£48,000 \times 0.7\% \times 7/12)$	196
--------------------------	--------------------------------------	-----

1 Nov 2020 – 31 Dec 2020	$(£40,000 \times 0.7\% \times 2/12)$	47
--------------------------	--------------------------------------	----

1 Jan 2021 – 5 Apr 2021	$(£28,000 \times 0.7\% \times 3/12)$	49
-------------------------	--------------------------------------	----

(292)

563

### (b) Strict method

		£
6 Apr 2020 – 31 Oct 2020	$(£48,000 \times 2.25\% \times 7/12)$	630
1 Nov 2020 – 31 Dec 2020	$(£40,000 \times 2.25\% \times 2/12)$	150
1 Jan 2021 – 5 Apr 2021	$(£28,000 \times 2.25\% \times 3/12)$	158
		<hr/>
		938
Less: Interest paid (as above)		(292)
		<hr/>
		646
		<hr/>

In this situation Celia would be assessable on £563 as it is unlikely that HMRC would elect to apply the strict method as the difference between the two methods is not material and there is no evidence of manipulation of the loan to influence the benefit.

## Notes



## 5.13 Comprehensive example

## Example 11



Dalesha is employed by Island Ltd.

The company accounts show the following information.

Year to 30 November	2019	2020	2021
	£	£	£
Salary (paid monthly)	47,780	48,500	53,000
Bonus (paid in the following February)	13,000	14,000	12,700

The following information is provided in respect of 2020/21.

- Dalesha received £200 in supermarket vouchers in December to put towards her Christmas food shopping.
- Dalesha belongs to a private medical scheme and the company paid the required premium of £1,350 (including £650 for her family).
- Dalesha took meals in the fully subsidised staff canteen, the cost for the year being £540.
- Dalesha uses a company car throughout the tax year. The car was registered on 6 April 2020 and purchased at its list price of £20,000. Running expenses including diesel paid by the company were £2,600 in the year. The car has CO<sub>2</sub> emissions of 163g/km and does not meet the RDE2 standard. The company pays for all business and private fuel.
- Dalesha is provided with a 1.25% loan from her employer of £18,000 which was granted three years ago to help her buy a house on Barry Island. She has no other loans and has paid interest only, on a monthly basis.
- She pays 3% of her basic salary (excluding bonus) into the company's registered occupational pension scheme. Her company contributes 6% of her salary.
- Dalesha lives in accommodation provided by Island Ltd. The accommodation has an annual rateable value of £4,000 and was purchased by Island Ltd for £110,000, together with furniture costing £5,000, three years ago (when Dalesha moved in).

**Compute Dalesha's employment income for the tax year 2020/21.**

### Dalesha

#### Taxable salary and bonus:

		£	£
Salary (6 Apr 2020 – 30 Nov 2020)	$8/12 \times 48,500$	32,333	
(1 Dec 2020 – 5 Apr 2021)	$4/12 \times 53,000$	17,667	
			50,000
Bonus (paid February 2021)			14,000
			<b>64,000</b>

#### Taxable benefits:

➤ Vouchers – cost to employer		200
➤ Medical insurance – premium paid		1,350
➤ Assuming canteen facilities are available to all staff on a similar basis, there is no assessable benefit.		0
➤ The provision of the car will give rise to a benefit calculated as follows:		
CO <sub>2</sub> emissions are 163g/km rounded down to 160g/km		
Appropriate %:		
$(160 - 55)/5 = 21\% + 14\% + 4\%$ (diesel) = 39%		
Restricted to maximum of 37%		
➤ Car benefit = 37% × £20,000		7,400
➤ Fuel benefit = £24,500 × 37%		9,065
➤ Beneficial loan:		
Interest on loan (£18,000 × 2.25%)	405	
Less: interest paid (£18,000 × 1.25%)	(225)	
		180
➤ Employer's contribution into a registered pension scheme is an exempt benefit.		0

## Employment income

	£	£
Accommodation benefit:		
Basic charge	4,000	
Extra charge $(£110,000 - £75,000) \times 2.25\%$	788	
Use of furniture $(£5,000 \times 20\%)$	1,000	
		5,788

### Taxable employment income

	£
Salary	50,000
Less: Pension contributions (3%)	(1,500)
	48,500
Bonus	14,000
Vouchers	200
Medical insurance	1,350
Car benefit	7,400
Fuel benefit	9,065
Beneficial loan	180
Accommodation benefit	5,788
	86,483
Employment income	

## Notes



### Questions



You should now be able to answer TYU questions 1 to 18 from the Study Text Chapter 5 as well as the question 'Gabriel' from Chapter 27.

Knowledge Check Test: Basic income tax on MyKaplan.

For further reading, visit Chapter 5 of the Study Text and review the TX article on 'benefits' at [www.accaglobal.com](http://www.accaglobal.com).

# Chapter 6

## Pensions



### Outcome

Upon completion of this chapter you will be able to:

- explain and compute the relief given for contributions to personal pension schemes, and to occupational pension schemes

and answer questions relating to this area.



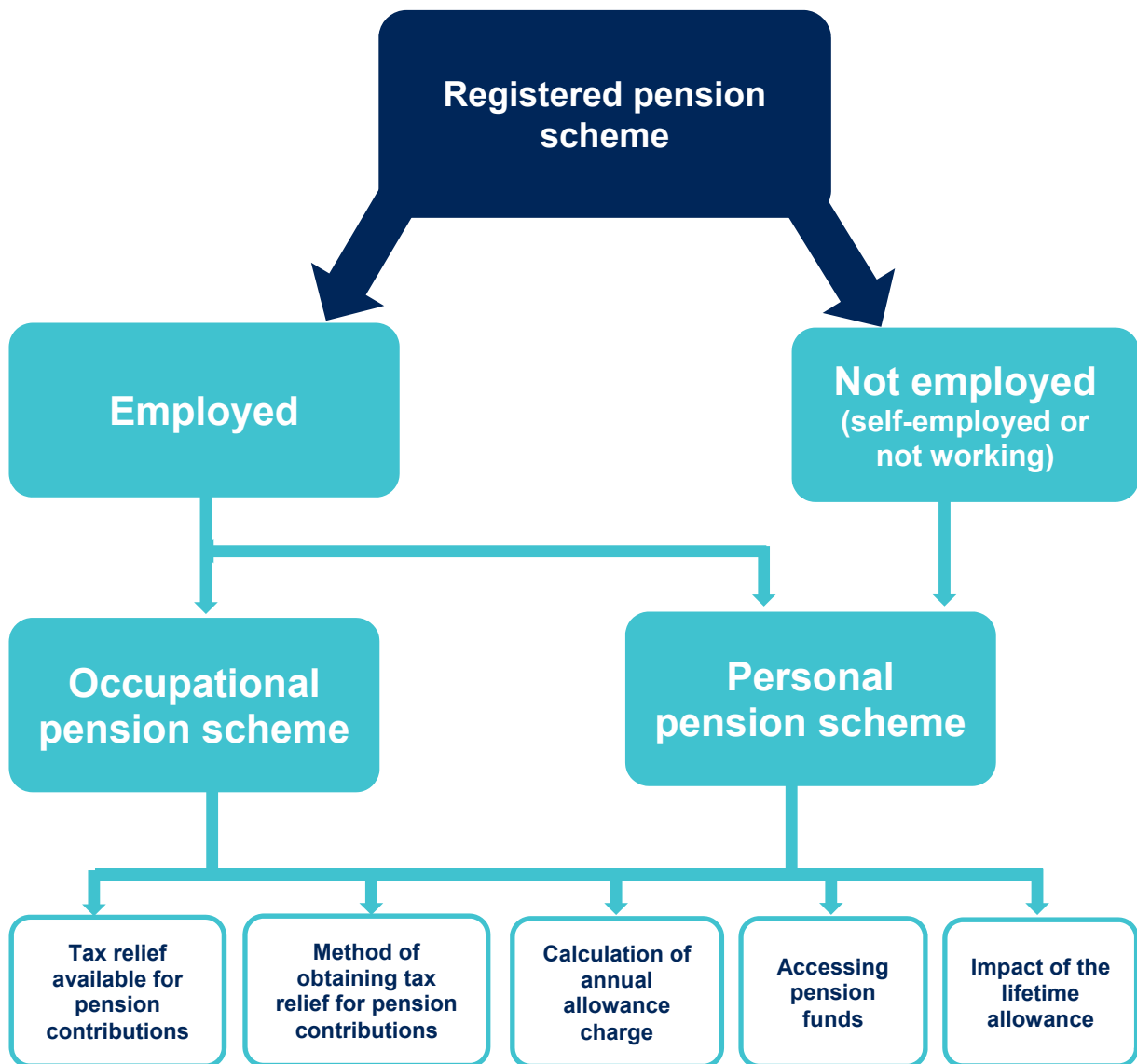
PER

One of the PER performance objectives (PO15) is to prepare computations of taxable amounts and tax liabilities according to legal requirements. Another objective (PO17) is to advise on mitigating and deferring liabilities through legitimate tax planning measures. Working through this chapter should help you understand how to demonstrate those objectives.

The underpinning detail for this Chapter in your Integrated Workbook can be found in Chapter 6 of the Study Text.



### Overview





# 1 Pension schemes



## 1.1 Tax advantages associated with pension scheme investments

Registered pension scheme = a long-term savings plan for retirement with special tax privileges:

- Individuals = tax relief for contributions made into the scheme
- Employer = deduction from trading profits for contributions into the scheme
- Employer contributions = an exempt benefit from the employee's perspective
- Funds held within the pension scheme = tax free growth
- On retirement, some funds can be taken as tax-free lump sum.

## 1.2 Types of pension scheme

Occupational Pension Scheme (OPS)	Personal Pension Scheme (PPS)
<ul style="list-style-type: none"> <li>➤ Set up by employer for benefit of employees</li> </ul>	<ul style="list-style-type: none"> <li>➤ Run by a financial institution (e.g. insurance company or bank)</li> <li>➤ Available to employed, self-employed or unemployed individuals</li> </ul>
<ul style="list-style-type: none"> <li>➤ Contributions can be made by:               <ul style="list-style-type: none"> <li>– Employee and/or,</li> <li>– Employer</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>➤ Contributions can be made by:               <ul style="list-style-type: none"> <li>– Individual</li> <li>– Any third party on individual's behalf, e.g. family member</li> </ul> </li> </ul>

## Notes



### 1.3 Amount of relief and method of obtaining relief

Individuals under the age of 75 who are active members of a registered pension scheme (occupational or personal) can get tax relief on their contributions.

However, there is a limit on the amount of relief that an individual can obtain on his/her own contributions in the tax year.

Note that:

- Regardless of the type of scheme (OPS or PPS):
  - the **amount** of tax relief available for pension contributions = **same**
- Depending on the type of scheme (OPS or PPS):
  - the **method** of obtaining tax relief for the contributions = **different**
- An individual may be a member of multiple pension schemes (i.e. can be a member of an OPS and a PPS, or multiple OPSs or PPSs)
  - the various limits per tax year within which an individual is bound apply to all schemes in aggregate, not each scheme separately.

## Notes



## 2 Tax relief for pension contributions

### 2.1 Amount of tax relief

#### Contributions paid by the individual

For contributions paid by an individual each tax year into his/her registered pension scheme(s) (any type), income tax relief is available on the

#### Lower of:

- Gross contributions paid (Note 1)
- Maximum annual amount

= Higher of

– £3,600



–  $100\% \times \text{individual's relevant earnings (Note 2)}$

Notes:

- (1) Contributions made into an occupation pension scheme are paid gross, but those paid into a personal pension scheme are paid net of 20% tax and therefore need to be grossed up at 100/80.
- (2) Relevant earnings = employment income, trading income and income from FHA.

#### Contributions paid by the employer

Tax relief available:

- For the employer = amount paid
  - Contributions made by employers into an occupational pension and/or into an employee's personal pension on his/her behalf are paid gross
  - Relief is therefore available for the amount actually paid.
- For the employee = exempt benefit.

### 2.2 Method of relief for individual's contributions

#### Contributions paid by the individual – into a personal pension scheme

Income tax relief operates in the same way as gift aid:

- Relief is given at source, as the contributions are deemed to be made net of the basic rate of tax at 20%.
- HMRC then pays an equivalent amount of the basic rate of tax into the pension scheme (i.e. all contributions receive basic rate relief at source).
- Higher and additional rate taxpayers receive additional relief by extending both their basic and higher rate bands by the gross pension contributions.

**Remember:** When calculating **adjusted net income (ANI)**, (e.g. when restricting an individual's PA or withdrawing child benefit), gross PPS contributions are deducted from net income.

### Example 1



Carvela has employment income of £70,000 for the tax year 2020/21. During the tax year she pays contributions of £8,000 into a personal pension fund.

**Calculate Carvela's income tax liability for the tax year 2020/21.**

## Notes



**Carvela**

			£
Net income			70,000
Less: PA			(12,500)
			<hr/>
Taxable income			57,500
			<hr/>
Income tax			
Non-savings income – basic rate (W)	£47,500	× 20%	9,500
Non-savings income – higher rate	£10,000	× 40%	4,000
	<hr/>		<hr/>
	£57,500		
			<hr/>
Tax liability			13,500
			<hr/>

**Working**

Extended BRB = £37,500 + (£8,000 × 100/80) = £47,500

## Notes

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### Contributions paid by the individual – into an occupational pension scheme

Income tax relief is as follows:

- Contributions are paid gross by the individual  
= an allowable deduction from the individual's employment income
- Relief is given automatically through the PAYE system as the employer deducts the gross contributions from the employee's salary each month before calculating the income tax due under PAYE.

### Example 2



Kurt is employed by Geiger Ltd on an annual salary of £66,000 per annum. He is a member of the company's occupational pension scheme.

Kurt pays 5% of his salary into the scheme each year and Geiger Ltd contributes a further 3%. Kurt has no other income.

**Calculate Kurt's income tax liability for the tax year 2020/21, showing how tax relief is obtained for his pension contributions.**

### Notes



**Kurt**

			£
Salary			66,000
Less: Employee contributions at 5% (Note)			(3,300)
Net income			62,700
Less: PA			(12,500)
Taxable income			50,200
Income tax			
Non-savings income – basic rate	£37,500	× 20%	7,500
Non-savings income – higher rate	£12,700	× 40%	5,080
	£50,200		
Tax liability			12,580

**Note**

The employer contributions are an exempt benefit for Kurt.

## Notes





## Example 3

The sole traders below want the following gross pension contributions to be paid into a personal pension scheme in the tax year 2020/21:

	Pension contributions (gross)	Trading profits
	£	£
Alex	5,000	Nil
Brian	5,000	20,000
Charlotte	25,000	20,000
Desmond	40,000	80,000

(a) For each individual:

- State the maximum tax relief available for contributions.
- Explain how tax relief for the pension contributions will be given.

(b) Calculate the income tax liability of Desmond for the tax year 2020/21.

(a) Tax relief available for contributions

### Alex

As Alex has no earnings he will obtain tax relief on a maximum gross amount of £3,600.

He will obtain basic rate tax relief at source of £720 ( $£3,600 \times 20\%$ ) and pay £4,280 ( $£5,000 - £720$ ) to the pension scheme.

### Brian

Brian's pension contributions are less than his earnings for the year and he will therefore receive tax relief on the full amount of the contribution.

He will obtain basic rate tax relief at source of £1,000 ( $£5,000 \times 20\%$ ) and pay £4,000 ( $£5,000 - £1,000$ ) to the pension scheme.

As Brian is not a higher rate or additional rate taxpayer no adjustment is required to his basic rate or higher rate bands.



## Charlotte

The tax relief available on Charlotte's pension contributions is restricted to 100% of her earnings, i.e. £20,000.

She will obtain basic rate tax relief at source of £4,000 ( $£20,000 \times 20\%$ ) and pay £21,000 ( $£25,000 - £4,000$ ) to the pension scheme.

As Charlotte is not a higher rate or additional rate taxpayer no adjustment is required to the basic rate or higher rate bands.

## Desmond

Desmond's pension contributions are less than his earnings for the year and he will therefore receive tax relief on the full amount of the contribution.

He will have obtained basic rate tax relief at source of £8,000 ( $£40,000 \times 20\%$ ) and pay £32,000 ( $£40,000 - £8,000$ ) to the pension scheme.

Higher rate tax relief will be given by extending the basic rate band by £40,000.

## (b) Desmond's income tax computation

			£
Trading income/Net income			80,000
Less: PA			(12,500)
			<hr/>
Taxable income			67,500
			<hr/>
Income tax:			
Non-savings income – basic rate (W)	£		
	67,500	$\times 20\%$	13,500
	<hr/>		<hr/>
Income tax liability			13,500
			<hr/>

## Working

Extended BRB =  $£37,500 + £40,000 = £77,500$

### 2.3 Tax relief for employer contributions

Tax relief is as follows:

- Gross contributions **paid** = allowable when calculating the tax adjusted trading profits of the business.
- Relief = a **paid** basis, not accruals basis.
- No limit on how much an employer can contribute into a pension scheme.
- No limit on how much tax relief employers can obtain.

## Notes

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## 3 Annual allowance

### 3.1 Annual allowance



Annual allowance (AA) = an overriding limit for **total gross pension contributions** into an individual's pension scheme from **all sources** during the tax year.

- Sources = contributions by the individual, his or her employer and any other third party that may have contributed during the tax year.



The **annual allowance** each tax year is **£40,000**

- Any unused AA in the **previous three tax years**
  - can be carried forward and added to the current year AA to calculate the 'available AA' for a tax year  
(provided the individual is a member of a registered pension scheme in those years).
  - is used on a **FIFO basis**, after the current year AA has been used.

## Notes





## Example 4

Robin made the following gross pension contributions in recent tax years:

2017/18	£50,000
2018/19	£35,000
2019/20	£30,000

**Calculate Robin's available annual allowance for the tax year 2020/21.**

### Robin

	£
AA for 2020/21	40,000
Add: B/f from previous three tax years (W)	15,000
	<hr/>
Available AA in 2020/21	55,000
	<hr/>

### Working

Tax year	Maximum AA	Contribution	Unused c/f
	£	£	£
2017/18	40,000	50,000	0
2018/19	40,000	35,000	5,000
2019/20	40,000	30,000	10,000
			<hr/>
C/f to 2020/21			15,000
			<hr/>

## Notes



### 3.2 Annual allowance charge

- If total pension contributions from all sources > the available AA:
  - an **AA charge arises** = an income tax charge on the individual
  - effectively removes the relief given on excess contributions
- Excess contributions are
  - taxed as if extra income was received
  - taxed after dividends at the non-savings rates, and
  - this AA charge is added to the individual's income tax liability.
- Therefore, excess contributions suffer tax as follows:
  - those that fit into the unused basic rate band suffer tax at 20%
  - any remaining excess contributions that fit into the unused higher rate band suffer tax at 40%
  - any contributions in the additional rate band suffer tax at 45%.
- Note that the AA charge is:
  - not added into the taxable income computation, and
  - does not affect the calculation of ANI (e.g. for the purposes of restricting PA or withdrawing child benefit).

## Notes

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## Example 5

Victor made the following gross contributions into his personal pension scheme:

2017/18	£35,000
2018/19	£36,000
2019/20	£37,000

Victor is employed by Kaliko Ltd, has earned income in the tax year 2020/21 of £94,900, but no other source of income.

In the tax year 2020/21, Victor contributes cash of £58,000 into his personal pension scheme and, for the first time, Kaliko Ltd contributed a further £30,000 into the scheme on Victor's behalf.

- Calculate Victor's excess contributions for the tax year 2020/21.
- Calculate Victor's income tax liability for the tax year 2020/21.

### Victor

#### (a) Excess contributions

		£
Victor's gross pension contributions (£58,000 × 100/80)		72,500
Employer's contributions		30,000
		<hr/>
Total contributions		102,500
Less: Available annual allowance		
Current year AA (2020/21)	40,000	
Unused AA b/f (W1)	12,000	
	<hr/>	(52,000)
		<hr/>
Excess contributions		50,500
		<hr/>

**(b) Income tax computation**

		£
Employment income/Net income		94,900
Less: PA		(12,500)
		<u>82,400</u>
Taxable income		
		<u>82,400</u>
Income tax:	£	
Non-savings income – basic rate (W2)	$82,400 \times 20\%$	16,480
AA charge (W3)		14,680
		<u>31,160</u>
Income tax liability		
		<u>31,160</u>

**Workings****(W1) Unused annual allowance b/f**

	£
2017/18 (£40,000 – £35,000)	5,000
2018/19 (£40,000 – £36,000)	4,000
2019/20 (£40,000 – £37,000)	3,000
	<u>12,000</u>
Unused AA b/f	
	<u>12,000</u>

**(W2) Income tax bands**

	Basic rate band	Higher rate band
	£	£
Normal band	37,500	150,000
Gross PPC ( $\pounds 58,000 \times 100/80$ )	72,500	72,500
	<u>110,000</u>	<u>222,500</u>
Extended band		
	<u>110,000</u>	<u>222,500</u>

### (W3) Annual allowance charge

	£		
BRB (W2)	110,000		
Used	(82,400)		
	<u>27,600</u>		
Remaining	27,600	× 20%	5,520
Taxed in HRB	22,900	× 40%	9,160
	<u>50,500</u>		
			<u>14,680</u>
Total AA charge			

## Notes





### 3.3 Restriction of annual allowance for high income individuals

The annual allowance for the tax year 2020/21 is gradually reduced for individuals with high income.



The restriction only applies to individuals with

- 'threshold income' > £200,000, and
- 'adjusted income' > £240,000.
- The threshold income amount of £200,000 is not examinable in TX.



**Adjusted income** is calculated as follows:

	£
Net income (from the income tax computation)	X
Add: Employee's own occupational pension contributions	X
Employer's contributions into any scheme for that individual	X
	—
Adjusted income	X
	—

Note: Adjusted income is **not** the same as the adjusted net income (ANI) used when restricting the PA.

- If the individual has adjusted income > £240,000:
  - The **current year AA** is **reduced by**:
  - **(Adjusted income – £240,000) × 50%**
  - However, the current year AA cannot go below £4,000
  - Accordingly, if adjusted income ≥ £312,000: the AA will be £4,000.

## Notes





## Example 6

The following individuals have occupational pension schemes into which contributions were made during the tax year 2020/21 as follows:

	Individual's gross contributions	Employer's contributions	Net income
	£	£	£
Aadarsh	11,000	18,000	190,000
Bryn	0	30,000	225,000
Chakor	12,000	20,000	250,000
Damian	20,000	28,000	275,000

Calculate the annual allowance for the tax year 2020/21 for each individual assuming they have no unused allowances brought forward.

### Annual allowance for high earners

#### Adjusted income

	Aadarsh	Bryn	Chakor	Damian
		£	£	£
Net income	190,000	225,000	250,000	275,000
Employee OPCs	11,000	0	12,000	20,000
Employer's contributions	18,000	30,000	20,000	28,000
Adjusted income	219,000	255,000	282,000	323,000

#### Aadarsh

Aadarsh's adjusted income is < £240,000 and therefore he will be entitled to the full AA of £40,000 in the tax year 2020/21.

**Bryn**

Bryn's adjusted income is > £240,000 so his AA is restricted as follows:

	£
Adjusted income	255,000
Less: Threshold	(240,000)
	<hr/>
Excess over threshold	15,000
	<hr/>
Excess × 50%	7,500
	<hr/>
Available allowance (£40,000 – £7,500)	32,500
	<hr/>

**Chakor**

Chakor's adjusted income is > £240,000 so his AA is restricted as follows:

	£
Adjusted income	282,000
Less: Threshold	(240,000)
	<hr/>
Excess over threshold	42,000
	<hr/>
Excess × 50%	21,000
	<hr/>
Available allowance (£40,000 – £21,000)	19,000
	<hr/>

**Damian**

Damian's adjusted income is > £312,000 and therefore the AA is restricted to the minimum amount of £4,000.

## Notes

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## Example 7

Dune has been employed as a shoe designer for a number of years, earning £365,000 per annum.

In the tax year 2020/21 she made gross contributions of £120,000 into her personal pension scheme and her employer contributed a further £130,000.

Dune has no unused annual allowance brought forward.

**Calculate Dune's income tax liability for the tax year 2020/21.**

**Dune**

### Income tax computation

			£
Employment income/Net income			365,000
Less: PA (W1)			0
			<hr/>
Taxable income			365,000
			<hr/>
Income tax:	£		
Non-savings income – basic rate (W2)	157,500	× 20%	31,500
Non-savings income – higher rate (W2)	112,500	× 40%	45,000
	<hr/>		
	270,000		
Non-savings income – additional rate (W2)	95,000	× 45%	42,750
	<hr/>		
	365,000		
	<hr/>		
			<hr/>
			119,250
AA charge (W3)			110,700
			<hr/>
Income tax liability			229,950
			<hr/>

## (W1) Personal allowance

	£	£
PA		12,500
Net income	365,000	
Less: Gross PPCs	(120,000)	
	<u>245,000</u>	
ANI	<u>245,000</u>	

As ANI > £125,000 PA = £Nil

## (W2) Extension of bands

	BR band £	HR band £
Bands	37,500	150,000
Gross PPCs	120,000	120,000
	<u>157,500</u>	<u>270,000</u>
Extended bands	<u>157,500</u>	<u>270,000</u>

## (W3) Excess contributions

	£
Dune's pension contribution	120,000
Employer's pension contribution	130,000
	<u>250,000</u>
Total gross contributions	250,000
Less: AA (W4)	(4,000)
	<u>246,000</u>
Excess contribution	<u>246,000</u>
	<u>246,000</u>
Unused BRB and HRB = Nil	
AA charge – additional rate (£246,000 × 45%)	110,700
	<u>110,700</u>

### (W4) Restriction on current year AA

#### Adjusted income

	£
Net income	365,000
Plus: Employer's contributions to her PPS	130,000
	<hr/>
Adjusted income	495,000
	<hr/>

Since adjusted income > £312,000: current year AA is restricted to £4,000

## Notes



## 4 Accessing the pension fund

### 4.1 Drawing a pension

- Pensions can never be paid out of a pension scheme until the individual reaches pension age
  - Pension age will depend on the scheme rules
  - Cannot be below the age of 55.
- All, or part, of the pension fund can be taken to provide a pension **at any time** above this pension age.
  - It is therefore possible to receive a pension and still continue to work.
- On reaching pension age, the individual may:
  - receive a tax-free lump sum payment – up to 25% of the value of the fund
  - withdraw the balance (the remaining 75%) of the pension fund at any time.

Any withdrawals = treated as taxable income and liable to income tax at the normal rates of tax for non-savings income.
- If not withdrawn, the remaining fund can continue to grow in a relatively tax-free environment.

### 4.2 Lifetime allowance



Lifetime allowance = a **maximum limit** to the amount that can be **accumulated** in a pension scheme to obtain the benefit of **tax free growth**.

The **lifetime allowance** = **£1,073,100** for 2020/21.

- If value of fund > lifetime allowance:
  - An additional income tax charge arises on the **excess** when the funds are withdrawn from the scheme – the detailed rules for calculating this are not within the TX syllabus.

## Notes



### Questions



You should now be able to answer TYU questions 1 to 11 from the Study Text Chapter 6.

For further reading, visit Chapter 6 of the Study Text.



# Chapter 7

## Income from self-employment



### Outcome

Upon completion of this Chapter you will be able to:

- recognise the basis of assessment for self-employment income
- describe and apply the badges of trade
- recognise the expenditure that is allowable in calculating the tax adjusted trading profit
- explain and compute the assessable profits using the cash basis for small businesses
- recognise the relief which can be obtained for pre-trading expenditure

and answer questions relating to these areas.



PER

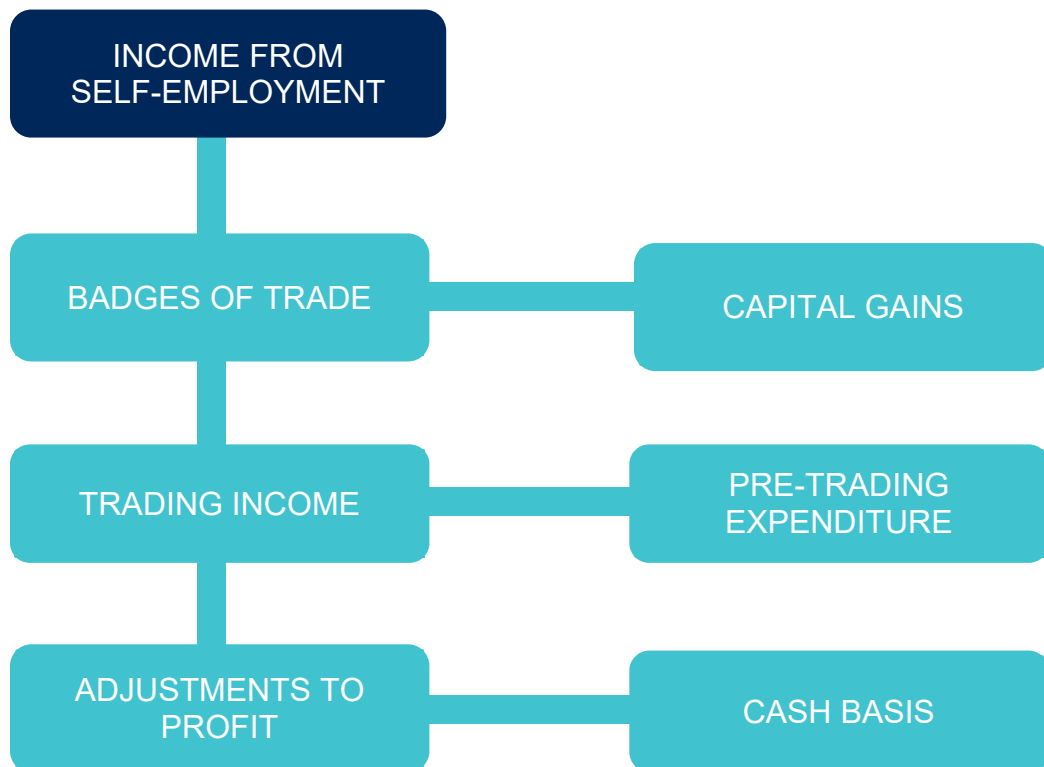
One of the PER performance objectives (PO15) is to prepare computations of taxable amounts and tax liabilities according to legal requirements. Working through this chapter should help you understand how to demonstrate that objective.

The underpinning detail for this Chapter in your Integrated Workbook can be found in Chapter 7 of your Study Text.



### Overview

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# 1 Trading income

## 1.1 Basis of assessment



The profits of an unincorporated trader arising from a trade, profession or vocation are assessed as **trading income**.



Profits of an ongoing business = assessed on a **current year basis**:  
(i.e. the profits assessed in a particular tax year  
= those of the 12 month accounting period ending in that tax year)

### Illustration 1 – current year basis

Annabelle, a sole trader, prepares her accounts for the year ended 31 December 2020.

The profits will be assessed in the tax year 2020/21.

## Notes

# 2 Badges of trade

## 2.1 Badges of trade

To determine whether a transaction should be 'trading' (chargeable to income tax) or 'capital' (chargeable to capital gains tax) the following tests have been developed:

- The **subject matter** of the transaction (whether the asset has been bought for personal use, for investment, or for resale) (S)
- The length of the **period of ownership** (shorter periods of ownership may indicate trading) (O)
- The **frequency** or number of similar transactions by the same person (a high frequency of similar transactions may indicate trading) (F)
- Supplementary work, **improvements** and marketing (work performed on goods to make them more marketable may indicate trading) (I)
- The circumstances/**reason for the sale** (being forced to make a sale to raise cash may indicate not trading) (R)
- The **motive** (an intention to profit may indicate trading) (M)

You can use the mnemonic SOFIRM to help you remember the above tests.

In addition to the above six badges of trade, HMRC guidance indicates that the following factors will also be taken into account to determine if someone is trading.

- The source of **finance** – if the purchase of the asset is funded by a loan which is likely to only be repaid when the asset is sold, this is an indication of trading (F)
- Method of **acquisition** – if the asset was acquired by gift or inheritance it is less likely that the taxpayer will be deemed to be trading (A)
- Existence of **similar trading transactions** – if an individual carries out a transaction, which is related to an existing trade, it is more likely that the transaction will be regarded as trading than if it had been carried out in isolation (ST)

You can use the mnemonic FAST to help you remember the above tests.

## Notes

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# 3 Adjusting the accounting profit

### 3.1 Adjusting the accounting profit

A sole trader is taxable on his/her tax adjusted trading profits for an accounting period, which is calculated as follows:

	£	£
Net profit per accounts	X	
Add: Disallowable expenditure	X	
Expenditure allowable for tax purposes	0	
Taxable trading income not credited in the accounts	X	
Less:		
Expenditure not charged in the accounts but allowable for tax		X
Income included in the accounts that is not taxable trading income		X
Capital allowances		X
	—	—
	X	Y
	(Y)	
	—	
<b>Tax adjusted trading profit</b>	<b>X</b>	
	—	



Your answer should be presented in accordance with the above in order to gain full marks, i.e. starting with the net profit figure per the accounts and listing all adjustments in the order of the question. Items which do not require adjustment should still be included but shown as 0. You can present the working as a single column, as long as you show clearly which items you are adding and which you are deducting.

## Notes



# 4 Disallowable (non-deductible) expenditure

## 4.1 Disallowable expenditure

Disallowable expenditure must be added back in the tax computation.

## 4.2 Expenditure not incurred wholly and exclusively for trading purposes

There are two reasons why such expenditure may be disallowed:

- It is too remote from the purposes of the trade – the remoteness test.
- It has more than one purpose and one of them is not trading – the duality principle.

Where expenditure has been incurred for both trading and non-trading purposes, a deduction can be claimed for the business use proportion.

## 4.3 Appropriations



An **appropriation** is the withdrawal of funds from a business's profits by its owner. These are disallowable expenditure.

Common examples of appropriations are:

- business owner's salary
- drawings made by a sole trader/partner
- a private element of expenditure (e.g. private use of a car or mobile phone by the sole trader)
- excess payments made to the sole trader's family member employees.

## Notes



## Chapter 7

### 4.4 Interest payable

- Interest on borrowings for the purpose of the trade (e.g. business account overdraft, loan to buy plant and machinery) is allowable.
- Interest on late paid tax is disallowable.

### 4.5 Capital expenditure

Expenditure on or relating to, capital assets is not an allowable trading expense.

Some common examples which must be added back are:

- depreciation
- loss on sale of non-current assets
- cost of capital assets included within repairs and maintenance
- capital related expenditure included within legal and professional fees.

#### Repairs and maintenance

- Repairs and maintenance are allowable costs.
- Improvements/enhancements are capital expenditure and therefore disallowed.
- Expenditure required to bring an asset into a useable state is capital expenditure and therefore disallowable.
- If the whole asset is replaced the expenditure will be treated as capital rather than a repair.

## Notes





### 4.6 Car leasing costs

- Leased motor cars:
  - CO<sub>2</sub> emissions > 110 g/km: disallow (15% × hire charge).
  - CO<sub>2</sub> emissions ≤ 110 g/km: no adjustment required.
- If the leased car is used by the sole trader partly for business and partly for private use, then there will also be a disallowance for the private use.

### 4.7 Subscriptions and donations

#### Subscriptions

Trade or professional association subscriptions are normally allowable since they will be made wholly and exclusively for the purposes of the trade.

#### Donations

The treatment of a donation depends on the nature of the organisation to which the donation is being made:

- Small donations to local charities are allowable.
- Gifts of stock or assets to local charities or schools are allowable.
- Donations to national charities are disallowable but tax relief may be available through the gift aid scheme (see Chapter 2).
- Subscriptions and donations to political parties are not allowable.

## Notes



### 4.8 Entertaining and gifts

#### Entertainment

- Expenditure relating to client entertaining is disallowable.
- Expenditure relating to staff entertaining is allowable.

#### Gifts to employees

- Gifts to employees are normally allowable expenditure.
- However, the gift may result in an income tax charge for the employee under the benefits rules.

#### Gifts to customers

Gifts to customers are disallowable except for:

- the gift of trade samples to customers, or
- gifts which:
  - cost  $\leq$  £50 per recipient per year, and
  - are not food, drink, tobacco or vouchers exchangeable for goods, and
  - carry a conspicuous advertisement for the business.

## Notes



### 4.9 Legal and professional charges

Expenditure on legal and professional fees is allowable if incurred for the purposes of the trade, for example:

- legal fees chasing trade debts
- legal fees incurred in agreeing staff or customer/supplier contracts.

Expenditure of a capital nature is disallowable, e.g. fees associated with acquiring new non-current assets. However, the following are exceptions to this rule:

- charges incurred in defending the title to non-current assets are allowable
- fees and other costs of obtaining long term debt finance are allowable
- the cost of registering patents is allowable
- the expense of renewing a short lease (i.e.  $\leq 50$  years) is allowable, although the expenses incurred on a new lease are not.

### 4.10 Impaired debts

Write-offs of trade bad debts are allowable but non-trade bad debts are disallowable.

Note that the recovery of a trade debt previously written off is taxable.

Allowances for the irrecoverability, or impairment, of trade receivables are allowable for tax purposes provided they are calculated in accordance with UK GAAP or IFRS standards.

## Notes



### 4.11 Employment payments and pensions

Most payments to staff are allowable. These include salary, bonuses, pensions and redundancy payments.

- Earnings not paid within nine months of the year end, are not deductible until the period in which they are paid.
- Redundancy payments made on the cessation of trade are allowable up to four times statutory redundancy pay.
- Counselling services provided to redundant employees are allowable.
- Employers' contributions to pension schemes are allowed when paid, rather than on the normal accruals basis.
- Premiums for insurance against employee's death/illness are also allowable.

## Notes

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### 4.12 Other expenses

#### Fines

- Fines are generally disallowable as are any other payments that constitute a criminal offence.
- Parking fines incurred by employees whilst on business activity, but not by the business owner, are allowable.
- Damages paid are allowable provided they relate to the trade and are not in connection with a breach in the law.

#### Provisions for future costs

- Generally allowed provided they are calculated in accordance with UK GAAP or IFRS Standards and relate to revenue expenditure.

#### Educational courses

- Allowable if for trade purposes.

#### Removal expenses

- Allowable provided the move is not an expansionary one.

#### Misappropriation (theft/fraud)

- Allowable if committed by employees but not by the owner of business.

## Notes

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# 5 Other adjustments

### 5.1 Taxable trading income not credited in the accounts

Taxable trading income not included in the accounts is usually when a sole trader removes goods from the business for his/her own use. For tax purposes, this is treated as if it were a sale at full market value.

The tax treatment depends on what has already happened for accounts purposes.

- If correctly treated in the accounts (i.e. the cost has been accounted for): need to add back the profit element.
- If still included in purchases (i.e. no adjustment made to the accounts): add back full selling price.

### 5.2 Income in the accounts that is not taxable as trading income

Non-trading income should be removed when calculating the tax adjusted profit:

- Income taxed elsewhere, e.g. capital receipts (such as profit on disposal of a capital asset), rental income, and savings income.
- Income that is exempt from tax, e.g. interest received on overpaid income tax.

## Notes



### 5.3 Expenditure not charged in accounts but allowable for tax

The main examples of allowable expenditure not included in the accounts are:

- capital allowances (see Chapter 8)
- business expenses borne personally by the owner
- allowable trading element of lease premiums in respect of short leases (see below).

#### Short lease premiums

When a landlord grants a short lease at a premium, part of the premium is assessable on the landlord as rental income (see Chapter 4).

The tenant can treat the amount assessed as property income on the landlord as a property expense if he/she is trading from those premises.

The allowable expense is spread over the life of the lease and taken as an annual deduction against trading income.

The adjustments required for the lease are therefore:

- Add back: amortisation on the lease charged in the accounts
- Deduct: allowable proportion of the lease premium.



Remember the property income assessable on the landlord is:

$$P \text{ less } (P \times 2\% \times (n - 1)) \quad \text{or} \quad P \times (51 - n)/50$$

P = the value of the premium paid on the grant of the lease

n = duration of the lease (complete years)

## Notes



### Illustration 2 – adjustment to profit



Sabrina, a sole trader, paid a lease premium of £180,000 to her landlord on 1 October 2020 in respect of a 12-year lease. She amortises the lease over 12 years, and the expense charged in her accounts in the year ended 31 March 2021 is £7,500 ( $£180,000/12 \times 6/12$ ).

The steps to correctly adjust her profit for year ended 31 March 2021 are as follows:

#### Step 1

Calculate the amount of the lump sum paid by the tenant that will be taxable on the landlord as property income on the grant of the lease.

The landlord will be taxed on  $P \times (51 - n)/50$

$$£180,000 \times (51 - 12)/50 = £140,400.$$

The alternative calculation is also acceptable:

$$£180,000 - (£180,000 \times 2\% \times (12 - 1)) = £140,400$$

The landlord is taxed in full in the year of receipt.

#### Step 2

As Sabrina uses the property for business purposes, throughout the duration of the lease she can claim an annual deduction from her trading profits.

$$\text{Annual deduction} = £140,400/12 = £11,700$$

However, in y/e 31 March 2021 Sabrina needs to pro-rate for the number of months of the lease: it was taken out on 1 October so only a 6-month deduction is allowed that year:

$$\text{Allowable deduction for y/e 31 March 2021} = £11,700 \times 6/12 = £5,850.$$

#### Step 3

Treat any amount in Sabrina's accounts relating to the premium as disallowed and replace with the allowed amount in step 2, i.e. add back £7,500 and deduct £5,850.





## Example 1

Gerald granted a 21-year lease of business premises to Steven on 1 July 2020 for a premium of £10,500. Steven uses the premises for his trade as a greengrocer and makes up accounts for the year ended 31 March 2021.

**What are the income tax consequences on Gerald and Steven?**

### Gerald

Amount taxable on Gerald:

	£
Taxable property income $10,500 \times \frac{51 - 21}{50}$	6,300
	<hr/>

Amount deductible each year by Steven:

$£6,300/21 =$	$£300$
	<hr/>

However, in the y/e 31 March 2021 only 9/12 (£225) is available for relief as the lease was granted part way through the year.

## Notes





## Example 2

**Classify each item of expenditure or income in terms of its treatment in the adjustments to trading profit calculation (allow/disallow/deduct) giving reasons for your decision.**

Item of Expenditure/Income	Treatment	Reason
Drawings of the proprietor of £12,000		
£55 parking fines incurred by employee on business		
£2,000 on party for 5 employees		
Subscription of £750 to golf club where sole trader might meet/entertain clients		
£400 on legal fees to acquire a short lease (7 years)		
£100 donation to Conservative Party		
£650 for trade related NVQ training course for apprentice employee		
Depreciation of £7,500		
Dividends received £5,000		
100 gifts of champagne to customers. Each bottle cost £20 and bears the business logo		

## Notes



## Classification of expenditure

Item of expenditure/Income	Treatment	Reason
Drawings of the proprietor of £12,000	Disallow	Appropriation of profit therefore add back £12,000
£55 parking fines incurred by employee on business	Allow	Parking fines of staff whilst on work business are allowable
£2,000 on party for 5 employees	Allow	Staff entertaining is allowable – the £150 per head limit only effects the taxable benefit
Subscription of £750 to golf club where sole trader might meet/entertain clients	Disallow	Not wholly and exclusively for the purposes of the trade therefore add back £750
£400 on legal fees to acquire a short lease (7 years)	Disallow	Legal fees incurred on the RENEWAL of a short lease only are allowed. Add back £400
£100 donation to Conservative Party	Disallow	Political donation therefore add back £100
£650 for trade related NVQ training course for apprentice employee	Allow	Provided the course is for the purpose of the trade it will be allowable
Depreciation of £7,500	Disallow	Add back £7,500 as relates to capital
Dividends received £5,000	Deduct	Amount is taxable, but not as trading income. Deduct £5,000 from trading income and include in the calculation of net income elsewhere in the income tax computation
100 gifts of champagne to customers. Each bottle cost £20 and bears the business logo	Disallow	Disallow £2,000 as gifts of drinks

# 6 Pre-trading expenditure

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## 6.1 Relief for pre-trading expenditure

Any revenue expenditure incurred in the seven years before a business starts to trade is treated as an expense incurred on the first day of trading.

## Notes

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## 6.2 Comprehensive example

## Example 3



Ayshah has a net profit per the accounts of £365,450 for the year ended 30 November 2020. In calculating this profit, you note the following:

- (1) A deduction has been made in the accounts for charitable donations to the following recipients:
 

Political party	£40,000
Local animal hospital	£500
National charity	£14,000
- (2) Ayshah has leased a car throughout the year which has emissions of 120 g/km. The lease payments, charged within the statement of profit or loss, are £700 per month. She used the car 80% for business use.
- (3) During the period she took goods for her own use costing £700. The cost of the goods has already been debited to her drawings account. Ayshah normally operates a 30% mark-up basis of pricing.
- (4) During the year Ayshah had a charge for impaired debts of £635 in the statement of profit or loss. This is made up as follows:

	£	£
Trade debts written off		437
Loan to former staff member written off		175
Allowance for impaired receivables		
As at 1 December 2019	500	
As at 30 November 2020	700	
	—	
		200
Trade debts recovered		(350)
Loan to supplier written off		173
		—
		635
		—

The loan to the supplier was written off after the parties agreed a settlement on the account – the balance was agreed to be irrecoverable.

- (5) During the year Ayshah employed her son in the business as a receptionist. Her son was paid £15,000 which is included within the wages charged in the statement of profit or loss – all other receptionists were paid £12,000.

**What are Ayshah's tax adjusted trading profits for the year ended 30 November 2020?**

**Ayshah**

**Adjusted trading profit computation**

	£
Net profit per the accounts	365,450
Donations – political	40,000
– local animal hospital	0
– national charity	14,000
Disallowed lease payments (W)	2,688
Profit on goods taken for own use (30% of £700) (Note 1)	210
Trade debts written off (Note 2)	0
Loan to former staff member written off	175
Movement in allowance for impaired receivables (Note 2)	0
Trade debts recovered (Note 2)	0
Loan to supplier written off	173
Excessive wages paid to son (£15,000 – £12,000)	3,000
<b>Adjusted trading profit</b>	<b>425,696</b>

**Working**

Annual rental payments: £700 × 12 = £8,400.

The allowable amount would be: £8,400 × 85% × 80% (business use) = £5,712

Disallow: (£8,400 – £5,712) = £2,688

**Notes:**

- (1) As the cost of goods taken out has already been accounted for, only the profit element needs to be adjusted for.
- (2) To be allowed, debt write offs must be in respect of normal trade debts.

The recovery of such debts already written off is taxable.

The write off of other debts is not allowable when computing trading profits and (if relevant) their recovery, after being written off, will therefore not be included in the tax adjusted trading profit.

# 7 Simplifications for small businesses

## 7.1 The cash basis

Small unincorporated businesses (sole traders and partnerships) can elect to use the cash basis of accounting, rather than the accruals basis (as used in UK GAAP).



To qualify the business must have **cash receipts** for the tax year  $\leq$  **£150,000**.

The business must stop using the cash basis if its receipts  $>$  £300,000 (twice the entry level threshold).



In an exam question you will be told if the cash basis is being used. If it is, you need to start your calculation with revenue received rather than net profit.

## 7.2 Calculating trading profits under the cash basis

Under the cash basis, trading profits are calculated as:

- total cash receipts
- less total allowable business expenses paid.

There is no distinction between capital and revenue expenditure, therefore capital assets are treated as follows:

- purchases are allowable deductions when paid for (except cars).
- proceeds are treated as part of the total taxable receipts when the asset is sold.
- capital allowances remain available for cars only; however, in TX you should assume that the flat rate expense deduction for car expenses is claimed instead (see below).



### Advantages of the cash basis:

- simpler accounting requirements
- only pay tax when receive the funds.



### Disadvantages of the cash basis:

- losses can only be carried forward as opposed to many more options under the accruals basis (see Chapter 15)
- expenses only deductible when physically paid.

### 7.3 Flat rate expense deductions

**Any** unincorporated business may make deductions for certain expenses on a fixed rate basis, rather than using the actual expenditure.



For exam purposes, if the cash basis is being claimed, you should assume that the use of flat rate expenses also applies.

The following are the examinable fixed flat rate deductions.

### 7.4 Motor vehicles

If a trader incurs expenditure on the acquisition, lease, hire or use of a car for the trade, he/she can claim a fixed rate deduction in respect of this expenditure using the approved mileage allowance rates.



The fixed deductions are the AMAP rates of 45p per mile for the first 10,000 miles, and 25p per mile thereafter.

## Notes





### 7.5 Business premises partly used as trader's home

If the trader uses part of the business premises as his/her home (e.g. where the sole trader lives in his/her hotel or bed and breakfast) a fixed rate monthly adjustment can be made for private use. The amount will be provided in the exam.

It represents the private use adjustment for services, rent, food and utilities. Any private element of other expenses (e.g. rates and mortgage interest) must be adjusted for as normal.

## Example 4



Claire runs a hotel, which she shares with her partner Don and their daughter Ellie. The overall business premises expenses were £15,000 for year ended 31 March 2021 and, based on the number of occupants, the private use adjustment comes to £7,800.

**Calculate Claire's allowable expenses for the year ended 31 March 2021.**

**Claire**

	£
Total premises expenses	15,000
Less: Flat rate disallowable amount	(7,800)
	<hr/>
Allowable expenses	7,200
	<hr/>

## Notes





## Example 5

Will started to trade as a sole trader on 1 June 2020 and has elected to use the cash basis.

The receipts figure in his accounts for year ended 31 May 2021 is as follows:

	£
Cash receipts from customers	20,000
Bank transfers from customers	38,000
Cash receipt from sale of machine	2,500
Interest received on bank account	150
	<hr/>
Total receipts	60,650
	<hr/>

The expense payments figure is as follows:

	£
Cash payments for suppliers of goods for resale	1,200
Bank transfers for purchase of goods for resale	22,000
Standing orders to utility companies	6,800
Bank transfer for purchase of car	4,200
Cheque payment for machinery	2,900
Petty cash payment for entertaining customer	50
Interest on bank loan	300
	<hr/>
Total payments	37,450
	<hr/>

The car has CO<sub>2</sub> emissions of 115g/km and is used 60% of the time for business purposes. Will drove 15,000 miles in the year and claims the fixed rate mileage allowance in respect of the car.

**Calculate Will's adjusted trading profits for the year ended 31 May 2021.**

## Will

### Tax adjusted trading profits using cash basis – year ended 31 May 2021

	£	£
Cash receipts from customers		20,000
Bank transfers from customers		38,000
Cash receipt from sale of machine		2,500
		<u>60,500</u>
Taxable trading receipts		60,500
Cash payments for suppliers of goods for resale	1,200	
Bank transfers for purchase of goods for resale	22,000	
Standing orders to utility companies	6,800	
Bank transfer for purchase of car	0	
Cheque payment for machinery	2,900	
Petty cash payment for entertaining customer	0	
Interest on bank loan	300	
Fixed rate mileage allowance (60% × 15,000 = 9,000 × 45p)	4,050	
	<u></u>	
Allowable trading expenses		(37,250)
		<u>23,250</u>
Tax adjusted trading profit		<u>23,250</u>

## Notes



### Questions



You should now be able to answer TYU questions 1 to 11 from the Study Text Chapter 7 as well as the questions 'Parson' and 'Angela' from Chapter 27.

For further reading, visit Chapter 7 of the Study Text and review the TX article on 'adjustment of profits' at [www.accaglobal.com](http://www.accaglobal.com).

# Chapter 8

## Capital allowances



### Outcome

Upon completion of this Chapter you will be able to:

- define plant and machinery for capital allowances purposes
- compute writing down allowances, first year allowances and the annual investment allowance
- compute capital allowances for motor cars
- compute balancing allowances and balancing charges
- compute structures and buildings allowances
- recognise the treatment of short life assets
- recognise the treatment of assets included in the special rate pool

and answer questions relating to these areas.



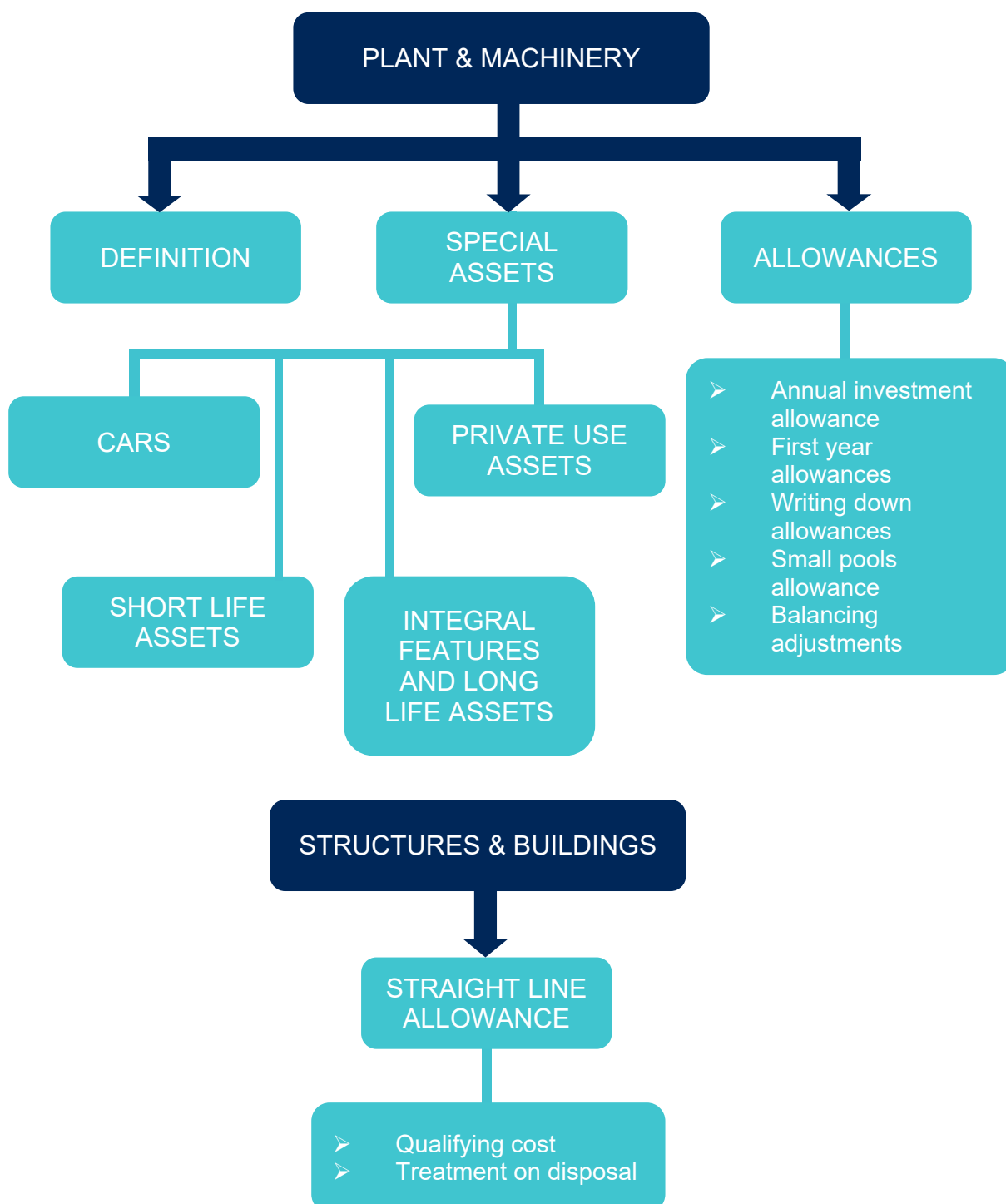
PER

One of the PER performance objectives (PO15) is to prepare computations of taxable amounts and tax liabilities according to legal requirements. Working through this chapter should help you understand how to demonstrate that objective.

The underpinning detail for this Chapter in your Integrated Workbook can be found in Chapter 8 of your Study Text.



### Overview



# 1 Capital allowances – plant and machinery

## 1.1 Capital allowances



**Capital allowances** are the tax version of depreciation on **plant and machinery**. They are available to persons who buy qualifying assets for use in a trade or business.

There are four types of capital allowance, explained in more detail below:

- Writing down allowance (WDA): available annually
- Annual investment allowance (AIA): available on most assets in the year of acquisition
- First year allowance (FYA): available on certain assets in the year of acquisition
- Balancing adjustments: a balancing allowance or charge may arise in the year of disposal.

## 1.2 Plant and machinery



**Plant and machinery** is the apparatus **with which** the business operates rather than the setting **in which** the business operates.

- The distinction can be difficult and there is significant case law defining “plant” (some of which is now enshrined in legislation). For example:
  - a canopy over a petrol forecourt was tantamount to a roof and did not qualify for capital allowances.
  - movable partitioning was held to be plant, while fixed partitioning fulfils the same function as walls and therefore was part of the setting.
- Therefore, buildings, land and structures do not usually qualify for capital allowances (with the exception of those qualifying for the structures and buildings allowance – see section 8).

## Notes



## Chapter 8

### Summary of qualifying assets

Machinery includes all machines, motor vehicles, computers; plant includes fixtures and fittings, movable partitioning, furniture, equipment.

From case law, the following also qualify for capital allowances:

- building alterations incidental to installation of P&M
- a license to use computer software.

## Notes

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### 1.3 The main pool (or general pool)

Subject to certain exceptions, rather than calculating capital allowances on an individual asset by asset basis, most items of plant and machinery purchased by a business are grouped together as part of a pool of expenditure on which capital allowances are then claimed.

The key assets that do **not** go into the main pool are as follows:

- New or second hand cars with CO<sub>2</sub> emissions of greater than 110 g/km
- Assets that are partly used for private purposes by the sole trader/partners
- Assets that need to go into the special rate pool rather than the main pool
- Assets for which a short life asset election has been made to take them out of the pool.

The balance on the pool – the equivalent of the net book value for tax purposes – is referred to as the tax written down value (TWDV).

The allowance for the period – the equivalent of tax allowable depreciation – is referred to as the writing down allowance (WDA).

## Notes

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## 2 Calculation of capital allowances

### 2.1 Capital allowance computation

A capital allowances working is prepared for each period of account. Here is a pro forma main pool working.

		Main pool	Allowances
	£	£	£
TWDV b/f		X	
Additions with no AIA or FYA		X	
Additions with AIA	X		
AIA	(X)		X
	<hr/>		
	X	→ X	
Disposals		(X)	
		<hr/>	
		X	
WDA at 18%		(X)	X
Additions qualifying for 100% FYA			
Low emission cars	X		
FYA at 100%	(X)		X
	<hr/>		
		0	
		<hr/>	
TWDV c/f		X	
		<hr/>	
Total allowances			<hr/> X <hr/>

## Notes



### 2.2 Writing down allowances (WDA)



The WDA available each year (except the year of cessation)  
**= 18% p.a. × TWDV.**

### 2.3 Annual investment allowance (AIA)



The rate of annual investment allowance for a 12 month period of account  
**= £1,000,000 on new purchases of plant and machinery.**

From 1 January 2021 the AIA limit will be £200,000 but this will not be examined in TX. It should be assumed that the £1 million limit applies even if the accounting period spans 1 January 2021.

#### Allocation of the AIA

- The AIA can be used on additions of assets in the main pool except cars.
- AIA does not have to be claimed in full, but any unused AIA cannot be carried forward or back.
- If expenditure > available AIA then the balance is eligible for 18% WDA.
- AIA is not available in the period to cessation of trade.

### 2.4 First year allowances (FYAs)



**FYA = 100% deduction in the period of acquisition on new low emission cars. A low emission car is defined as one with CO<sub>2</sub> emissions of ≤ 50 g/km.**

- Second hand low emission cars go into the main pool and are treated in the same way as all other cars with CO<sub>2</sub> emissions of 51 – 110 g/km.
- FYAs are given instead of the WDA.
- FYAs are not available in the period to cessation.
- Low emission cars provided to employees as company cars also have lower taxable benefits = lower income tax (employee) and lower class 1A NICs (employer). Zero emission have no taxable benefit at all. They are therefore very beneficial from a tax perspective.



## Example 1

Ava commenced trading on 1 January 2020. Her trading profits for the year ended 31 December 2020, adjusted for tax purposes but before capital allowances, are £125,500.

On 9 November 2020 she bought a new car with CO<sub>2</sub> emissions of 105g/km for £10,000 and another new car with CO<sub>2</sub> emissions of 46g/km for £22,700; on 1 December 2020 she purchased a milling machine for £42,000.

**Calculate Ava's tax adjusted trading profits for the year ended 31 December 2020.**

**Ava**

**y/e 31 December 2020**

	£
Adjusted trading profit	125,500
Capital allowances (W)	(66,500)
	<hr/>
Tax adjusted trading profit	59,000
	<hr/>

## Notes



## Working – capital allowances computation

		Main pool	Allowances
y/e 31 December 2020	£	£	£
TWDV b/f		0	
Addition: no AIA or FYA (car)		10,000	
Addition: AIA (milling machine)	42,000		
AIA	(42,000)		42,000
		0	
		10,000	
WDA at 18%		(1,800)	1,800
Additions: FYA (low emission car: CO <sub>2</sub> ≤ 50g/km)	22,700		
FYA at 100%	(22,700)		22,700
		0	
TWDV c/f		8,200	
Total allowances			66,500

## Notes



### 2.5 Short or long periods of account

WDAs and AIA are given for periods of account:

- Where there is a short or long period of account, the WDA and AIA are time apportioned accordingly.
- The WDA and AIA are never restricted by reference to the length of ownership of an asset within the period of account.
- The FYA is never time apportioned.

## Example 2



Paula commenced trading on 1 July 2020 and prepared her first set of accounts to 31 December 2020. Her tax adjusted trading profits before capital allowances for the 6 months ended 31 December 2020 was £141,000.

She bought machinery on 28 September 2020 for £112,000. On 30 November 2020, she bought a new car with CO<sub>2</sub> emissions of 102g/km for £14,000 and on 10 December 2020 she bought a new car with CO<sub>2</sub> emissions of 47g/km for £21,000.

**Calculate Paula's tax adjusted trading profits for the period ended 31 December 2020.**

**Paula**

**6 m/e 31 December 2020**

	£
Adjusted trading profit	141,000
Capital allowances (W)	(134,260)
	<hr/>
Tax adjusted trading profit	6,740
	<hr/>

## Working – capital allowances computation

		Main pool	Allowances
6 m/e 31 December 2020	£	£	£
TWDV b/f		0	
Addition: no AIA or FYA (car)		14,000	
Additions: AIA			
Machinery	112,000		
AIA ( $\text{£}1\text{m} \times 6/12 = \text{£}500,000$ )	(112,000)		112,000
		0	
		14,000	
WDA at $18\% \times 6/12$		(1,260)	1,260
Additions: FYA	21,000		
(low emission car: $\text{CO}_2 \leq 50\text{g/km}$ )			
FYA at 100%	(21,000)		21,000
		0	
TWDV c/f		12,740	
Total allowances			134,260

## Notes



### 2.6 Small pool WDA

If the balance in the main pool (before calculating the current period's WDA)  $\leq$  £1,000 the whole balance can be claimed at once rather than having to write down at 18%.

The £1,000 is time apportioned for periods not equal to 12 months.

### 2.7 Disposals from the main pool

When an item from the main pool is sold, deduct the lower of:

- proceeds, and
- original cost.

before giving writing down allowances for the period.

## Notes

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## Example 3



John draws up accounts to 31 December. On 1 July 2020, he purchased an item of plant and machinery costing £67,000 for his business.

The tax written down value brought forward on the main pool at 1 January 2020 was £228,000. On 1 August 2020, he sold an item of plant for £15,200 (original cost £18,000).

**Calculate the maximum capital allowances available for the year ended 31 December 2020.**

**John**

		Main pool	Allowances
y/e 31 December 2020	£	£	£
TWDV b/f		228,000	
Additions: AIA (plant)	67,000		
AIA	(67,000)		67,000
		0	
Disposal proceeds		(15,200)	
		212,800	
WDA × 18%		(38,304)	38,304
TWDV c/f		174,496	
Total allowances			105,304

## Notes



### 2.8 Balancing charges

For as long as there is a positive balance on the main pool, it keeps being written down at 18% (subject to the small pool WDA – see above).

However, if the disposal of an asset from the main pool makes the pool balance negative, then too many allowances have been claimed in the past.

These excess allowances will be recovered and charged to tax by means of a balancing charge (BC), which reduces the capital allowances claim for the period.

If there is an overall net BC it is added to the tax adjusted trading profit.

### Example 4



Odysseus has traded for many years. During the year ended 31 December 2020 he had the following transactions:

11 June 2020	Purchased some computer equipment for £93,500
19 July 2020	Sold some machinery for £117,200 which originally cost £145,000
30 August 2020	Purchased a new car with CO <sub>2</sub> emissions of 48g/km for £17,800
30 October 2020	Purchased some office furniture for £30,000

The tax written down value at 1 January 2020 was £103,000.

**Compute the capital allowances for the year ended 31 December 2020.**

## Notes



## Odysseus

		Main pool	Allowances
y/e 31 December 2020	£	£	£
TWDV b/f		103,000	
Additions: AIA			
Computer equipment	93,500		
Office furniture	30,000		
AIA	(123,500)		123,500
		0	
Disposal		(117,200)	
		(14,200)	
Balancing charge		14,200	(14,200)
Additions: FYA			
(low emission car: CO <sub>2</sub> ≤ 50g/km)	17,800		
FYA at 100%	(17,800)		17,800
		0	
TWDV c/f		0	
Total allowances			127,100

### 3 Special rate pool

#### 3.1 Special rate pool



**Special rate pool:** the WDA for 2020/21 is  $\text{TWDV} \times 6\% \text{ p.a.}$  The special rate pool operates in the same way as the main pool but includes the following assets:

- Long life assets
- Integral features of a building
- High emission cars (emitting  $> 110 \text{ g/km}$ ).

#### 3.2 Integral features

The following items are classified as **integral** features:

- Electrical systems (including lighting systems)
- Cold water systems
- Space or water heating systems, powered systems of ventilation, air cooling or purification
- Lifts/escalators/moving walkways
- External solar shading.

Additionally, thermal insulation in all business buildings is included in the special rate pool.

## Notes



### 3.3 Long life assets

**Long life assets** are plant and machinery with an expected working life of at least 25 years and total cost in a 12-month period of account of  $\geq$  £100,000 (time apportion for length of period of account).

The following cannot be classified as long life assets:

- cars
- plant and machinery used in retail shops, showrooms, offices, hotels or houses.

### 3.4 Use of annual investment allowance (AIA)

The AIA is available on the acquisition of any asset except cars.



To be tax efficient, first allocate the AIA against assets with the lowest rate of allowances (SRP then main pool).

Expenditure in excess of the AIA qualifies for the normal WDA.

## Notes



### Example 5



Adam makes up accounts to 30 September each year. The TWDV of his plant and machinery at 1 October 2019 were as follows:

	£
Main pool	32,300
Special rate pool	103,000

During the year ended 30 September 2020 Adam made the following acquisitions:

		£
10 April 2020	New car (CO <sub>2</sub> emissions 50g/km)	18,000
10 May 2020	Machinery	107,000
1 August 2020	Crane (expected working life of 30 years)	138,000
1 September 2020	Car (CO <sub>2</sub> emissions 117g/km)	17,400
18 September 2020	Air conditioning system	87,000

**Calculate Adam's capital allowances for the year ended 30 September 2020.**

## Notes



## Adam

		Main pool	Special rate pool	CAs
y/e 30 September 2020	£	£	£	£
TWDV b/f		32,300	103,000	
Additions: no FYA/AIA (High emission car)			17,400	
Additions: AIA (SRP)				
Crane (long life asset)	138,000			
Air conditioning	87,000			
	<u>225,000</u>			
AIA	(225,000)			225,000
	<u></u>			
			0	
Additions: AIA (MP machine)	107,000			
AIA (Note)	(107,000)			107,000
	<u></u>			
		0		
		<u>32,300</u>	<u>120,400</u>	
WDA at 18%		(5,814)		5,814
WDA at 6%			(7,224)	7,224
Additions: FYA				
Car	18,000			
FYA at 100%	(18,000)			18,000
	<u></u>			
		0		
		<u>26,486</u>	<u>113,176</u>	
TWDV c/f				
Total allowances				<u>363,038</u>

## Note

Although it is clear that there is plenty of AIA available to cover the additions you must show it being allocated to the special rate pool additions before the main pool addition.

# 4 Private use assets

## 4.1 Private use assets

Special rules apply to the calculation of capital allowances where **the owner** of the business (not an employee) has some private use of the asset.

- In the pro forma set up a separate column for each private use asset.
- Calculate allowances as normal but only claim the business proportion as a deductible allowance.
- On the disposal of a private use asset a balancing adjustment is computed by comparing the sales proceeds to the tax written down value
  - If the sales proceeds > TWDV, there is a balancing charge
  - If the sales proceeds < TWDV, there is a balancing allowance.
- Only the relevant business proportion of the balancing charge or allowance is then available to the business.
- AIA is available against private use assets that are not cars, but should first be set against other assets; otherwise it will be restricted to the business use. However, most private use assets are cars, therefore the AIA is unavailable.

## Notes







## Example 6

Gary started in business on 1 April 2020 and decided to prepare his accounts to 30 June each year.

In April 2020 he bought a car for £15,000 with CO<sub>2</sub> emissions of 104g/km. He sold the car in September 2022 for £4,000.

Gary used his car for both business and private purposes and estimated a 70% business use proportion.

**Show the capital allowances and balancing adjustment for the 15 month period ending 30 June 2021, and the years ended 30 June 2022 and 2023. Assume FA20 rates apply throughout.**

**Gary**

	Private use car £	Business use	Allowances £
<b>15 m/e 30 June 2021</b>			
Addition: no FYA/AIA	15,000		
WDA at 18% × 15/12	(3,375)	× 70%	2,363
	<u>11,625</u>		<u></u>
TWDV c/f	11,625		
<b>y/e 30 June 2022</b>			
WDA at 18%	(2,093)	× 70%	1,465
	<u>9,532</u>		<u></u>
TWDV c/f	9,532		
<b>y/e 30 June 2023</b>			
Disposal proceeds	(4,000)		
	<u>5,532</u>		
Balancing allowance	(5,532)	× 70%	3,872
	<u>0</u>		<u></u>
TWDV c/f	0		

### Example 7



Angela is in business as a sole trader. In the year ended 31 December 2020 she has the following transactions:

- 15 May 2020 Purchased new office furniture for £24,800
- 1 June 2020 Sold Ford car for £9,400 (used by Angela 30% for private purposes)
- 2 June 2020 Purchased a new Toyota car (CO2 emissions 108g/km) for £10,000 which Angela will use 20% of the time for private purposes
- 10 June 2020 Bought new plant for £9,000
- 1 July 2020 Sold office equipment for £10,000 (original cost £18,000)

As at 1 January 2020 the tax written down value on the main pool was £10,800 and on the Ford car was £14,500.

**Calculate Angela's capital allowances for the year ended 31 December 2020.**

### Notes



## Angela

		Main pool £	PU Ford £	PU Toyota £	Bus. use	CAs £
<b>y/e 31 December 2020</b>						
TWDV b/f		10,800	14,500			
Additions: no AIA/FYA				10,000		
Additions: AIA						
Office furniture	24,800					
Plant	9,000					
AIA	(33,800)					33,800
		0				
Disposals		(10,000)	(9,400)			
		800	5,100			
Balancing allowance			(5,100)		×70%	3,570
Small pool allowance		(800)				800
WDA at 18%				(1,800)	×80%	1,440
TWDV c/f		0		8,200		
Total allowances						39,610

# 5 Short life assets

## 5.1 Short life assets



**Short life assets** = main pool assets (except cars) which are expected to be sold or scrapped within eight years of the end of the accounting period of purchase.

A de-pooling election may be made to put a short life asset into a separate column to enable the calculation of a balancing allowance on disposal.

If the short life asset is not disposed of within eight years of the end of the period of account in which it was acquired:

- transfer the TWDV to the main pool at the start of the next period.

The **time limit for the de-pooling election** is:



First anniversary of 31 January following end of tax year in which period of account of expenditure ends.

AIA can be used against short life assets but it would be preferable to offset it against other additions first, since they will take longer to write off for tax purposes. Also, it is probable that a balancing charge would arise on the disposal of the short life asset if the AIA had been offset against it in the period of acquisition.

## Notes



## Illustration 1 – short life asset election

Kendra has traded for many years, making accounts up to 31 December. On 1 January 2020 she had a TWDV brought forward on the main pool of £25,000. On 1 May 2020 she bought integral features for £980,000 and a machine for £100,000. The machine lasted for less time than expected and she sold it on 30 June 2021 for £12,500.

**Calculate the capital allowances for the years ended 31 December 2020 and 31 December 2021 showing if the de-pooling election would be beneficial.**

### Without de-pooling

	£	Main pool £	SRP £	CAs £
<b>y/e 31 December 2020</b>		25,000		
Additions: AIA (SRP)	980,000			
AIA	(980,000)			980,000
			0	
Additions: AIA (Main pool)	100,000			
AIA (£1,000,000 – £980,000)	(20,000)			20,000
		80,000		
		105,000		
WDA at 18%		(18,900)		18,900
TWDV c/f		86,100		
Total allowances				1,018,900
<b>y/e 31 December 2021</b>				
Disposal		(12,500)		
		73,600		
WDA at 18%		(13,248)		13,248
TWDV c/f		60,352		
Total allowances				13,248

## Chapter 8

### With de-pooling

		Main pool	SRP	SLA	CAs
	£	£	£	£	
<b>y/e 31 December 2020</b>		25,000			
Additions: AIA (SRP)	980,000				
AIA	(980,000)				980,000
			0		
Additions: AIA (SLA)	100,000				
AIA	(20,000)				20,000
Transfer				80,000	
		25,000		80,000	
WDA at 18%		(4,500)		(14,400)	18,900
TWDV c/f		20,500		65,600	
Total allowances					1,018,900
<b>y/e 31 December 2021</b>					
Disposal				(12,500)	
		20,500		53,100	
BA				(53,100)	53,100
WDA at 18%		(3,690)			3,690
TWDV c/f		16,810		0	
Total allowances					56,790

**Conclusion:** The election is beneficial because it maximises the allowances in the year ended 31 December 2021. This is a timing issue only but it is advantageous from a cash flow perspective.

## Notes



# 6 Cessation of trade

## 6.1 Cessation of trade

When a business is permanently discontinued, no AIA, WDA or FYA is available in the final period of account.

Instead of the normal capital allowance computation being prepared, the following steps should be followed:

- Add in any additions made in the final period.
- Deduct any disposals made in the final period.
- Calculate a balancing adjustment on each pool to bring the TWDV c/f to nil.

This is the only occasion on which a balancing allowance can arise on the main or special rate pool.

## Notes



### Example 8



Dermot makes up accounts to 31 December each year. He ceased to trade on 30 June 2021.

The tax written down values as at 1 January 2020 were:

Main pool	£28,000
Car – CO <sub>2</sub> emissions 105g/km (60% private use)	£18,000

During the year ended 31 December 2020 the following transactions took place:

31 July 2020      Bought plant for £22,800

During the final period the following transactions took place:

1 January 2021      Bought plant for £11,400

30 June 2021      Sold all main pool items (each for less than cost) for a total of £37,600

30 June 2021      Took the car for his personal use. The market value at that date was £11,000.

**Calculate Dermot's capital allowances for the year ended 31 December 2020 and the 6 months ended 30 June 2021. Assume FA20 rates apply throughout.**

## Notes





## Dermot

		Main pool	40% BU asset	Allowances
	£	£	£	£
<b>y/e 31 December 2020</b>				
TWDV b/f		28,000	18,000	
Additions: AIA				
Additions (plant)	22,800			
AIA	(22,800)			22,800
		0		
		28,000	18,000	
WDA at 18%		(5,040)		5,040
WDA at 18%			(3,240) × 40%	1,296
		22,960	14,760	
TWDV c/f				
Total allowances				29,136
<b>6 m/e 30 June 2021</b>				
Additions (plant)		11,400		
Disposals:				
Main pool		(37,600)		
Car			(11,000)	
		(3,240)	3,760	
Balancing charge		3,240		(3,240)
Balancing allowance			(3,760) × 40%	1,504
		0	0	
Total allowances (net balancing charge)				(1,736)



## The capital allowance pro forma



Year ended		Main pool	SRP	PU asset	SLA	Business use	Allowances
	£	£	£	£	£		£
TWDV b/f		X	X	X	X		
Additions: No AIA		X					
Additions: AIA							
SRP additions	X						
AIA	(X)						
			0				
MP additions	X						
AIA	(X)						X
		X					
Disposals		(X)			(X)		
		X			X		
BA/BC					(X)		X
Small pool WDA							
WDA @ 18%		(X)					X
WDA @ 6%			(X)				X
WDA @ 18%/6%				(X)		× BU%	X
Additions: FYA	X						
FYA @ 100%	(X)						X
		0					
TWDV c/f		X	X	X			
Total allowances							X

## Notes



## Example 9



David commenced trading as a manufacturer of industrial valves on 1 September 2020. He prepared his first set of accounts for the 4 month period to 31 December 2020 and made the following acquisitions during this period.

1 September 2020	Bought machinery for £98,400
15 September 2020	Installed air conditioning system into the office at a cost of £250,000
2 October 2020	Bought a car with emissions of 109g/km (used by David's production manager – 35% private use) for £11,780
11 November 2020	Bought a visual imaging machine for £46,000 – this machine is expected to have an expected useful economic life of 3 years, after which time it will be scrapped
1 December 2020	Bought a car with emissions of 148g/km (used by David – 20% private use) for £14,600

**Calculate David's capital allowances for the 4 months ended 31 December 2020.**

## Notes



## Chapter 8

### David

		Main pool	80% BU car	SLA	CAs
	£	£	£	£	£
<b>4 m/e 31 December 2020</b>					
Additions: no FYA/AIA		11,780	14,600		
Additions: AIA (SRP)	250,000				
AIA (Note)	(250,000)				250,000
Additions: AIA (MP)	98,400				
AIA (Note)	(83,333)				83,333
		15,067			
Additions: SLA (Note)				46,000	
		26,847	14,600	46,000	
WDA at 18% × 4/12		(1,611)		(2,760)	4,371
WDA at 6% × 4/12			(292) × 80%		234
TWDV c/f		25,236	14,308	43,240	
Total allowances					337,938

### Note

The maximum AIA is  $£1,000,000 \times 4/12 = £333,333$ . Both the main pool and short life asset additions qualify for the AIA, however £250,000 of the available AIA has first been allocated to the special rate pool additions. There is therefore only  $£333,333 - £250,000 = £83,333$  of AIA remaining to set against the main pool addition. The short life asset addition is simply put into a short life asset column and given a WDA in the year of acquisition.

## 8 Structures and buildings allowances

### 8.1 Structures and buildings allowance



**Structures and buildings allowances (SBAs)** are a type of capital allowance for commercial structures and buildings only. The building must have been constructed or renovated on or after 29 October 2018 to qualify for SBAs. However, a question will only be set where construction/renovation is on or after 6 April 2020 in the TX exam.

These buildings are not included in the main capital allowances computation. If the trader has more than one qualifying building or structure, each must have its own separate SBAs.

SBAs are calculated on a **straight-line basis at 3%** per annum on qualifying cost. They are therefore spread over  $33\frac{1}{3}$  years.

- Qualifying buildings include offices, factories, warehouses, retail and wholesale premises. Qualifying structures include walls, bridges and tunnels.
- The building or structure must be used for a trade or property letting business, but residential property (dwelling houses) does not qualify.
- Costs of converting, renovating or improving the property also qualify for the allowance. These costs qualify for a separate allowance from the original purchase price (if that also qualified).
- The cost of land, legal and professional fees and planning permission do not qualify for SBAs.
- Plant and machinery expenditure that qualifies for capital allowances cannot also qualify for the SBA.
- When an unused building is purchased from a builder or developer:  
Qualifying cost = price paid – value of land
- SBAs can only be claimed from the first day the building or structure comes into qualifying use. The allowance will be time apportioned in the period of first use.
- SBAs are time apportioned for a short or long periods.
- Any asset eligible for SBAs will not be eligible for the AIA.



For any questions involving the purchase (rather than construction) of a building, which do not state the construction date, you should assume that SBAs are **not** available unless stated otherwise.

## Chapter 8

### 8.2 Disposals

On disposal of the building or structure no balancing adjustment arises.

- The purchaser takes over the remainder of the original life and allowances.
- The SBA is apportioned between the parties in the period of disposal.

The SBAs claimed to the date of disposal are added to sales proceeds to calculate the chargeable gain or allowable loss arising for the vendor.

## Notes

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## Example 10

Katrin purchased a building for £270,000 from a property developer to use in her trade. She purchased the building on 1 June 2020 but the property was not used in the trade until 1 September 2020.

On 1 November 2022 Katrin sold the building to Erna for £375,000. Erna immediately started to use the building for trading purposes.

Both Katrin and Erna have a December year end.

**Calculate Katrin and Erna's capital allowances for the year ended 31 December 2020 to 31 December 2022.**

### Katrin

#### Year ended 31 December 2020

Katrin will be entitled to a 3% straight line SBA from when the building is brought into use on 1 September 2020.

$$(3\% \times £270,000 \times 4/12) = £2,700$$

#### Year ended 31 December 2021

$$3\% \times £270,000 = £8,100$$

#### Year ended 31 December 2022

Katrin will be able to claim allowances up to the date of disposal.

$$(3\% \times £270,000 \times 10/12) = £6,750$$

### Erna

#### Year ended 31 December 2022

Erna will be able to claim allowances for the last two months of her year end.

$$(3\% \times £270,000 \times 2/12) = £1,350$$

### Questions



You should now be able to answer TYU questions 1 to 14 from the Study Text Chapter 8 as well as the question 'Austin' from Chapter 27.

For further reading, visit Chapter 8 of the Study Text.



# Chapter 9

## Sole traders: basis of assessment



### Outcome

Upon completion of this Chapter you will be able to:

- recognise the basis of assessment for self-employment income
  - compute the assessable profits on commencement and on cessation
  - recognise the factors that will influence the choice of accounting date
- and answer questions relating to these areas.



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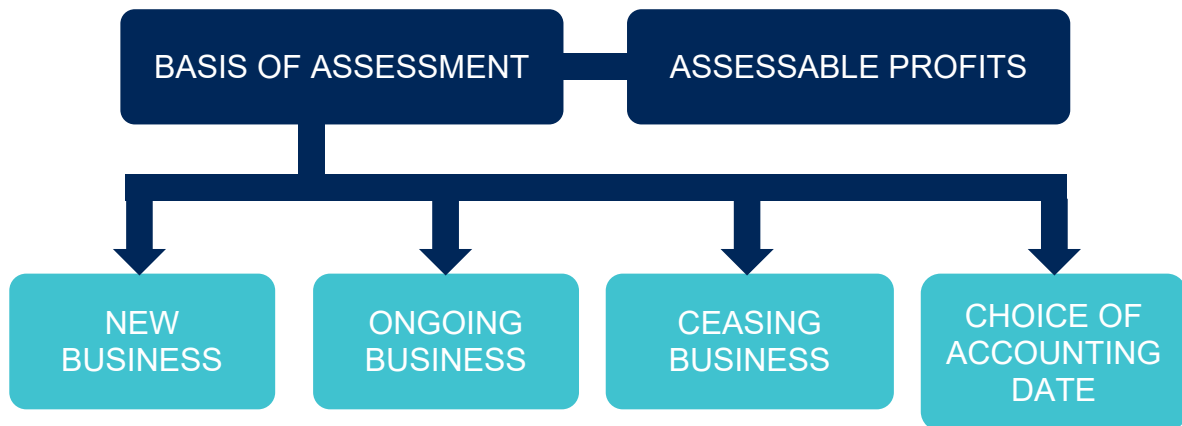
One of the PER performance objectives (PO15) is to prepare computations of taxable amounts and tax liabilities according to legal requirements. Working through this chapter should help you understand how to demonstrate that objective.

The underpinning detail for this Chapter in your Integrated Workbook can be found in Chapter 9 of your Study Text.



### Overview

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# 1 Taxation of sole trader

## 1.1 Steps to tax a sole trader

### Step 1:

Adjust profits for the accounting period X

### Step 2:

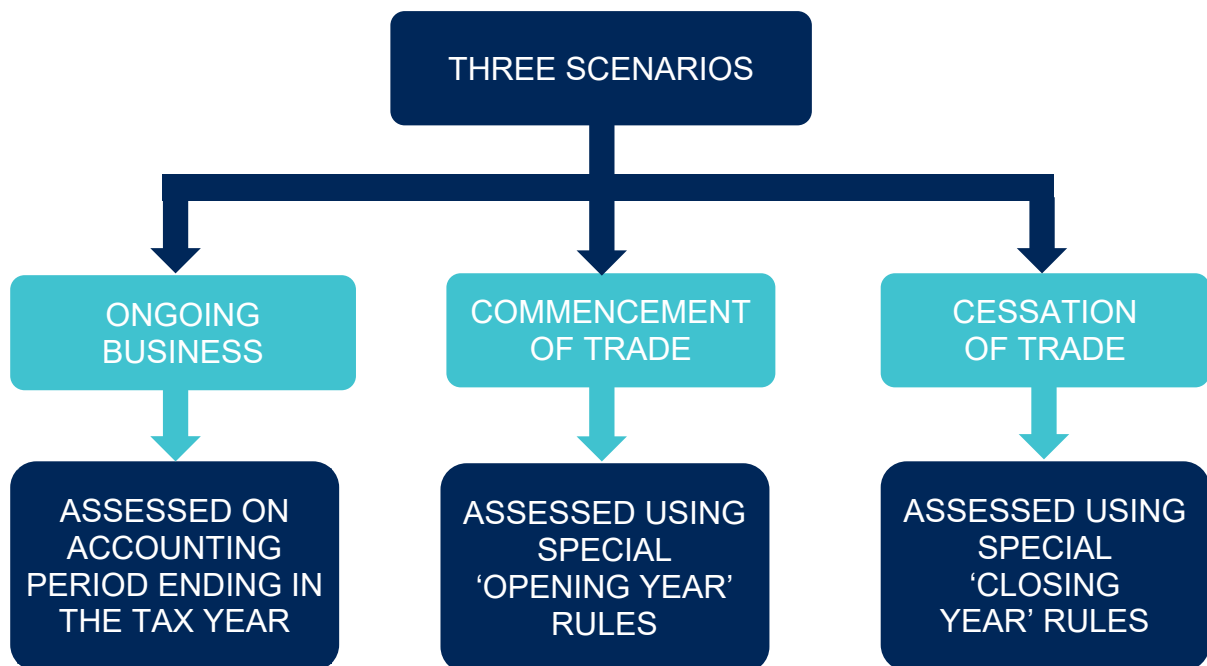
Deduct capital allowances for that accounting period (X)

Adjusted trading profit for the accounting period X

### Step 3:

Consider which tax year to assess this accounting period in = basis periods.

## 1.2 Basis periods



## Notes



# 2 Current year basis (CYB)

## 2.1 Current year basis



As seen in Chapter 7, profits of an ongoing business = assessed on a **current year basis (CYB)**, (i.e. profits assessed in a tax year = those of the 12 month accounting period ending in that tax year).

### Example 1



Antonio prepares accounts to 30 April annually. His recent taxable trading profits have been as follows:

	£
Year ended 30 April 2019	67,200
Year ended 30 April 2020	98,100

**In which tax years will these profits be assessed?**

**Antonio**

These taxable trading profits form the basis for the assessable amounts for tax years 2019/20 and 2020/21:

Tax year	Basis period	£
2019/20	Year ended 30 April 2019	67,200
2020/21	Year ended 30 April 2020	98,100

## Notes



## 3 Opening year rules

### 3.1 First tax year

Special opening year rules apply when a sole trader begins to trade.

- First tax year = the tax year in which trade starts.
- Basis of assessment = actual basis.



**Actual basis:** time apportion the tax adjusted profits and tax from start of trade to the end of the relevant tax year.

## Example 2



Miriam commenced trading on 1 December 2019 and made up her first set of accounts to 30 November 2020.

Her tax adjusted profits for the 12 months ended 30 November 2020 were £26,400.

**Calculate her assessable trading profits for the first tax year of trade.**

### Miriam

First identify in which tax year Miriam begins to trade: 1 December 2019 falls within the 2019/20 tax year.

Since this is her first year of trade, Miriam is assessed on the profits which are made in that tax year.

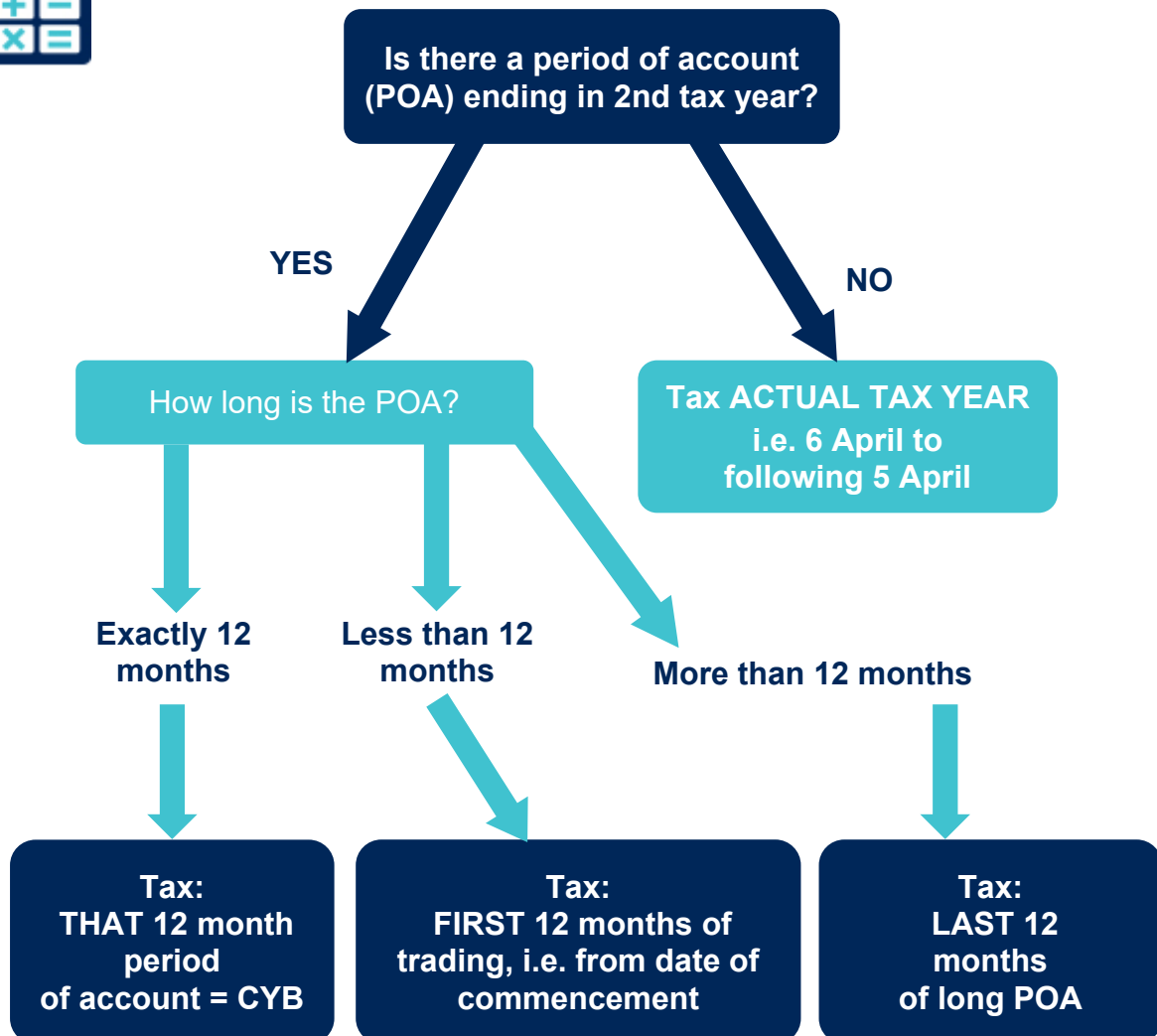
Therefore, the profits assessed for 2019/20 will be the actual profits falling in the period on a time apportioned basis.

Tax year	Basis period assessable	£
2019/20	1 December 2019 – 5 April 2020	$\frac{4}{12} \times £26,400 = £8,800$

**Note:** For ease of calculation the 5 days in April are ignored. This will also be the case in the examination. Apportionment should be done on a monthly basis when relevant.



### 3.2 Second tax year and onwards



#### Third tax year

- CYB unless no POA ended in the second year, in which case: tax the last 12 months of the long period of account.

#### Fourth year onwards

- CYB.

## Notes



### 3.3 Period of account ending in the second tax year is 12 months long

If the period of account ending in the second tax year is 12 months long, then the sole trader will start to use the current year basis.

## Example 3



Valentina started in business on 1 November 2018, preparing accounts to 31 October each year.

Her adjusted profits were as follows:

	£
Year ended 31 October 2019	15,000
Year ended 31 October 2020	36,500
Year ended 31 October 2021	49,000

**Calculate her assessable trading profits for the first four tax years of trading.**

#### Valentina

Tax year	Basis period	£
2018/19	Actual basis: 1 November 2018 – 5 April 2019 (£15,000 × 5/12)	6,250
2019/20	Current year basis: Year ended 31 October 2019	15,000
2020/21	Current year basis: Year ended 31 October 2020	36,500
2021/22	Current year basis: Year ended 31 October 2021	49,000

**Note:** The profits between 1 November 2018 and 5 April 2019 (5 months) are taxed in two tax years. This totals £6,250 of overlap profits.

## Notes



## Chapter 9

As a result of the application of the opening year rules, some of the profits can be taxed twice.



**Overlap profits** arise when the same profits are taxed in more than one tax year. The overlap profits are carried forward and are normally deducted from the final assessment when the business ceases to trade (see below).

### Example 4



Hardeep started to trade on 1 June 2019 and prepared accounts for the year ended 31 May 2020. His tax adjusted profits after the deduction of capital allowances were £50,000.

**Calculate the assessable trading profits for all relevant tax years and state the overlap profits.**

**Hardeep**

Tax year	Basis period	£
2019/20	Actual basis: 1 June 2019 – 5 April 2020 (£50,000 × 10/12)	41,667
2020/21	CYB: Year ended 31 May 2020	50,000

**Note:** The profits between 1 June 2019 and 5 April 2020 (10 months) are taxed in both tax years. This totals £41,667 of overlap profits.

## Notes





### 3.4 Period of account ending in the second tax year is shorter than 12 months

If the period of account ending in the second tax year is less than 12 months long, then the sole trader is assessed on the first 12 months of trade.

## Example 5



Harry started in business on 1 January 2019. He prepared his first set of accounts for the period ended 31 July 2019 and annually to 31 July thereafter.

His adjusted profits were as follows:

	£
Period ended 31 July 2019	15,500
Year ended 31 July 2020	30,200
Year ended 31 July 2021	29,000

**Show the assessable trading profits for all relevant tax years and calculate the amount of any overlap profits.**

**Harry**

Tax year	Basis of assessment	£
2018/19	Actual basis: 1 January 2019 – 5 April 2019 (£15,500 × 3/7)	6,643
2019/20	First 12 months of trade: 1 January 2019 – 31 December 2019 £15,500 + (£30,200 × 5/12)	28,083
2020/21	CYB: 1 August 2019 – 31 July 2020	30,200
2021/22	CYB: 1 August 2020 – 31 July 2021	29,000

The overlap profits are:

((1 January 2019 – 5 April 2019 = £6,643) + (1 August 2019 – 31 December 2019 = £12,583)) = £19,226

## Notes



### 3.5 Period of account ending in the second tax year is longer than 12 months

If the period of account ending in the second tax year is more than 12 months long, then the sole trader is assessed on the last 12 months of the long period of account ending in the second tax year.

## Example 6



Zachary started in business on 1 July 2019. He prepared his first set of accounts for the period ended 31 December 2020 and annually to 31 December thereafter.

His adjusted profits were as follows:

	£
Period ended 31 December 2020	7,500
Year ended 31 December 2021	3,400

**Calculate the assessable trading profits for all relevant tax years and the amount of any overlap profits.**

#### Zachary

Tax year	Basis of assessment	£
2019/20	Actual basis: 1 July 2019 – 5 April 2020 (£7,500 × 9/18)	3,750
2020/21	12m to accounting date: 1 January 2020 – 31 Dec 2020 (£7,500 × 12/18)	5,000
2021/22	CYB: Year ended 31 December 2021	3,400

The overlap profits are for the period 1 January 2020 – 5 April 2020

$$= (3/18 \times £7,500) = £1,250$$

## Notes



### 3.6 No period of account ending in the second tax

If no period of account ends in the second tax year, then the sole trader must:

- In the second tax year continue to use the actual basis (i.e. tax the actual months falling in that tax year).
- In the third tax year apply the rules for a period of account longer than 12 months ending in the tax year, (i.e. tax 12 months' worth of profits up to the accounting date).

## Example 7



Camille started to trade on 1 February 2018 and drew up her first accounts to 31 July 2019 and 31 July thereafter.

Her tax adjusted trading profits are as follows:

	£
Period ended 31 July 2019	42,000
Year ended 31 July 2020	45,000

**Calculate the trading profits assessable for all relevant tax years and the overlap profits arising.**

#### Camille

Tax year	Basis of assessment	£
2017/18	Actual basis: 1 February 2018 – 5 April 2018 (£42,000 × 2/18)	4,667
2018/19	Actual basis (No accounting period ending in the year): 6 April 2018 – 5 April 2019 (£42,000 × 12/18)	28,000
2019/20	12m to accounting date: 1 August 2018 – 31 July 2019 (£42,000 × 12/18)	28,000
2020/21	CYB: Year ended 31 July 2020	45,000

The overlap profits are for the period 1 August 2018 – 5 April 2019

$$= (8/18 \times £42,000) = £18,667$$

# 4 Closing year of trade

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## 4.1 Closing year of trade

The closing year rules operate as follows:

- Identify the final tax year of the business – this is by reference to the tax year in which the date of cessation falls.
- Tax the immediately preceding tax year on the current year basis.
- In the final tax year, tax all profits not yet assessed in previous years.
- Any overlap profits from commencement are deducted.

## Notes

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## Example 8

Faisal has been trading for some years preparing his accounts to 31 December.

He ceases to trade on 31 March 2021 with profits as follows:

	£
Year ended 31 December 2019	19,000
Year ended 31 December 2020	22,000
Period ended 31 March 2021	12,000

The overlap profits arising in opening years were £3,500.

**Calculate the trading profits that will be assessed on Faisal for all relevant tax years.**

**Faisal**

Tax year	Basis of assessment	£
2019/20	CYB: Year ended 31 December 2019	19,000
2020/21	Profits not yet assessed:	
	Year ended 31 December 2020	22,000
	3 months to 31 March 2021	12,000
	Less: Overlap relief b/f	(3,500)
		<hr/>
		30,500
		<hr/>

## Notes





## Example 9

Jerome has been trading for some years preparing his accounts to 30 November.

He ceases to trade on 30 April 2020 with profits as follows:

	£
Year ended 30 November 2019	33,600
Period ended 30 April 2020	16,700

The overlap profits arising in the opening years of trade were £4,100.

**Calculate the trading profit assessments for all relevant years.**

### Jerome

The final tax year (by reference to the date he ceases trading) is 2020/21.

Tax year	Basis of assessment	£
2019/20	CYB: Year ended 30 November 2019	33,600
2020/21	Profits not yet assessed:	
	5 months ended 30 April 2020	16,700
	Less: Overlap relief b/f	(4,100)
		12,600

## Notes



## Example 10



Mila started to trade on 1 September 2015 and made up her first accounts to 30 June 2016 and thereafter to 30 June annually. Mila ceased to trade on 31 January 2021.

Given below are the tax adjusted trading profits for all the relevant periods:

	£
Period ended 30 June 2016	21,600
Year ended 30 June 2017	33,200
Year ended 30 June 2018	39,600
Year ended 30 June 2019	41,300
Year ended 30 June 2020	19,100
Period ended 31 January 2021	4,700

**Calculate the trading profit assessments for all relevant tax years.**

## Notes



## Chapter 9

### Mila

Tax year	Basis period	£
2015/16	Actual basis: 1 September 2015 – 5 April 2016 (£21,600 × 7/10)	15,120
2016/17	1st 12m of trade: 1 September 2015 – 31 August 2016 (£21,600 + (£33,200 × 2/12 = £5,533))	27,133
2017/18	CYB: Year ended 30 June 2017	33,200
2018/19	CYB: Year ended 30 June 2018	39,600
2019/20	CYB: Year ended 30 June 2019	41,300
2020/21	Profits not yet assessed:	
	Year ended 30 June 2020	19,100
	7 months ended 31 January 2021	4,700
	Less: Overlap relief b/f (Note 1)	(20,653)
		<u>3,147</u>
		<u>159,500</u>

### Notes

- 1 The overlap profits are for the period 1 September 2015 – 5 April 2016 and 1 July 2016 – 31 August 2016 (£15,120 + £5,533 = £20,653).
- 2 The profits for the entire period of trade total £159,500 (£21,600 + £33,200 + £39,600 + £41,300 + £19,100 + £4,700) and the profits that have been taxed also total £159,500. It is not necessary to show this in the answer but can be a useful double check.

## Notes





## 5 Choice of accounting date



### Factors to consider

In applying the CYB:

- the year ended 31 March 2020 will be taxed in the tax year 2019/20
- the year ended 30 April 2020 will be taxed in the tax year 2020/21.

Picking an accounting date just after, rather than just before 5 April (e.g. 30 April):

- increases the time lag between earning the profits and paying the tax
- results in increased overlap profits, which may not be relieved for some time.

Conversely, an accounting date just before 5 April (e.g. 31 March):

- reduces the time lag between earning the profits and paying the tax
- reduces the overlap (a 31 March year end has no overlaps profits)
- has the shortest interval to implement tax planning methods.

## Notes



### Questions



You should now be able to answer TYU questions 1 to 14 from the Study Text Chapter 9 as well as the questions 'Abiya' and 'Maggie' from Chapter 27.

For further reading, visit Chapter 9 of the Study Text.

# Chapter 10

## Partnerships



### Outcome

Upon completion of this Chapter you will be able to:

- explain and compute how a partnership is assessed to tax
- explain and compute the assessable profits for each partner following a change in the profit sharing ratio
- explain and compute the assessable profits for each partner following a change in the membership of the partnership

and answer questions relating to these areas.



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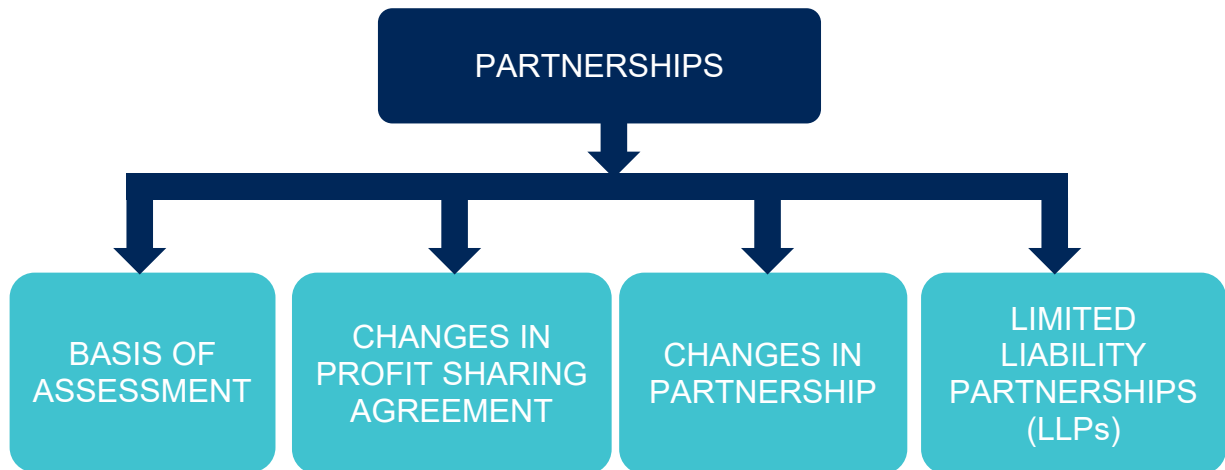
One of the PER performance objectives (PO15) is to prepare computations of taxable amounts and tax liabilities according to legal requirements. Working through this chapter should help you understand how to demonstrate that objective.

The underpinning detail for this Chapter in your Integrated Workbook can be found in Chapter 10 of your Study Text.



### Overview

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# 1 Partnerships

## 1.1 Introduction



**Partnership** = a body of persons carrying on business together with a view to profit (i.e. a group of sole traders acting together).

### Basis of assessment

- Each partner is taxed as an individual, on his or her share of the taxable profits of the partnership.

## 1.2 Steps to tax a partnership

<b>Step 1:</b>	£
Adjust the profits of the partnership for the accounting period	X
<b>Step 2:</b>	
Deduct capital allowances for the partnership for the accounting period	(X)
	_____
Adjusted trading profit for the accounting period	X
	_____
<b>Step 3:</b>	
Share this between the partners as shown in section 1.3.	
<b>Step 4:</b>	
Tax each partner individually using the standard basis period rules.	

## Notes



## Chapter 10

### 1.3 Allocation of the partnership profits

Each partner is allocated his or her share of taxable profit as follows:

	Total	A	B	C
	£	£	£	£
Salary	X	X	X	X
Interest on capital	X	X	X	X
Balance according to profit sharing ratio (PSR)	X	X	X	X
	—	—	—	—
	X	X	X	X
	—	—	—	—



Note that the salaries and interest

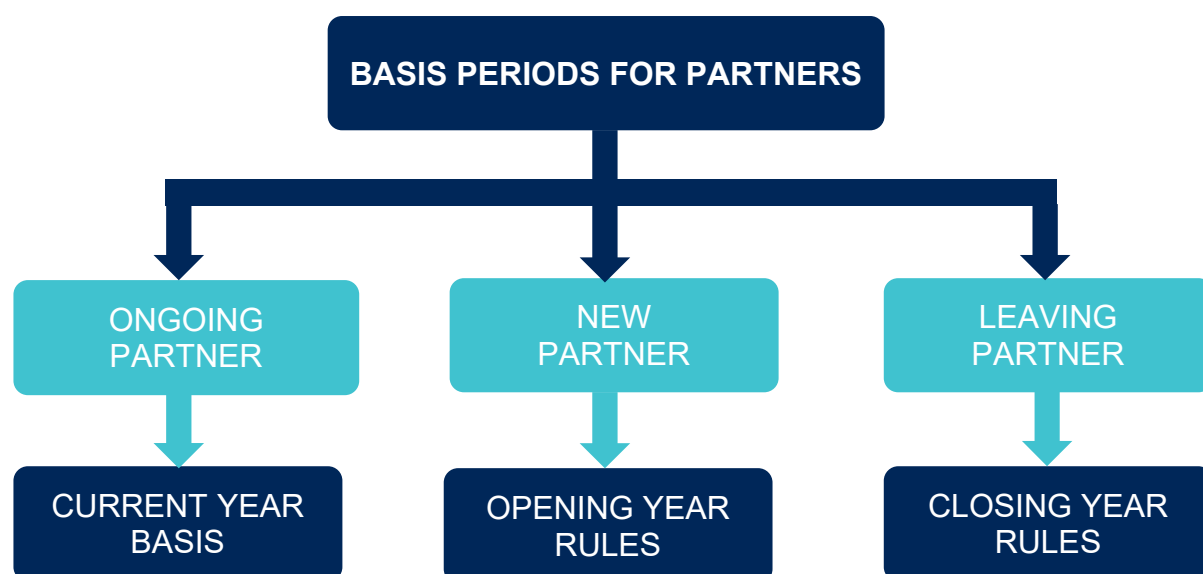
= just methods devised by the partners to allocate the trading profits.

- They are not 'real' salaries or interest and do not appear as such in the individual partner's income tax computation.
- The individual income tax computations will show the partner's total trading profit share of that partner (which includes the salary and interest allocation).

## Notes



## 1.4 Basis period rules for partners



Notes





## Example 1

Debs and Hayley have been in partnership for many years making accounts up to 31 December each year.

The partnership agreement provides Debs with a salary of £3,000 and Hayley is entitled to 15% interest on her capital balance at the start of the period. This balance was £27,000 on 1 January 2020. They split any remaining profits equally.

The partnership trading profits as adjusted for tax were £30,000 for the year ended 31 December 2020.

**Calculate the profits assessable on each of the partners in the tax year 2020/21.**

### Debs and Hayley

Year ended 31 December 2020	Total £	Debs £	Hayley £
Salary	3,000	3,000	
Interest on capital (£27,000 × 15%)	4,050		4,050
	<hr/>	<hr/>	<hr/>
	7,050	3,000	4,050
PSR (1:1)	22,950	11,475	11,475
	<hr/>	<hr/>	<hr/>
Total allocation	30,000	14,475	15,525
	<hr/>	<hr/>	<hr/>

This profit represents each partner's share of the partnership profits for this period of account. Having arrived at the appropriation, it is then treated as trading income on an individual basis.

### Trading income for tax year 2020/21 (current year basis)

Debs – £14,475

Hayley – £15,525



### 1.5 Changes in profit sharing agreement

During an accounting period the way in which profits are allocated will alter if there is:

- a change in the terms the existing partners agree to share the profits, or
- a new partner joining the partnership, or
- a partner leaves the partnership.

In each case:

- time apportion the taxable trading profits of the partnership for the accounting period around the date of change in the partnership agreement
- then allocate the profits of each period separately according to the different profit sharing agreements.



Remember that any salaries and interest on capital rates given in the question are annual rates, therefore the salaries and interest must be time apportioned according to the length of the separate periods.

## Notes





## Example 2

Stuart and Danielle are in partnership sharing profits in the ratio of 1:1 after providing Stuart with an annual salary of £12,000 and interest on £20,000 capital at 5% per annum.

On 1 January 2020, the profit sharing arrangements were changed such that no salary or interest is paid; profits are to be shared in the ratio of 3:1.

Profits for the year to 30 June 2020 are £40,000.

**Calculate Stuart and Danielle's trading income assessments for the tax year 2020/21.**

### Stuart and Danielle

	Total £	Stuart £	Danielle £
<b>1 July 2019 to 31 December 2019</b> (Profits £40,000 × 6/12 = £20,000)			
Salaries (6/12)	6,000	6,000	0
Interest (£20,000 × 5% × 6/12)	500	500	0
PSR (1:1)	13,500	6,750	6,750
	<hr/>	<hr/>	<hr/>
	20,000	13,250	6,750
<b>1 January 2020 to 30 June 2020</b> (Profits £40,000 × 6/12 = £20,000)			
PSR (3:1)	20,000	15,000	5,000
	<hr/>	<hr/>	<hr/>
<b>Total allocation</b>	<b>40,000</b>	<b>28,250</b>	<b>11,750</b>
	<hr/>	<hr/>	<hr/>

### Trading income assessments for 2020/21:

#### Current year basis – Year ended 30 June 2020

Stuart	£28,250
Danielle	£11,750

### 1.6 Partner joins, or leaves, the partnership – basis period rules

- If a partner joins the partnership, that partner must use the opening year rules.
- If a partner leaves a partnership, that partner will apply the closing year rules (with any overlap profit deducted if relevant).
- In both cases, the rest of the partners will continue with the current year basis.

## Notes

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## Example 3

David and Emma have been in partnership preparing accounts to 31 December each year and sharing profits and losses equally. On 1 January 2020 Ryan is admitted to the partnership. Profits are to be shared equally.

The adjusted profits are as follows:

	£
Year ended 31 December 2019	36,000
Year ended 31 December 2020	42,000

**Calculate each partner's assessable profits for the tax years 2019/20 and 2020/21.**

### David and Emma

#### Year ended 31 December 2019

	Total £	David £	Emma £	Ryan £
PSR (1:1)	36,000	18,000	18,000	0

#### Year ended 31 December 2020

	Total £	David £	Emma £	Ryan £
PSR (1:1:1)	42,000	14,000	14,000	14,000

**David & Emma – trading income assessments (current year basis)****2019/20**

y/e 31 December 2019	£18,000
----------------------	---------

**2020/21**

y/e 31 December 2020	£14,000
----------------------	---------

**Ryan – trading income assessments (opening year rules apply)****2019/20**

Actual basis (first year of trade)

1 January 2020 – 5 April 2020	$3/12 \times £14,000$	£3,500
-------------------------------	-----------------------	--------

**2020/21**

y/e 31 December 2020	£14,000
----------------------	---------

Ryan's overlap period is 1 January 2020 to 5 April 2020 – £3,500

**Note:** Opening year rules apply solely to the partner joining – the other partners continue under the current year basis

## Notes





## Example 4

Eisha, Mona and Zineb have been in partnership together for many years. After suffering a period of ill health, Eisha retired on 30 September 2020. The profit sharing ratio was equal until Eisha retired; thereafter it was split 60:40 in Mona's favour.

Profits for year ended 31 December 2020 were £24,000.

**Calculate Eisha's trading income assessment for the tax year 2020/21 assuming she had overlap profits on commencement of £3,600.**

**Eisha, Mona and Zineb**

**Year ended 31 December 2020**

	<b>Total</b> £	<b>Mona</b> £	<b>Eisha</b> £	<b>Zineb</b> £
<b>1 January – 30 September 2020</b>				
PSR (1:1:1) × 9/12	18,000	6,000	6,000	6,000
<b>1 October – 31 December 2020</b>				
PSR (3:2) × 3/12	6,000	3,600	0	2,400
	<hr/>	<hr/>	<hr/>	<hr/>
<b>Totals</b>	24,000	9,600	6,000	8,400
	<hr/>	<hr/>	<hr/>	<hr/>

**Eisha's trading income for tax year 2020/21 (end of previous basis period to cessation)**

Basis period: 1 January 2020 – 30 September 2020	£
Partnership allocation	6,000
Less: Overlap profits	(3,600)
	<hr/>
Taxable trading income	2,400
	<hr/>

## Notes



## 2 Limited liability partnerships

### 2.1 Taxing a limited liability partnership (LLP)



A **LLP** is a special type of partnership where the liability of the partners = limited to:

- the amount of capital introduced to the partnership.

However, for tax purposes, LLPs are:

- taxed in the same way as all other partnerships
- normal loss reliefs are available.

## Notes



### Questions



You should now be able to answer TYU questions 1 to 8 from the Study Text Chapter 10 as well as the question 'Roger, Brigitte and Xavier' from Chapter 27.

Knowledge Check Test: Business income tax on MyKaplan.

For further reading, visit Chapter 10 of the Study Text.



# Chapter 11

## National insurance



### Outcome

Upon completion of this Chapter you will be able to:

- explain and compute national insurance contributions payable:
  - (i) Class 1 and 1A NIC
  - (ii) Class 2 and 4 NIC
- understand the annual employment allowance

and answer questions relating to these areas.



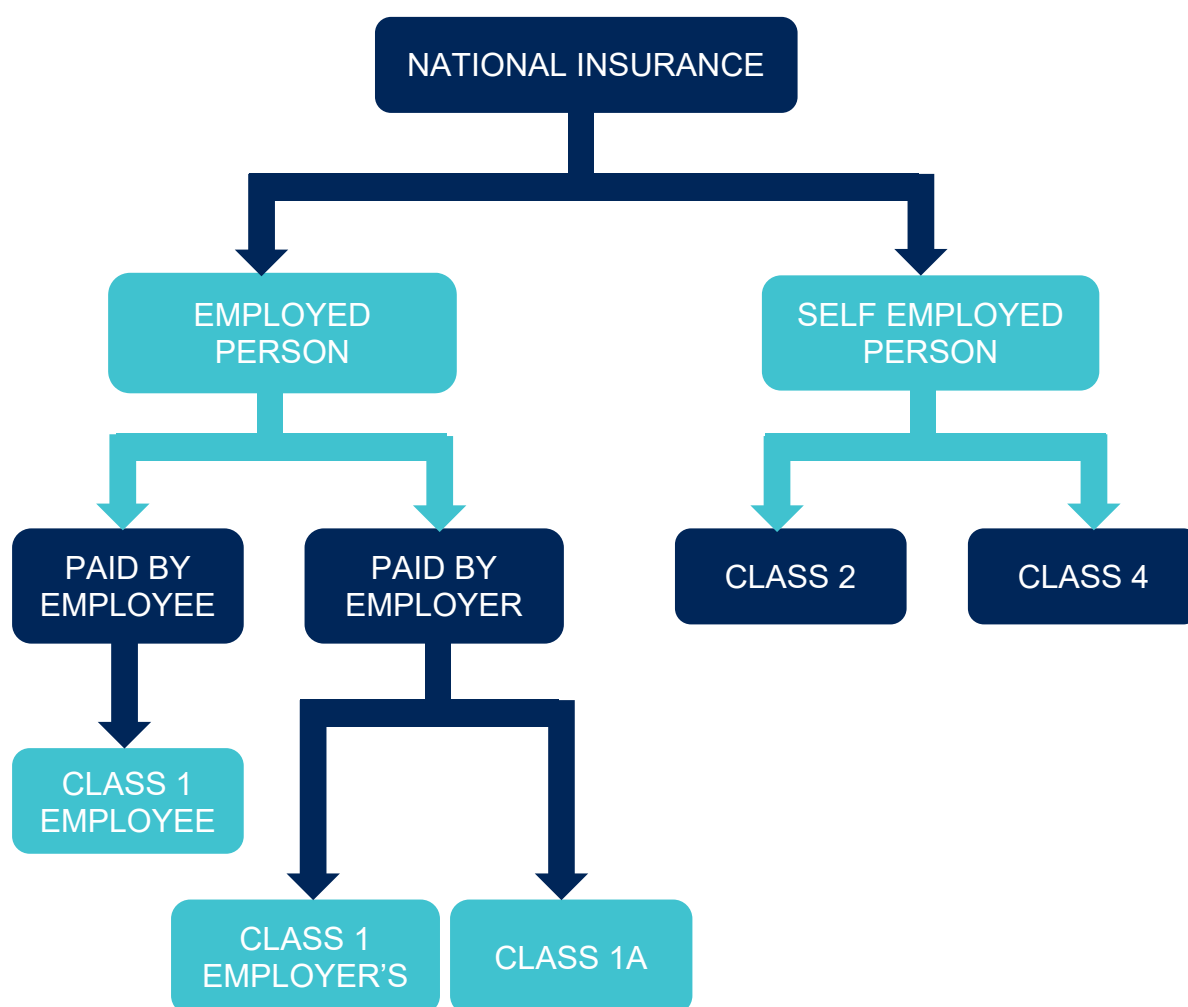
**PER**

One of the PER performance objectives (PO15) is to prepare computations of taxable amounts and tax liabilities according to legal requirements. Working through this chapter should help you understand how to demonstrate that objective.

The underpinning detail for this Chapter in your Integrated Workbook can be found in Chapter 12 of your Study Text.




### Overview



# 1 Class 1 contributions

## 1.1 Class 1 national insurance contributions

National insurance contributions are payable both by employees and their employers.

	Class 1 Employee	Class 1 Employer's
<b>Paid by</b>	Employees  From: <b>aged 16</b> To: <b>state retirement age</b>	Employers In respect of employees From: <b>aged 16</b> To: <b>no upper age limit</b>
<b>Paid on</b>	Cash earnings (no deductions allowed)  <i>Includes:</i> ➤ <b>Vouchers exchangeable for cash or non-cash items</b> ➤ <b>Reimbursed travel from home to work</b>  <i>Excludes:</i> ➤ <b>Exempt benefits</b> ➤ <b>Non-cash benefits</b> ➤ <b>Reimbursed business expenses</b>	
<b>Rates</b> 	Annual limits: £1 – £9,500                      0% £9,501 – £50,000              12% £50,001 and above              2%	Annual limits: £1 – £8,788                      0% £8,789 and above              13.8% (no upper threshold)

## Notes



## Chapter 11

Class 1 employee and employer NICs should strictly be calculated by reference to the employee's normal payment period – i.e. if paid weekly or monthly they should be calculated on a weekly or monthly basis.

- If the employee's salary stays the same for every period, calculate the NICs on an annualised basis.
- If salary fluctuates, calculate according to the earnings period of the employee = dividing the annual limits by either 52 (weekly) or 12 (monthly).

For directors, however, NICs are always calculated by reference to the annual limits, irrespective of their payment periods.



In the examination class 1 NIC calculations should be performed on an annual basis unless you are told otherwise.

### Example 1



James is paid an annual salary of £16,200 and Susan is paid an annual salary of £52,600.

**Calculate the employee's and employer's NIC liabilities for the tax year 2020/21.**

## Notes



**James****Class 1 employee**

£

**James**

$$(\pounds 16,200 - \pounds 9,500) \times 12\%$$

804

**Susan**

$$(\pounds 50,000 - \pounds 9,500) \times 12\%$$

4,860

$$(\pounds 52,600 - \pounds 50,000) \times 2\%$$

52

4,912

**Class 1 employer's****James**

£

$$(\pounds 16,200 - \pounds 8,788) \times 13.8\%$$

1,023

**Susan**

$$(\pounds 52,600 - \pounds 8,788) \times 13.8\%$$

6,046

## Notes





## Example 2

Sangeeta is employed by Strathmore Ltd and is paid an annual salary of £122,000.

She pays 6% of her salary into the occupational pension scheme of Strathmore Ltd and is provided with a company car which has a benefit value of £11,200 for tax purposes.

**Calculate Sangeeta's and Strathmore Ltd's class 1 NIC liabilities for the tax year 2020/21.**

### Sangeeta

#### Earnings for class 1 employee and employer purposes

	£
Salary	122,000
Company car benefit (Note 1)	0
Employee's pension contributions (Note 2)	(0)
	<hr/>
<b>Gross earnings for class 1 NIC purposes</b>	<b>122,000</b>
	<hr/>

#### Notes:

- (1) The car benefit is excluded since it is a non-cash benefit.
- (2) Employee's pension contributions are non-deductible when calculating earnings for NIC purposes.

#### Class 1 Employee Contributions

$(£50,000 - £9,500) \times 12\%$	4,860
$(£122,000 - £50,000) \times 2\%$	1,440
	<hr/>
	<b>6,300</b>
	<hr/>

#### Class 1 Employer Contributions

$(£122,000 - £8,788) \times 13.8\%$	15,623
	<hr/>

## 1.2 Tax relief on contributions

Employers can deduct their employer class 1 contributions from their profits as tax allowable expenses.

Employees get no tax relief for their contributions.

## 1.3 Employment allowance

Employers receive an allowance to reduce the total employer's class 1 NIC liability.



The **employment allowance** for tax year 2020/21 is **£4,000 p.a. per employer** (not per employee).

- If the employer's liability is less than the allowance the employer pays no class 1 employer's NICs for the year.
- The allowance cannot be used against other classes of NICs, e.g. class 1A.

The employment allowance is **not** available to

- Companies where a director is the sole employee.
- Employers with total class 1 employer's NIC  $\geq$  £100,000 in previous tax year (the previous year's NIC liability will be provided in questions where required).

## 1.4 Payment of class 1 NICs

- The employer is responsible to ensure correct calculation of class 1 employee and employer's NICs.
- Employee's class 1 NICs are then deducted from employee's wages.



- Class 1 NICs are payable under PAYE within 14 days of end of the tax month (i.e. by 19th of each month)
- Deadline extended to 22nd of the month for electronic payment.



The electronic payment date should be used in the examination.

# 2 Class 1A contributions

## 2.1 Class 1A national insurance contributions

Class 1A NICs are paid by **employers** on the value of taxable benefits provided to employees  $\geq 16$ , excluding vouchers exchangeable for cash, goods or services (which are liable to class 1 NICs).



The **class 1A** charge is **13.8% × value of taxable benefit** (calculated in the same way as for income tax).



Class 1A NICs need to be paid annually by 19 July following the end of the tax year. This deadline is extended to 22 July if they are being paid electronically.



The electronic payment date should be used in the examination.

## Notes







## Example 3

Jamie is employed by Drop Ltd. Jamie received the following from Drop Ltd in the tax year 2020/21:

	£
Salary	71,400
Benefit in respect of company car and fuel	8,300
Benefit in respect of living accommodation	3,750
Free meals in the staff canteen (cost to Drop Ltd per employee)	410
Vouchers exchangeable for goods	650

- (a) Calculate Jamie's earnings for the purposes of calculating class 1 NICs.
- (b) Calculate Jamie's liability to class 1 NICs for the tax year 2020/21.
- (c) 2020/21 in respect of Jamie. Ignore the employment allowance.
- (d) Calculate the liability of Drop Ltd to class 1A NICs for the tax year 2020/21 in respect of Jamie.

## Notes



### Jamie

#### (a) Jamie's earnings for the purposes of calculating class 1 NICs

	£
Salary	71,400
Benefit in respect of company car and fuel	n/a
Benefit in respect of living accommodation	n/a
Free meals in the staff canteen (cost to Drop Ltd per employee)	Exempt
Vouchers exchangeable for goods	650
	<hr/>
	72,050
	<hr/>

#### (b) Jamie's liability to class 1 NICs

	£
$(£50,000 - £9,500) = £40,500 \times 12\%$	4,860
$(£72,050 - £50,000) = £22,050 \times 2\%$	441
	<hr/>
	5,301
	<hr/>

#### (c) Drop Ltd's liability to class 1 NICs

	£
$(£72,050 - £8,788) = £63,262 \times 13.8\%$	8,730
	<hr/>

#### (d) Drop Ltd's liability to class 1A NICs

	£
Salary	n/a
Benefit in respect of company car and fuel	8,300
Benefit in respect of living accommodation	3,750
Free meals in the staff canteen (cost to Drop Ltd per employee)	Exempt
Vouchers exchangeable for goods	n/a
	<hr/>
	12,050
	<hr/>
Class 1A at 13.8%	1,663
	<hr/>

## 2.2 Tax relief on contributions

Employers can deduct their class 1A contributions from profits as tax allowable expenses.

### Example 4



Gorka is a sole trader with a 31 March year end. His only employee, Henry, is paid an annual salary of £77,000.

Henry was provided with a company car throughout the tax year, which had a list price of £18,200. The car was first registered on 6 April 2020 and has CO<sub>2</sub> emissions of 123g/km. Petrol for both business and private mileage is provided by Gorka.

Gorka's Class 1 employer contributions were £6,435 in the previous year.

- (a) Calculate the national insurance contributions payable by Henry for the tax year 2020/21.
- (b) Calculate the national insurance contributions payable by Gorka for the tax year 2020/21 in respect of Henry.
- (c) Calculate the total tax deductible expense for Gorka in respect of employing Henry during y/e 31 March 2021 assuming the total running costs of the car (including fuel) were £200 per month.

Ignore capital allowances and VAT.

## Notes



## Gorka

	£
<b>(a) Class 1 employee contributions payable by Henry</b>	
$(£50,000 - £9,500) \times 12\%$	4,860
$(£77,000 - £50,000) \times 2\%$	540
	<hr/>
	5,400
	<hr/>
<b>(b) Class 1 employer contributions payable by Gorka</b>	
$(£77,000 - £8,788) \times 13.8\%$	9,413
Less: Employment allowance	(4,000)
	<hr/>
	5,413
	<hr/>
<b>Class 1A contributions payable by Gorka</b>	
$(£4,914 + £6,615) (W) \times 13.8\%$	1,591
	<hr/>
<b>(c) Tax allowable cost (ignoring capital allowances)</b>	
Class 1 employer	5,413
Class 1A	1,591
Salary	77,000
Running costs of car $(£200 \times 12)$	2,400
	<hr/>
Tax allowable cost	86,404
	<hr/>

## Working

Henry's taxable benefits for class 1A purposes are as follows:

### Company motor car



$13\% + ((120 - 50) \times 1/5) = 27\% \times £18,200$  4,914

### Private fuel provided by company

$(27\% \times £24,500)$  6,615

## 3 NICs payable by the self-employed

### 3.1 Class 2 and class 4 NIC

	Class 2	Class 4
<b>Paid by</b>	Self-employed individual  From: week/month aged 16  To: week/month reached state retirement age	Self-employed individual  From: start of tax year after 16th birthday  To: start of tax year after reaching state retirement age
<b>Paid on</b>	Flat rate  if the profits for the tax year exceed the small profit threshold	<div>£</div> <div>Trading income X</div> <div>Less: Trading losses (X)</div> <div>—</div> <div>Class 4 profits X</div> <div>—</div>
<b>Rates</b> 	Small profits threshold: £6,475  Flat rate: £3.05 per week	Annual limits: <div>£1 – £9,500 0%</div> <div>£9,501 – £50,000 9%</div> <div>£50,001 and above 2%</div>
<b>Due dates</b> 	31 January following the end of the tax year	Paid under self-assessment with income tax (see Chapter 12)

## Notes





## Example 5

Tim is self-employed and has taxable trading income of £57,600 for the year ended 30 September 2020.

For the year ended 30 September 2021, he anticipates his taxable trading income will be £64,750.

**Calculate the class 2 and class 4 NICs payable by Tim for the tax year 2020/21.**

**Tim**

	£
<b>Class 2 contributions (Note 1)</b>	
$52 \times £3.05$	159
	<hr/>
<b>Class 4 contributions (Note 2)</b>	
$(£50,000 - £9,500) \times 9\%$	3,645
$(£57,600 - £50,000) \times 2\%$	152
	<hr/>
	3,797
	<hr/>

**Notes:**

- (1) Taxable trading income exceeds the small profits threshold therefore Class 2 NIC due.
- (2) Tax year 2020/21  
 Basis period = y/e 30 September 2020 (current year basis)  
 Taxable trading income = £57,600

## Notes



### 3.2 NICs payable by the self employed

- Class 2 and class 4 NICs in respect of their trading profits – you should note that these payments do not constitute allowable expenditure when calculating tax adjusted trading profits.
- Also need to account for class 1 employee, employer's and class 1A contributions with regard to any staff employed by the business.
- Class 1 employer and class 1A contributions represent an additional cost of employing staff and are therefore deductible when calculating the sole trader's tax adjusted trading profits for tax purposes.

## Notes

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### Questions



You should now be able to answer TYU questions 1 to 8 from the Study Text Chapter 12.

Knowledge Check Test: National insurance and pensions on MyKaplan.

For further reading, visit Chapter 12 of the Study Text.



# Chapter 12

## Tax administration for individuals



### Outcome

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Upon completion of this Chapter you will be able to:

- explain and apply the features of the self-assessment system as it applies to individuals
- recognise the time limits that apply to the filing of returns and the making of claims
- recognise the due dates for the payment of tax under the self-assessment system, and compute payments on account and balancing payments/repayments for individuals
- list the information and records that taxpayers need to retain for tax purposes
- explain the circumstances in which HM Revenue & Customs can make a compliance check into a self-assessment tax return
- explain the procedures for dealing with appeals and First and Upper Tier Tribunals
- calculate late payment interest and state the penalties that can be charged
- explain the PAYE system, how benefits can be payrolled, and the purpose of form P11D
- 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

and answer questions relating to these areas.



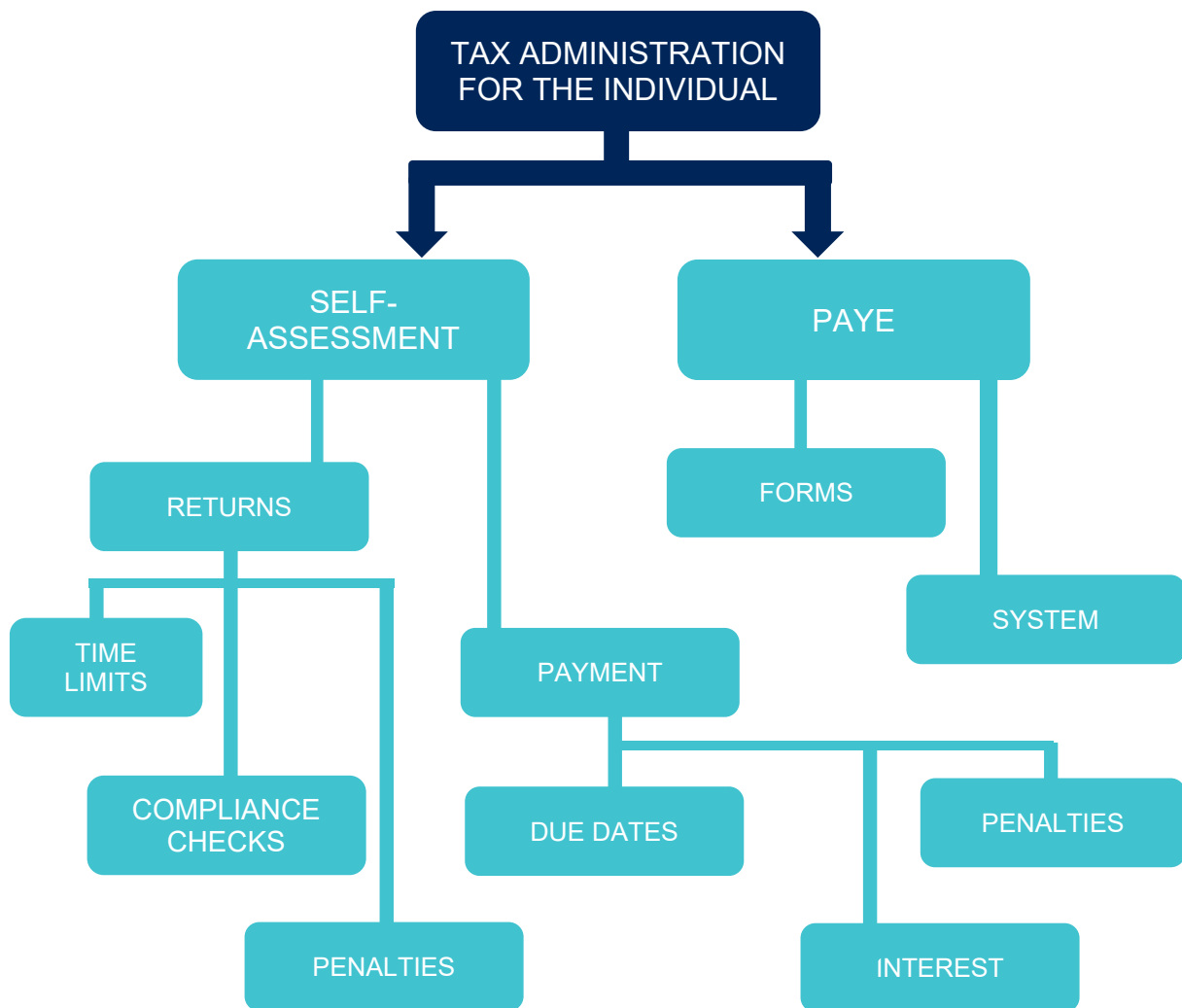
PER

One of the PER performance objectives (PO16) is to make sure that individuals and entities comply with their tax obligations – on time, and in the spirit and letter of the law. Working through this chapter should help you understand how to demonstrate that objective.

The underpinning detail for this Chapter in your Integrated Workbook can be found in Chapter 13 of your Study Text.



## Overview



# 1 Collection of income tax

## 1.1 The self-assessment tax return

- HMRC automatically issues a self-assessment tax return to those who are likely to need them
  - for example: the self-employed, landlords, those with capital gains and employees with less straightforward tax affairs.
- For employees with straightforward tax affairs:
  - income tax and NICs = collected through the PAYE system
  - therefore, if they have no other income, there is no need for them to submit a tax return.
- If an individual does not receive a tax return, he/she must notify HMRC by:



- **5 October following the end of the tax year** (unless he/she has no need to complete the return).
- Failure to notify can lead to a penalty (see below).

## 1.2 Submission of the annual tax return

The **due date** for submission of a tax return depends on whether the return is to be filed **electronically** or in **paper form**.



The deadlines are as follows:

- **31 October following the end of the tax year** for a paper return  
(or 3 months after the issue of the notice to file a return if later).
- **31 January following the end of the tax year** for an electronic (online) return  
(or 3 months after the issue of the notice to file a return if later).

## Notes



### 1.3 Calculating the tax liability

- For electronic returns:
  - the tax liability = calculated automatically when submitting the return.
- For paper returns:
  - the taxpayer must calculate the tax themselves, or
  - request HMRC to do so.

**Note:** HMRC will calculate the liability based on the numbers provided by the taxpayer, which is then treated as the self-assessment on behalf of the taxpayer.

### 1.4 Amending tax returns



- HMRC may correct anything in the return that they consider is incorrect:
  - within **9 months** of the **actual filing date**.
- The taxpayer may amend his/her tax return for any reason:
  - within **12 months** after the **31 January following the end of the tax year**  
(i.e. 31 January 2023 for the tax year 2020/21).

## Notes

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## Chapter 12

### 1.5 Penalties for failure to submit a tax return on time

The following penalties apply if an individual fails to file a return by the due filing date (31 January following the tax year).

	Penalties
Filed after due date	£100 fixed amount
Additional penalties:	
➤ Filed > 3 months late	In addition to fixed £100 above: daily penalties of up to £10 per day (maximum 90 days)
➤ Filed > 6 months late	In addition to the penalties above: 5% of the tax due (minimum = £300)
➤ Filed > 12 months after filing date where withholding information was:	In addition to the above penalties:
– Not deliberate	5% of tax due (minimum = £300)
– Deliberate but no concealment	70% of tax due (minimum = £300)
– Deliberate with concealment	100% of tax due (minimum = £300)

- The above penalties operate cumulatively.

Accordingly, if a taxpayer filed his/her tax return seven months late, the penalty would be:

- an immediate penalty of £100
- plus daily penalties of up to £10 per day for a maximum of 90 days
- plus a further 5% penalty based on the tax due.

- Penalties can be reduced by taxpayer co-operation (i.e. disclosure).

## Notes



### 1.6 Claims

- A claim for a relief, allowance or repayment can be made to HMRC. Wherever possible, claims should be made (and quantified) within the relevant tax return.
- If a claim relates to an earlier year (e.g. a loss carry back):
  - the earlier self-assessment return is not reopened
  - any reduction in liability = netted off against the liability of the later year.

There is therefore no impact on the quantification of payments on account for the current year.



- If an assessment proves to be excessive due to an error or mistake in a return, a claim for relief can be made:
  - **within 4 years of the end of the tax year concerned.**

### 1.7 Determinations

- If a return is not received by the filing date:
  - HMRC can make a determination (estimate) of the tax due, and
  - treat this as the amount owing under self-assessment.



- A determination must be made:
  - **within three years of the statutory filing date.**
- A determination cannot be appealed against and is only displaced by the actual self-assessment.

## Notes





### Example 1

Malik submitted his tax return for the tax year 2020/21 on 10 September 2022 which showed a tax liability of £4,000. Malik paid this amount on the same date.

**Explain the penalties that may apply in relation to the late filing of the return.**

#### **Malik**

As the return was not filed by the due date of 31 January 2022, a penalty of £100 will be charged.

As the return was more than three months late, daily penalties of £10 per day could be enforced for a maximum of 90 days ( $£10 \times 90 \text{ days} = £900$ ).

As the return was more than six months late, a penalty of 5% of the liability to tax will be charged (i.e.  $£4,000 \times 5\% = £200$ ). Since this is less than £300, a minimum penalty of £300 will apply.

## Notes





## 2 Record keeping

### 2.1 General requirements

- A taxpayer must keep adequate information to prepare a complete and correct tax return.
- For a business, the records that must be kept include:
  - all receipts and expenses
  - all goods purchased and sold
  - all relevant supporting documents (e.g. accounts, books, contracts, vouchers, etc.)
- For other taxpayers, fewer records need to be retained, but they should keep evidence of:
  - all income received (e.g. dividend vouchers, P60s, P11Ds), and
  - relevant bank statements.
- The information retained can be electronic but must be able to be made available in a legible form on request.

## Notes



## Chapter 12

### 2.2 Time limits



The relevant time limits for which records must be kept are as follows:

The self employed	<b>5 years from 31 January following the end of the tax year</b> = all records (not just business ones) For 2020/21 = until 31 January 2027
Other taxpayers	<b>1 year from 31 January following the end of the tax year</b> For 2020/21 = until 31 January 2023

- If a compliance check has been started, records must be kept until the check has been completed.

### 2.3 Penalties

- A penalty of **£3,000 per tax year or accounting period** can be charged for failure to keep records.
- This penalty can be reduced by HMRC.

## Notes



## 3 Payment of tax

### 3.1 Normal due date



- Taxpayers are expected to settle outstanding liabilities by:

**31 January following the end of the tax year** for:

- income tax
- class 2 and class 4 NICs
- capital gains tax.

### 3.2 Payments on account

- Any income tax and class 4 NICs not collected at source are payable by self-assessment and payments on account (POAs) may be required.

- but no POAs are ever required for capital gains tax or class 2 NICs.



- Due dates of POAs are:

- first POA = **31 January in the tax year**
- second POA = **31 July following the end of the tax year.**

- Each POA = **calculated based on 50% of the previous year's tax payable by self-assessment**

(e.g. POAs for 2020/21 are based on the tax payable for 2019/20).

- Temporary Covid-19 tax deferral options are available re the second POA for 2019/20, due on 31 July 2020. In the exam, you should assume the taxpayer has not deferred any payments.

## Notes



## Chapter 12

- No POAs are required if the amount of tax payable (IT plus class 4 NICs less PAYE) in the previous tax year under self-assessment was:
  - < £1,000, or
  - < 20% of total tax liability (typically this will be the situation when most of the individual's liability for a particular year has been collected through the PAYE system).
- A taxpayer can claim to reduce POAs if there are grounds to believe that the tax payable under self-assessment for the current year will be less than last year's.

### Illustration 1 – Payments on account

Details of Amina's tax liability for 2019/20 were as follows:

	£
Income tax liability	11,280
Tax deducted at source under PAYE	2,520
Class 4 NIC	840
CGT	4,200

Her payments on account for the tax year 2020/21 are calculated as follows:

Total income tax liability for 2019/20	11,280
Less: Deducted at source	(2,520)
	<hr/>
Income tax payable under self-assessment	8,760
Class 4 NIC	840
	<hr/>
	9,600
	<hr/>

Payments on account:

31 January 2021 ( $£9,600 \times \frac{1}{2}$ )	4,800
31 July 2021 ( $£9,600 \times \frac{1}{2}$ )	4,800

## Notes

## Example 2



Details of Gilbert's tax liability for the tax year 2019/20 were as follows:

	£
Income tax liability	19,400
Less: PAYE	(3,600)
	<hr/>
	15,800
Class 2 NICs	156
Class 4 NICs	700
CGT	2,700

**Calculate the payments on account for the tax year 2020/21 and state the due dates for payment.**

<b>Gilbert</b>	£
Total income tax liability for 2019/20	19,400
Less: PAYE	(3,600)
	<hr/>
Income tax payable under self-assessment	15,800
Class 4 NICs	700
	<hr/>
	16,500
	<hr/>
Payments on account:	
31 January 2021 ( $£16,500 \times \frac{1}{2}$ )	8,250
31 July 2021 ( $£16,500 \times \frac{1}{2}$ )	8,250

## Notes



## Chapter 12

### 3.3 Balancing payment



- A balancing payment is due on

**31 January following end of the tax year:**

- The balancing payment for 2020/21 is calculated as follows:

	£
Balance of unpaid income tax and class 4 NICs for 2020/21	X
Plus: CGT for 2020/21	X
Class 2 NICs for 2020/21	X
	—
Balancing payment	X
	—

- The first POA for the following tax year will be due on the same date.

## Notes



## Illustration 2 – Balancing payment

Continuing with Amina from Illustration 1 above, suppose that her tax liability for 2020/21 is as follows:

	£
Income tax liability	22,100
Less: Tax deducted at source	(4,210)
	<hr/>
2020/21 IT payable (after deducting tax deducted at source)	17,890
Class 2 NIC	159
Class 4 NIC	1,470
CGT	12,315
	<hr/>
Total tax liability	31,834
	<hr/>

The following amounts fall due on 31 January 2022:

### Balancing payment for 2020/21

	£
Total tax liability	31,834
Less: Payments on account ( $2 \times £4,800$ )	(9,600)
	<hr/>
Balancing payment due 31 January 2022	22,234
	<hr/>

### First POA for 2021/22

	£
2020/21 IT payable (after deducting tax deducted at source)	17,890
2020/21 Class 4 NIC	1,470
	<hr/>
Relevant amount	19,360
	<hr/>
First POA due 31 January 2022 ( $£19,360 \times \frac{1}{2}$ )	9,680
	<hr/>

## Notes



## Example 3

Continuing with Gilbert from above, assume that his tax liability for the tax year 2020/21 is as follows:

	£
Income tax liability	19,360
Less: Tax deducted at source	(2,146)
	<hr/>
	17,214
Class 2 NICs	159
Class 4 NICs	1,090
CGT	3,695
	<hr/>
Total tax liability	22,158
	<hr/>

**Calculate the balancing payment for the tax year 2020/21, the first payment on account for the tax year 2021/22, and state the due date for payments.**

**Gilbert (continued)**

**Balancing payment for 2020/21**

	£
Total tax liability	22,158
Less: Payments on account ( $2 \times £8,250$ )	(16,500)
	<hr/>
Balancing payment: <b>due 31 January 2022</b>	5,658
	<hr/>

**First payment on account for 2021/22**

	£
2020/21 IT payable (after tax deducted at source)	17,214
Class 4 NICs	1,090
	<hr/>
Relevant amount	18,304
	<hr/>
First POA: <b>due 31 January 2022</b> ( $£18,304 \times \frac{1}{2}$ )	9,152
	<hr/>



## 4 Late payment – penalties and interest

### 4.1 Penalties for late payment of IT and CGT

A penalty may be charged on the late payment of:

- balancing payments under self-assessment (but not POAs)
- additional tax payments arising from amendments to a self-assessment
- tax payable under a discovery assessment (see below).

The amount of the penalty depends on:

- the length of the delay, and
- the amount of unpaid tax and is calculated as follows:

Tax paid	Penalty (% of tax due)
> 1 month late	5%
> 6 months late	Additional 5%
> 12 months late	Additional 5%

- Penalties can be reduced by at HMRCs discretion if there is a reasonable excuse

(but lack of funds to pay will never count as a reasonable excuse).

## Notes



## Chapter 12

### 4.2 Late payment interest

- For any late payment of tax (POAs and/or balancing payments) interest runs:
  - from: the due date
  - to: the date of payment.



For exam purposes: work to the nearest month.



The relevant interest rate to use for the exam = 2.75%

### 4.3 Repayment interest

- Interest = paid to taxpayers by HMRC on any **overpayments** of tax runs:
  - from: the later of
    - the due date, and
    - the date HMRC received the tax
  - to: the date of repayment.



For exam purposes: work to the nearest month.



The relevant interest rate to use for the exam = 0.50%

## Notes





## Example 4

Druthi was due to make the following payments of tax in relation to the tax year 2020/21:

Payment	Amount	Actual date of payment
1st POA	£2,100	28 February 2021
2nd POA	£2,100	30 November 2021
Balancing payment	£1,000	30 June 2022

**Calculate the amount of interest payable and any penalties due.**

### Druthi

#### Interest payable

Payment	Amount	Interest due
1st POA (due 31 Jan 2021)	£2,100	$(£2,100 \times 2.75\% \times 1/12) = £5$
2nd POA (due 31 July 2021)	£2,100	$(£2,100 \times 2.75\% \times 4/12) = £19$
Balancing payment (due 31 Jan 2022)	£1,000	$(£1,000 \times 2.75\% \times 5/12) = £11$

#### Penalty

As the balancing payment was paid > one month late:

Penalty =  $(£1,000 \times 5\%) = £50$

No further penalty due as the tax was paid within six months of the due date.

## Notes



# 5 HMRC powers and rights of appeal

## 5.1 Compliance checks

- Written notice must be issued if HMRC enquire into the completeness or accuracy of any tax return (known as a compliance check).



- Assuming the return is filed on time (i.e. by 31 January 2022 for a 2020/21 return)

HMRC must give notice of their intention to conduct the check by:

- **12 months after the actual filing date.**

- HMRC:
  - does not have to state the reason for the compliance check
  - but should set out the information required in the request, and
  - must limit the information requested to that connected with the tax return.
- Once completed, HMRC gives written notice to this effect and must confirm either:
  - no amendments are required, or
  - any proposed amendments to the self-assessment return as a result of the checks they have carried out.
- The taxpayer has 30 days to appeal in writing against the amendments.

## Notes



### 5.2 Discovery assessments

- A discovery assessment can be raised by HMRC if they come into possession of information about a taxpayer's tax affairs **after the normal time limit** for starting a compliance check has passed.



- The time limits for raising a discovery assessment are:

	Date from the end of the tax year	For 2020/21
Basic time limit	4 years	5 April 2025
Careless behaviour	6 years	5 April 2027
Deliberate behaviour	20 years	5 April 2041

### 5.3 Appeals

- Taxpayers can appeal against HMRC decisions, such as:
  - discovery assessments
  - the reasonableness of information requests as part of a compliance check
  - amendments to a self-assessment arising from a compliance check.



- An appeal must be:
  - made in writing **within 30 days**, and
  - state the grounds for the appeal.
- Any tax due will have to be paid, unless postponed.
- Most appeals = settled by agreement but if not, the taxpayer can either ask:
  - for the case to be reviewed by another HMRC office, or
  - for it to be heard by the First-tier tax Tribunal.
- Appeals from the First-tier Tribunal
  - = heard by the Upper Tribunal who decide on a point of law.
- Upper Tribunal hearings are in public and decisions are published
  - there is a right of appeal against their decision to the Court of Appeal on points of law only.

## Notes



# 6 Additional penalty provisions

## 6.1 Standard penalties

- In addition to the late filing and late payment penalties already considered, there is a standard system of penalties, which applies to:
  - failure to notify liability to tax (IT, CGT, CT, VAT and NIC)
  - submission of incorrect returns (all taxes) involving an understatement of the taxpayer's liability without reasonable steps having been taken to advise HMRC of the inaccuracy.

- Penalties = % × potential lost revenue (PLR)

PLR = the tax unpaid due to the error/failure to notify.

The % = dependent on the taxpayer's behaviour and penalties can be reduced for disclosure by the taxpayer.



The following table is given in the tax tables:

Taxpayer behaviour	Maximum penalty	Minimum penalty – unprompted disclosure	Minimum penalty – prompted disclosure
Deliberate and concealed	100%	30%	50%
Deliberate but not concealed	70%	20%	35%
Careless	30%	0%	15%

- Note that there is greater reduction given for unprompted disclosure
  - i.e. disclosure at a time when there is no reason to suppose HMRC have discovered, or are about to discover, the error.

## Notes





## Example 5

Kira is a sole trader. She files her tax return for the tax year 2019/20 by the due date.

The return includes trading income of £75,000, but omits the property income she earns from letting out her flat now that she lives with her boyfriend in his house.

HMRC initiate an enquiry into Kira's return and Kira admits she has under declared her income by £10,500.

**State the maximum and minimum penalties that could be levied on Kira.**

### Kira

The potential lost revenue will be the higher rate tax (40%) that should have been paid on the undeclared income.

$$£10,500 \times 40\% = £4,200$$

The error appears to be deliberate, but not concealed, so the maximum penalty is 70%:

$$\text{Maximum penalty} = (£4,200 \times 70\%) = £2,940$$

However, Kira has disclosed the income but only after HMRC initiated their review. Hence it will be treated as a prompted disclosure. The minimum penalty is:

$$\text{Minimum penalty} = £4,200 \times 35\% = £1,470$$

## Notes





### Example 6

Stewart has never had to submit a tax return. During July 2020 he inherits a large sum of money which he invests in offshore high interest deposits.

The deposits produce income of £2,500 during the tax year 2020/21 and Stewart does not realise he should inform HMRC. He finally informs them in June 2022 when he receives a letter from HMRC asking about his inheritance.

Tax of £1,000 should have been paid on this 2020/21 income.

**Calculate the maximum penalty that Stewart is likely to be charged in respect of his failure to notify liability in respect of this income.**

#### **Stewart**

Stewart should have notified HMRC by 5 October 2021.

His actions are not deliberate, therefore the maximum penalty

$$= (30\% \times £1,000) = £300$$

## Notes





## 7 The PAYE system

### 7.1 PAYE system



Pay As You Earn (**PAYE**) = system used to collect IT and NICs from cash earnings paid to employees. It can be used to record and collect the tax on non-cash benefits, if the employer has applied to do so.

- Aim = ensure the employee pays roughly the right amount of tax as the year progresses – this is achieved by way of a coding system.
- HMRC issues each employee a tax code, which takes into account their particular tax affairs and any deductions and allowances available to them.
- The coding notice can also be used to show unpaid tax in earlier years or income tax on the taxpayer's estimated savings income and dividend income.
- The employer's payroll software spreads employees' allowances (as determined by their PAYE code) evenly over the tax year.

### 7.2 Payments to HMRC

Employers generally make monthly payments of income tax and NIC to HMRC as follows:



- Income tax and NIC deducted during **each tax month** is due for payment **14 days after the month ends**.
  - The tax month runs from 6th to 5th of each month, therefore the payment due date is the **19th of each month**.
  - The deadline is extended to **22nd of the month** for electronic payment.
- Employers with ≥ 250 employees must make their monthly PAYE payments electronically.
- Employers whose average monthly payments of PAYE and NICs ≤ £1,500 in total are allowed to make payments quarterly, rather than monthly.

## Notes



### 7.3 Real time information

- Under Real Time Information (RTI), employers are required to inform HMRC about tax, NICs and other deductions electronically, every time a payment is made to an employee.
- HMRC charges penalties for the late submission of RTI returns.
- No penalty is charged for the first late submission in the year but the level of penalty for subsequent late submissions in the same year depends on the number of employees as follows:

Number of employees	Monthly penalty £
1 – 9	100
10 – 49	200
50 – 249	300
≥250	400

- If the submission is > 3 months late, an additional penalty is charged based on 5% of the tax and NICs that should have been reported.

## Notes



### 7.4 Key PAYE forms

There are a number of forms used to convey information from employers to employees and to HMRC. The key ones are as follows:

Form	Purpose of use	Content	Timing
P45	Provided to employees when they leave	Summary of taxable pay, tax and NICs for the employee, up to the date of leaving (to provide to new employer)	Ongoing with staffing changes
P60	Year end summary	Total earnings for the year and tax and NICs deducted (to enable completion of self-employment tax return)	Provided to employee by 31 May following tax year
P11D	Summary of benefits	Summary of all benefits provided to employees (other than those being dealt with through the PAYE system)	Provided to HMRC and employee by 6 July following tax year

## Notes



### Questions



You should now be able to answer TYU questions 1 to 11 from the Study Text Chapter 13 as well as the questions 'Sadiq', 'BM Ltd' and 'Olive' from Chapter 27.

For further reading, visit Chapter 13 of the Study Text.

# Chapter 13

## Corporation tax – introduction



### Outcome

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Upon completion of this Chapter you will be able to:

- define the terms 'period of account', 'accounting period', and 'financial year'
- recognise when an accounting period starts and when an accounting period finishes
- explain how the residence of a company is determined
- recognise the expenditure that is allowable in calculating the tax adjusted trading profit
- recognise the relief which can be obtained for pre-trading expenditure
- compute capital allowances (as for income tax)
- compute property business profits
- recognise and apply the treatment of interest paid and received under the loan relationship rules
- recognise and apply the treatment of qualifying charitable donations
- compute taxable total profits
- compute the corporation tax liability

and answer questions relating to these areas.



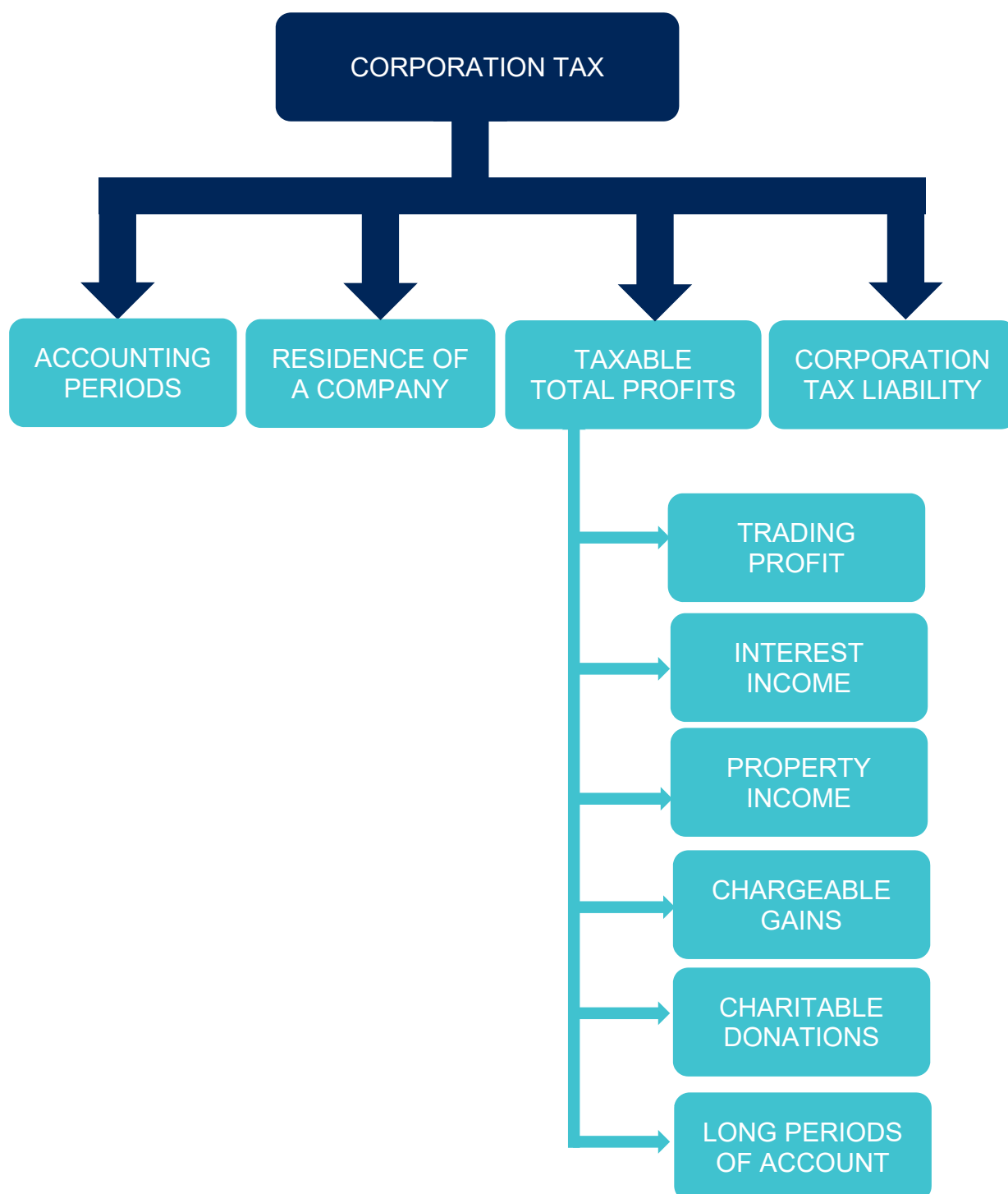
**PER**

One of the PER performance objectives (PO15) is to prepare computations of taxable amounts and tax liabilities according to legal requirements. Working through this chapter should help you understand how to demonstrate that objective.

The underpinning detail for this Chapter in your Integrated Workbook can be found in Chapters 14 and 15 of your Study Text.



### Overview



# 1 Scope of corporation tax

---

## 1.1 Scope of corporation tax

Corporation tax is paid by UK resident companies on their worldwide income and gains for an **accounting period (AP)**.



The total income and gains of a company is known as **taxable total profits (TTP)**.

## 1.2 Residence



A company is **resident** in the UK if:

- it is incorporated in the UK, or
- it is 'centrally managed and controlled in the UK'.

## Notes

---





# 2 Accounting period

## 2.1 Accounting period



An **accounting period** (AP) is usually the company's period of account (the period covered by the financial statements) but cannot exceed 12 months.

## 2.2 When does an AP start?

An AP **starts** when:

- a company starts to trade
- a company acquires a source of income chargeable to corporation tax
- immediately after the end of the previous AP.

## 2.3 When does an AP end?

An AP **ends** on the earliest of:

- 12 months after the beginning of the AP
- at the end of the company's period of account (the statement of financial position date)
- when the company begins or ceases to trade.

## Notes



### 2.4 Long periods of account

If the period of account is longer than 12 months, it needs to be split into two APs:

- First AP: first 12 months
- Second AP: remainder of the long period.

See section 5 for how to allocate accounting profits between the two APs.

### Example 1



Apricot Ltd started to trade on 1 April 2020. The first set of accounts was prepared for the 15 months ended 30 June 2021.

**What is/are the accounting period(s) for corporation tax purposes?**

**Apricot Ltd**

Apricot Ltd has the following accounting periods:

12 months ended 31 March 2021, and

3 months ended 30 June 2021.

Two separate corporation tax computations must be prepared.

## Notes



## 3 Taxable total profits



### 3.1 Pro forma corporation tax computation

X Ltd corporation tax computation for the AP ended xxx:

	£
Tax adjusted trading profit	X
Interest income	X
Property income	X
Chargeable gains	X
Miscellaneous income	X
	<hr/>
Total profits	X
Less: Qualifying charitable donations (QCDs)	(X)
	<hr/>
Taxable total profits (TTP)	X
	<hr/>

Each section of the pro forma is considered below, except for chargeable gains, which are considered in Chapter 22.

## Notes



## Chapter 13

### 3.2 Tax adjusted trading profits

The calculation of trading income for a company is similar to the calculation for a sole trader, although a few key differences are noted below.

Net profit per the accounts	X
Add:	
Allowable expenditure	0
Disallowed expenditure	X
Deduct:	
Capital allowances	(X)
Non trading income taxed elsewhere	(X)
	<hr/>
Trading income	X
	<hr/>

The main differences between the adjustments made for a company and those made for an unincorporated trader are:

#### Private use adjustments

- No private use restrictions: private expenses of a company director/employee = fully allowable (may be subject to income tax and NIC as taxable benefit).

#### Capital allowances

- Full capital allowances on all assets, even if private use by director/employee.
- Capital allowances = calculated for each AP rather than the period of account (cannot exceed 12 months).

#### Dividends

- Dividends paid = appropriations of profit = not allowable deductions.

#### Interest payable/receivable

- Interest payable relating to trading activities = deductible from trading income.
- Interest payable for non-trading activities = deductible from interest income and dealt with elsewhere in the corporation tax computation (see section 3.3).

## Notes



## Example 2



Exe Ltd supplies catering services to the airline industry.

You are presented with the following statement of profit or loss for the year ended 31 December 2020.

	£	£
Revenue		1,345,600
Less: Cost of sales		(678,000)
		<hr/>
Gross profit from trading		667,600
Interest income		47,200
		<hr/>
		714,800
Less: Expenses:		
Depreciation	117,200	
Storage & distribution costs	26,480	
Motor car expenses	(Note 1) 8,300	
Miscellaneous expenses	(Note 2) 1,985	
Rates	1,180	
Repairs and renewals	(Note 3) 2,480	
Staff wages	(Note 4) 342,100	
Telephone	351	
	<hr/>	(500,076)
Profit before tax		<hr/> 214,724 <hr/>

### Notes:

- (1) Motor car expenses relate to the hire costs of a car which is used 75% for business purposes and 25% for private purposes by the company's CEO. The car emits 145g of CO<sub>2</sub> per km.

## Chapter 13

- (2) Miscellaneous expenses are made up as follows:

	£
Subscription to the Caterer magazine	160
Contribution to a national charity	1,000
Gifts to customers:	
20 bottles of wine costing £17.75 each and bearing the company's name	355
Four pens each bearing the company's name	112
Other allowable expenses	358
	<hr/>
	1,985
	<hr/>

- (3) Repairs and renewals comprise the following expenditure:

	£
Redecorating administration offices	833
Fork lift truck servicing costs	1,647
	<hr/>
	2,480
	<hr/>

- (4) Staff wages includes accrued bonuses of £94,200. These were not paid until 1 November 2021.
- (5) Capital allowances have been calculated as £246,400.

**Calculate the tax adjusted trading profits of Exe Ltd for the year ended 31 December 2020.**

## Notes



## Exe Ltd – Tax adjusted trading profit – year ended 31 December 2020

		£
Profit before tax		214,724
Interest income		(47,200)
Depreciation		117,200
Storage and distribution		0
Motor expenses	(Note 1)	1,245
Subscription to the Caterer magazine		0
Charitable donation	(Note 2)	1,000
Gifts to customers:		
Wine	(Note 3)	355
Pens	(Note 3)	0
Rates		0
Repairs and renewals		0
Staff wages	(Note 4)	94,200
Telephone		0
Capital allowances		(246,400)
		<hr/>
Adjusted trading profits		135,124
		<hr/>

### Notes:

- (1) The car emits >110g per km therefore 15% of the lease costs must be disallowed ( $\pounds 8,300 \times 15\% = \pounds 1,245$ ). The private use of the motor car is however irrelevant for a company.
- (2) Donations to a national charity made by a company are disallowable as trading expenditure but will be deductible when calculating TTP.
- (3) Gifts to customers are disallowed, unless they amount to £50 or less per customer per year and display a conspicuous advert for the business. Gifts of food, drink, tobacco or vouchers are always disallowed.
- (4) Staff costs not paid within nine months of the year end are only allowed on a paid rather than an accrued basis.

## Chapter 13

### 3.3 Interest income – loan relationship rules



The **loan relationship rules** determine the treatment for corporation tax of interest receivable, interest payable and other costs relating to borrowing money.

#### Loan relationship rules

- All interest is taxed on the accruals basis.
- To apply the correct rules a company must determine whether interest payable/receivable is classified as trading or non-trading.

	Trading	Non-trading
<b>Income:</b> (interest receivable)	<ul style="list-style-type: none"><li>– If trade is lending money, e.g. a bank (you are very unlikely to see this in the exam)</li></ul>	<ul style="list-style-type: none"><li>– Any other interest received, e.g. from investments or interest on repayments of corporation tax</li></ul>
<b>Expenses:</b> (e.g. interest payable)	<ul style="list-style-type: none"><li>– Interest payable/expenses related to:<ul style="list-style-type: none"><li>▪ a loan to purchase plant and machinery</li><li>▪ a loan or overdraft to fund daily operations</li></ul></li><li>– Write-off of trade receivables</li></ul>	<ul style="list-style-type: none"><li>– Interest payable/expenses related to:<ul style="list-style-type: none"><li>▪ a loan to buy a let property</li><li>▪ a loan to buy shares of another company/investments</li></ul></li><li>– Interest paid on overdue corporation tax</li><li>– Write off of a non-trade loan</li></ul>
<b>Tax treatment:</b>	<ul style="list-style-type: none"><li>– Include amounts as part of <b>trading profits</b></li><li>– If amounts are already included in the accounts, no adjustment to trading profits should be required</li></ul>	<ul style="list-style-type: none"><li>– In the calculation of trading profits<ul style="list-style-type: none"><li>▪ interest income should be deducted</li><li>▪ interest payable for a non-trading purpose should be added back</li></ul></li><li>– Include amounts as part of <b>interest income</b> instead</li></ul>

## Notes





## Loan relationship rules: further points

- Incidental costs of loan finance (e.g. expenses in relation to raising the loan finance) follow the treatment of the loan itself.
- The write-off of an impaired debt that arises from the lending of money is also dealt with under the loan relationship rules.

## Example 3



The net profit of Superstore Ltd, for the year ended 31 January, is £413,255.

This profit includes the following:

Bank interest payable on loan to purchase machinery	£9,456
Interest payable on loan to purchase shares in another company	£8,944
Interest payable on loan to purchase an investment property	£4,322
Bank interest receivable	£17,900

**Calculate the taxable total profits of Superstore Ltd for the year ended 31 January.**

### Superstore Ltd

	£	£
<b>Adjusted trading profit</b>		
Profit per accounts	413,255	
Bank interest payable (trading)	0	
Interest to purchase shares (non-trading)	8,944	
Interest to purchase property (non-trading)	4,322	
Less: Non-trading interest receivable	(17,900)	
		408,621
<b>Interest income</b>		
Non-trading interest receivable	17,900	
Less: Non-trading interest payable (£8,944 + £4,322)	(13,266)	
		4,634
<b>Taxable total profits</b>		413,255

## Chapter 13

### 3.4 UK property income

- Profits of letting = taxable on an **accruals basis** for the AP.

Rent accrued	X
Allowable deductions	(X)
Assessable amount of lease premium (as for individuals)	X
	—
	X
	—

#### Interest on loan to buy a rental property

- Interest payable on a loan to acquire or improve property is not allowed as a property income expense.
- Relief is given instead under the 'loan relationship' rules (section 3.3 above).
- There is no restriction regarding loans to purchase residential properties.

#### Property losses

- The treatment of property losses is covered in Chapter 14.

## Notes



## Example 4



Delta Ltd prepares accounts to 31 December each year.

On 1 June 2020 Delta Ltd bought an investment property and immediately let it out under a 10 year lease. The terms of the lease which was granted were an initial premium of £45,000 and annual rent of £18,000.

The rent was payable quarterly in advance.

**Calculate Delta's property income assessment for the year ended 31 December 2020.**

### Delta Ltd

	£
<b>Element of premium taxable as rental income:</b>	
Premium	45,000
Less: $2\% \times (10 - 1) \times £45,000$	(8,100)
	<hr/>
	36,900
Rent accrued: 1 Jun 2020 to 31 Dec 2020 ( $£18,000 \times 7/12$ )	10,500
	<hr/>
Property income	47,400
	<hr/>

## Notes



## Chapter 13

### 3.5 Miscellaneous income

- Patent royalties receivable in respect of non-trade patents would be included here – however you are very unlikely to see these in your exam.

### 3.6 Dividend income

- Dividends received by companies are exempt from corporation tax = should be **excluded** in the calculation of TTP.

### 3.7 Qualifying charitable donations

- Small local donations = deducted as trading expenses.
- All other charitable donations (e.g. to national charities) = deducted as qualifying charitable donations ('QCDs') in TTP computation.
- Companies pay charitable donations **gross**.
- QCDs are deductible in the period in which they are paid.
- If QCDs exceed total profits, then no relief for the excess is given (subject to group relief – see chapter 16).

## Notes

---



# 4 Calculating the corporation tax liability

## 4.1 Tax rate

- Rates of corporation tax are set for financial years.
- A financial year runs from 1 April to 31 March and is identified by reference to the calendar year in which it begins. So FY2020 runs from 1 April 2020 to 31 March 2021.



The rate of corporation tax for FY2020 is 19%.

The rate of corporation tax for FY2019 and FY2018 was also 19%.

Corporation tax is applied to the company's TTP for the relevant AP.



If a company's AP straddles 31 March then the corporation tax liability should be calculated according to the time apportioned profits falling into each financial year. However, since the corporation tax rate has been 19% for the past three years this will not be necessary in the examination.

## Notes





## Example 5

Oak Ltd has the following results for the year ended 31 March 2021:

	£
Tax adjusted trading profit	480,000
Property income	57,000
Dividends received	32,000

**Calculate Oak Ltd's corporation tax liability for the year ended 31 March 2021.**

### Oak Ltd – year ended 31 March 2021

	£
Tax adjusted trading profits	480,000
Property income	57,000
	<hr/>
TTP	537,000
	<hr/>
Corporation tax (£537,000 × 19%)	102,030
	<hr/>

**Note:** Dividend income is exempt for corporation tax purposes and therefore should not be included.

## Notes





## Example 6

Lemon Ltd has tax adjusted trading profits of £345,600 in its year ended 30 June 2020. It also received bank interest income of £46,900, and dividend income of £78,000 from its wholly owned subsidiary Lime Ltd. Its accounts showed accrued charitable donations of £23,000 to Oxfam during the year but of this amount only £20,000 was paid.

**What is the company's corporation tax liability for the year ended 30 June 2020?**

### Lemon Ltd – year ended 30 June 2020

	£
Tax adjusted trading profits	345,600
Interest income	46,900
	<hr/>
Total profits	392,500
Less: Qualifying charitable donations (paid amount)	(20,000)
	<hr/>
TTP	372,500
	<hr/>
Corporation tax (£372,500 × 19%)	70,775
	<hr/>

### Notes:

- (1) Dividend income is exempt for corporation tax purposes and therefore should not be included.
- (2) The accounting period straddles FY2019 and FY2020. However, as the same corporation tax rate applies in both periods, the tax can simply be calculated at 19%.

## Notes



### 5 Long period of account

Where a company has a period of account of more than 12 months, it must be split into two APs as follows:

- first 12 months
- remainder of the period of account.

Profits are split between the APs as follows:

Income	Method of allocation
Trading profits before capital allowances	Adjust profits for period of account for tax purposes and then time apportion
Capital allowances	Separate calculation for each AP Time apportion AIA and WDAs if AP < 12m
Interest/property income	Accruals basis  If accruals information is not available then time apportion
Chargeable gains	Date of disposal
Qualifying charitable donations	Date paid

- Two separate corporation tax computations are then prepared.
- Note that there will be:
  - two separate pay days  
(e.g. 9 months and one day after the end of each AP for a company which is not large – see Chapter 17).
  - only one file date for returns  
(i.e. 12 months after the end of the long period of account).

## Notes





## Example 7



Tasty Ltd prepared accounts for the 15 month period to 31 December 2020, with the following results:

	£
Trading income (adjusted for tax purposes but before CAs)	380,000
Bank interest (received 30 June 2020)	22,000
Bank interest (received 30 June 2021)	20,000
Bank interest accrued at 30 September 2019	6,000
Bank interest accrued at 30 September 2020	6,200
Bank interest accrued at 31 December 2020	12,000
Rental income	10,000
Chargeable gain (disposal of land on 1 December 2020)	16,000
Qualifying charitable donation paid (1 September 2020)	24,000

The company bought and sold plant as follows:

Bought a machine	1 November 2019	25,000
Sold a lorry (original cost £5,400)	20 March 2020	(3,600)
Bought equipment	15 November 2020	60,000

The balance brought forward on the pool on 1 October 2019 was £20,000.

**Calculate the taxable total profits of Tasty Ltd for the 15 months ended 31 December 2020.**

## Notes



## Chapter 13

### Tasty Ltd

The 15 month period ended 31 December 2020 must be split into two accounting periods:

- The first period is the 12 months ended 30 September 2020
- The second period is the 3 months ended 31 December 2020

	y/e 30 Sep 2020	3 m/e 31 Dec 2020
	£	£
Trading profit (12:3)	304,000	76,000
Less: Capital allowances (W1)	(27,952)	(60,605)
	<hr/>	<hr/>
Trading income	276,048	15,395
Interest income		
y/e 30 Sep 2020 (£22,000 – £6,000 + £6,200)	22,200	
3 m/e 31 Dec 2020 (£12,000 – £6,200)		5,800
Property income (12:3)	8,000	2,000
Chargeable gain (1 Dec 2020)		16,000
	<hr/>	<hr/>
Total profits	306,248	39,195
Less: QCD (1 Sep 2020)	(24,000)	
	<hr/>	<hr/>
TTP	282,248	39,195
	<hr/>	<hr/>

## Workings:

### (W1) Capital allowances

		Main pool	Allowances
	£	£	£
<b>y/e 30 September 2020</b>			
TWDV b/f		20,000	
Addition:			
1 November 2019	25,000		
AIA	(25,000)		25,000
		0	
Disposal – 20 March 2020		(3,600)	
		16,400	
WDA ( $£16,400 \times 18\%$ )		(2,952)	2,952
		13,448	27,952
<b>3 m/e 31 December 2020</b>			
TWDV b/f		13,448	
Addition:			
15 November 2020	60,000		
AIA (Max $£1,000,000 \times 3/12$ )	(60,000)		60,000
		0	
		13,448	
WDA ( $£13,448 \times 18\% \times 3/12$ )		(605)	605
		12,843	60,605

# Questions



You should now be able to answer TYU questions 1 to 7 from the Study Text Chapter 14 and TYU questions 1 to 11 from the Study Text Chapter 15.

For further reading, visit Chapter 14 and 15 of the Study Text.

# Chapter 14

## Losses for companies



### Outcome

Upon completion of this Chapter you will be able to:

- understand how relief for a property business loss is given
- understand how trading losses can be carried forward
- understand how trading losses can be claimed against income of the current or previous accounting periods
- recognise the factors that will influence the choice of loss relief claim
- explain and compute the treatment of capital losses

and answer questions relating to these areas.



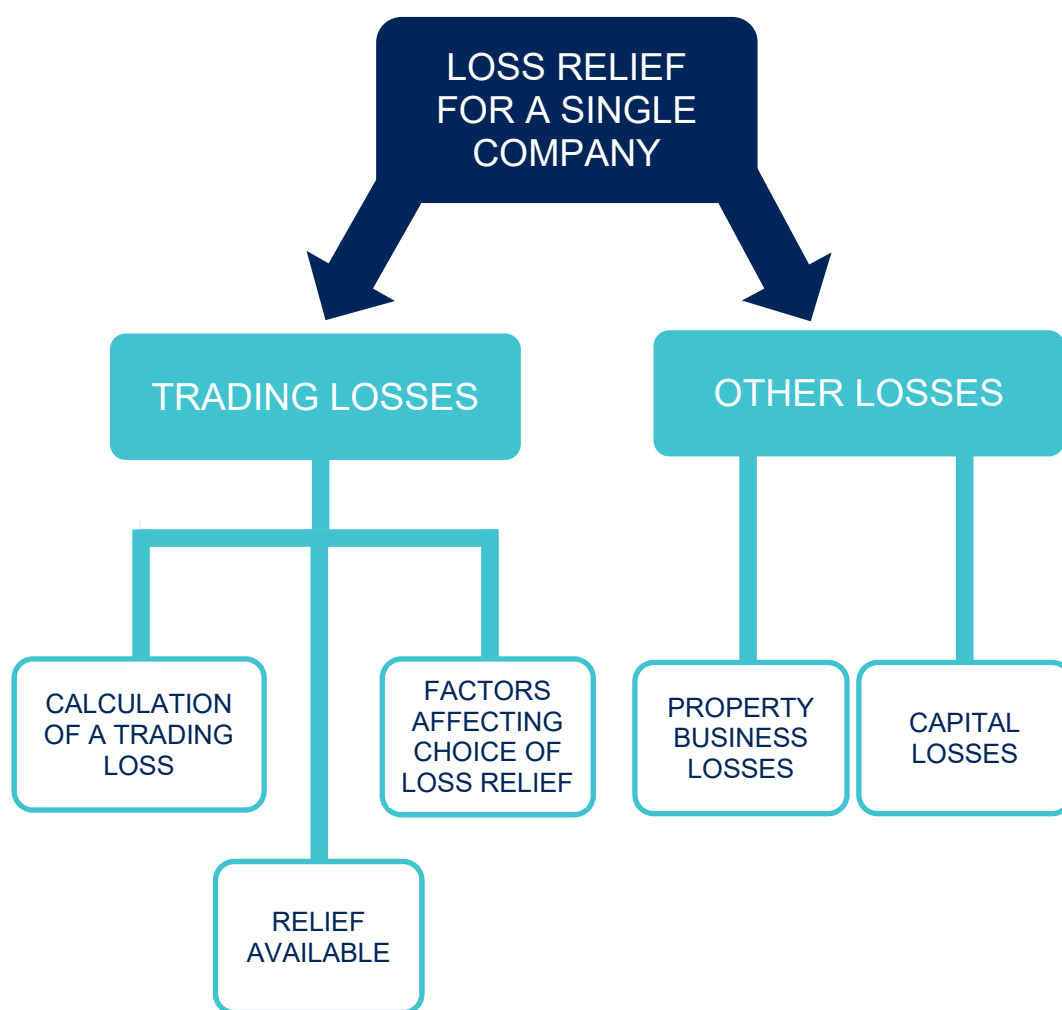
PER

One of the PER performance objectives (PO15) is to prepare computations of taxable amounts and tax liabilities according to legal requirements. Working through this chapter should help you understand how to demonstrate that objective.

The underpinning detail for this Chapter in your Kaplan Integrated Workbook can be found in Chapter 16 of the Study Text.



### Overview



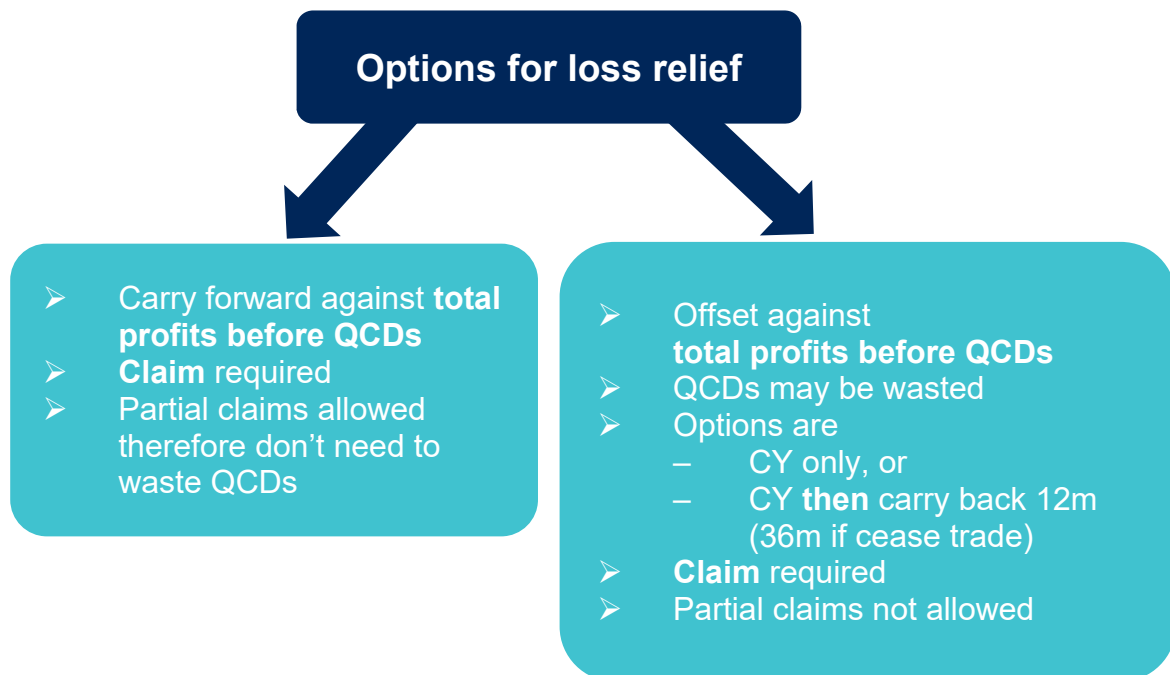
# 1 Trading losses

## 1.1 How a trading loss arises

- A trading loss arises when the tax adjusted trading profit after capital allowances is negative.
- The trading income assessment in the tax computation is £Nil.

## 1.2 How a trading loss can be relieved

The loss can be used in a number of ways:



Notes



### Example 1



Ariel Ltd had a current year adjusted trading loss of £41,000 for the year ended 31 March 2021. The company's projected trading income for the next two years is:

Year ended 31 March 2022	£19,200
Year ended 31 March 2023	£21,750

The company also receives interest income of £2,200 and property income of £7,100 each year. It makes a charitable donation to the Red Cross (a UK national charity) of £1,500 every year.

**Calculate the TTP for the three years ended 31 March 2023, assuming Ariel Ltd claims carry forward relief in the most efficient way.**

### Notes





## Ariel Ltd

	y/e 31 Mar 2021	y/e 31 Mar 2022	y/e 31 Mar 2023
	£	£	£
Trading income	0	19,200	21,750
Interest income	2,200	2,200	2,200
Property income	7,100	7,100	7,100
Total profits	9,300	28,500	31,050
Less: Trading loss b/f		(27,000)	(14,000)
	9,300	1,500	17,050
Less: QCDs	(1,500)	(1,500)	(1,500)
TTP	7,800	0	15,550

## Loss memo working

	£
y/e 31 March 2021 trading loss	41,000
Less: Used against total profits of y/e 31 March 2022 (Note)	(27,000)
Less: Used against total profits of y/e 31 March 2023	(14,000)
Loss c/f against future total profits	0

**Note:** The claim against total profits in the year ended 31 March 2022 is restricted to avoid wasting QCDs.

## Example 2



XYZ plc has the following results for the three accounting periods to 30 April 2021.

	Year ended 30 April 2019	Year ended 30 April 2020	Year ended 30 April 2021
	£	£	£
Trading income/(loss)	17,250	7,650	(31,200)
Interest income	1,300	450	320
Chargeable gains	—	—	11,200
Qualifying charitable donations	(400)	(1,000)	(600)

**Show the TTP for all periods assuming that loss relief is taken in the current and prior years.**

## Notes



## XYZ plc

	y/e 30 Apr 2019	y/e 30 Apr 2020	y/e 30 Apr 2021
	£	£	£
Trading income	17,250	7,650	0
Interest income	1,300	450	320
Chargeable gains			11,200
Total profits	18,550	8,100	11,520
Less: Used in current year			(11,520)
Less: Used in 12 month carry back		(8,100)	
	18,550	0	0
Less: QCDs	(400)	Wasted	Wasted
TTP	18,150	0	0
Unrelieved qualifying charitable donations		1,000	600

## Loss memo working

	£
y/e 30 April 2021 trading loss	31,200
Less: Used in current year – y/e 30 April 2021	(11,520)
Less: Used in 12 month carry back – y/e 30 April 2020	(8,100)
Loss c/f against future total profits	11,580

## Notes



## Chapter 14

### 1.3 Short accounting periods prior to year of loss

- A trading loss is carried back against total profits of the last 12 months.
- If the accounting period preceding the period of loss is short, the loss should be carried back for a full 12 months on a LIFO basis.
- The profits of the earlier period must be time apportioned.

## Notes

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## Example 3



Lily Ltd has the following results for the periods to 31 March 2021:

	y/e 30 September 2019	6 m/e 31 March 2020	y/e 31 March 2021
	£	£	£
Trading profit/(loss)	20,000	13,000	(50,000)
Chargeable gains	2,000	1,000	—
Qualifying charitable donations	(500)	(1,000)	(1,000)

**Calculate the TTP for all three periods, assuming that loss relief is claimed as soon as possible. Show any losses available to carry forward at 1 April 2021.**

## Notes



## Chapter 14

### Lily Ltd

The loss may be carried back against profits falling within the 12 months prior to the year to 31 March 2021, therefore

- against 6 months ended 31 March 2020
- against 6 months of the year ended 30 September 2019 (the loss may be set against  $6/12 \times$  profits for this period).

### TTP computation for the three periods ending 31 March 2021

	y/e 30 Sept 2019	6 m/e 31 Mar 2020	y/e 31 Mar 2021
	£	£	£
Trading income	20,000	13,000	0
Chargeable gains	2,000	1,000	0
	<u>          </u>	<u>          </u>	<u>          </u>
Total profits	22,000	14,000	0
Less: Used in current year			0
Less: Used in 12 month carry back	(11,000)	(14,000)	
	<u>          </u>	<u>          </u>	<u>          </u>
	11,000	0	0
Less: QCDs	(500)	Wasted	Wasted
	<u>          </u>	<u>          </u>	<u>          </u>
TTP	10,500	0	0
	<u>          </u>	<u>          </u>	<u>          </u>
Unrelieved qualifying charitable donations		1,000	1,000
		<u>          </u>	<u>          </u>

### Loss memo working

	£
y/e 31 March 2021 trading loss	50,000
Less: Used in current year – y/e 31 March 2021	0
Less: Used in 12 month carry back – 6 m/e 31 March 2020	(14,000)
– y/e 30 Sept 2019 (6 months)	
$\frac{6}{12} \times £22,000$	(11,000)
	<u>          </u>
Loss c/f against future total profits	25,000
	<u>          </u>

### 1.4 Loss-making period of less than 12 months

The length of the loss-making period is not important:

- Full relief is given against the current period total profits before QCDs.
- The remaining loss can be carried back in full in the normal way.

### 1.5 Losses in the last 12 months of trading

When a loss arises in the last 12 months of trade, a terminal loss relief claim can be made:

- after a current period claim, the carry back period is extended to **36 months** before the start of the loss making period, (rather than 12 months).
- Losses are set against total profits before QCDs on a LIFO basis.



Claims to set losses against total profits must be made **within two years of the end of the loss making period.**

## Notes

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## Example 4



Pudding Ltd ceased trading on 30 September 2020. It had the following results for the accounting periods up to cessation:

	y/e 30 Sept 2017	y/e 30 Sept 2018	y/e 30 Sept 2019	y/e 30 Sept 2020
	£	£	£	£
Trading income	35,000	30,000	20,000	(95,000)
Interest income	5,000	—	6,000	—
Property income	2,500	3,500	7,000	8,000
QCDs	(3,000)	(2,500)	(1,500)	(500)

**Show how the losses should be relieved using terminal loss relief.**

## Notes





## Pudding Ltd

	y/e 30 Sept 2017	y/e 30 Sept 2018	y/e 30 Sept 2019	y/e 30 Sept 2020
	£	£	£	£
Trading income	35,000	30,000	20,000	0
Interest income	5,000	0	6,000	0
Property income	2,500	3,500	7,000	8,000
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Total profits	42,500	33,500	33,000	8,000
Less: Used in current year				(8,000)
Terminal loss relief	(20,500)	(33,500)	(33,000)	—
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
	22,000	0	0	0
Less: QCDs	(3,000)	wasted	wasted	wasted
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
TTP	19,000	0	0	0
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>

The loss of the final 12 months of trade can be carried back 36 months against total profits before QCDs, after a current year claim has been made.

## Loss memo working

	£
y/e 30 September 2020 trading loss	95,000
Less: Used in current period	(8,000)
Less: Used in y/e 30 September 2019	(33,000)
Less: Used in y/e 30 September 2018	(33,500)
Less: Used in y/e 30 September 2017	(20,500)
	<u>          </u>
	0
	<u>          </u>

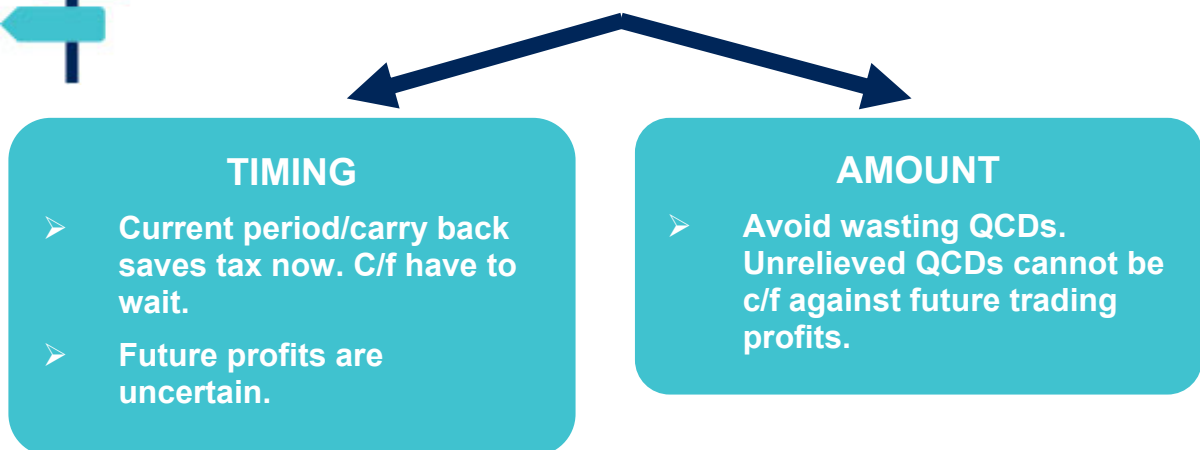
## Notes



# 2 Choice of loss relief



## 2.1 Factors that influence choice



## 2.2 Timing

- Carry back usually better than carry forward as this will generate tax repayments and **help cash flow** problems.



Remember:  
Can only carry back losses **after** making a current period claim.

## 2.3 Wastage of QCDs

Must also consider the risk of wasting QCDs:

- Current/prior period offsets are made **before** the deduction of QCDs, which cannot be preserved.
- Partial claims are possible for carried forward losses, so QCDs need not be wasted.

## Notes



## 3 Property business losses

### 3.1 Property losses

- The treatment of property losses is different for a company from the rules that apply for individuals.
- Net property losses are set against **total profits before QCDs** in the current accounting period.
  - This is an **automatic** relief.
  - Partial claims are **not** allowed, therefore QCDs may be wasted.
- Any excess is **carried forward** and a **claim** can be made to offset it against **total profits before QCDs**.



Must claim relief  
**within two years of the end of the loss making period.**

- Partial claims **are** allowed, therefore QCDs can be preserved.
- Carry back claims are not allowed
- If relevant, property losses are offset against total profits before trading losses.

## Notes



### Example 5



Avanti Ltd has the following results for the year ended 31 March 2021:

	£
Trading losses	(145,000)
Property losses	(62,000)
Interest receivable on building society deposit	87,000
Chargeable gain	12,000
Qualifying charitable donation	(2,400)

Avanti Ltd also had a trading loss brought forward at 1 April 2020 of £40,000.

**Calculate the TTP of Avanti Ltd for the year ended 31 March 2021 assuming it wants to use its losses as soon as possible (to the extent that this is beneficial) and stating (if relevant) the amount of any losses carried forward at the end of the accounting period.**

**(You should assume that the total profits for the year ended 31 March 2020 were £Nil.)**

## Notes



## Avanti Ltd

A partial claim can be made to offset the trading loss brought forward to avoid wasting QCDs. The remainder will be carried forward and offset against future total profits before QCDs.

The property losses will be offset against total profits before trading losses of the current period – therefore they will all be relieved. This relief is automatic.

This means the current period trading losses will be carried forward to future periods along with the remaining loss brought forward of £5,400 (£40,000 – £34,600).

## TTP computation for the year ended 31 March 2021

	£
Trading income	0
Property income	0
Interest income	87,000
Chargeable gains	12,000
	<hr/>
Total profits	99,000
Less: Property losses	(62,000)
Less: Trading loss b/f	(34,600)
	<hr/>
	2,400
Less: QCDs	(2,400)
	<hr/>
TTP	0
	<hr/>

## Amounts c/f at 31 March 2021 – all trading losses

	£
Trading losses b/f	40,000
Less: Offset in year ended 31 March 2021	(34,600)
Add: Current year trading losses	145,000
	<hr/>
Trading losses c/f at 31 March 2021	150,400
	<hr/>

## 4 Capital losses

### 4.1 Capital losses

- Set against **chargeable gains** in current accounting period.
- Excess is **carried forward** against first available **chargeable gains**.
- This is an **automatic** relief. The net gains figure appears in the tax computation.

### Example 6



Snake Ltd had the following recent results:

	y/e 30 Jun 2018	y/e 30 Jun 2019	y/e 30 Jun 2020	y/e 30 Jun 2021
	£	£	£	£
Trading profit/(loss)	250,000	300,500	(500,000)	200,000
Property income/(loss)	(13,500)	45,000	40,000	35,000
Chargeable gain/(loss)	6,000	(12,000)	11,000	5,000
QCDs	(12,000)	(12,000)	(12,000)	(12,000)

Show the TTP for all years assuming relief for the losses is to be taken as soon as possible.

## Notes



## Snake Ltd

The property loss for y/e 30 June 2018 is automatically offset against the total profits of the same accounting period.

The unused capital loss for y/e 30 June 2019 (£12,000) is carried forward and must be offset against the first available capital gains (£11,000 in y/e 30 June 2020 and £1,000 in y/e 30 June 2021).

If the trading losses are to be relieved as soon as possible they must be:

- (1) offset against total profits of the current accounting period
- (2) carried back and offset against total profits of the previous 12 months.

Any remaining balance will be carried forward and a claim can be made to offset against future total profits before QCDs in y/e 30 June 2021 for £114,500 (£500,000 – £40,000 – £345,500).

Therefore, the final position will be:

	y/e 30 June 2018	y/e 30 June 2019	y/e 30 June 2020	y/e 30 June 2021
	£	£	£	£
Trading income	250,000	300,500	0	200,000
Property income	0	45,000	40,000	35,000
Chargeable gains	6,000	0	0	4,000
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Total profits	256,000	345,500	40,000	239,000
Less: Property losses	(13,500)			
Less: Trading loss used in current year			(40,000)	
Less: Trading loss used in 12 month carry back		(345,500)		
Less: Trading loss b/f				(114,500)
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
	242,500	0	0	124,500
QCDs	(12,000)	Wasted	Wasted	(12,000)
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
TTP	230,500	0	0	112,500
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>

### Questions



You should now be able to answer TYU questions 1 to 11 from the Study Text Chapter 16 as well as the question 'Ball Ltd' from Chapter 27.

For further reading, visit Chapter 16 of the Study Text.



# Chapter 15

## Trading losses for individuals



### Outcome

Upon completion of this Chapter you will be able to:

- understand how trading losses can be carried forward
- understand how trading losses can be claimed against total income and chargeable gains, and the restriction that can apply
- explain and compute the relief for trading losses in the early years of a trade
- explain and compute terminal loss relief
- recognise the factors that will influence the choice of loss relief claim
- describe the alternative loss relief claims that are available to partners

and answer questions relating to these areas.



One of the PER performance objectives (PO15) is to prepare computations of taxable amounts and tax liabilities according to legal requirements. Another objective (PO17) is to advise on mitigating and deferring liabilities through legitimate tax planning measures. Working through this chapter should help you understand how to demonstrate those objectives.

The underpinning detail for this Chapter in your Kaplan Integrated Workbook can be found in Chapter 11 of the Study Text.



### Overview

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# 1 Trading losses

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### 1.1 How a trading loss arises

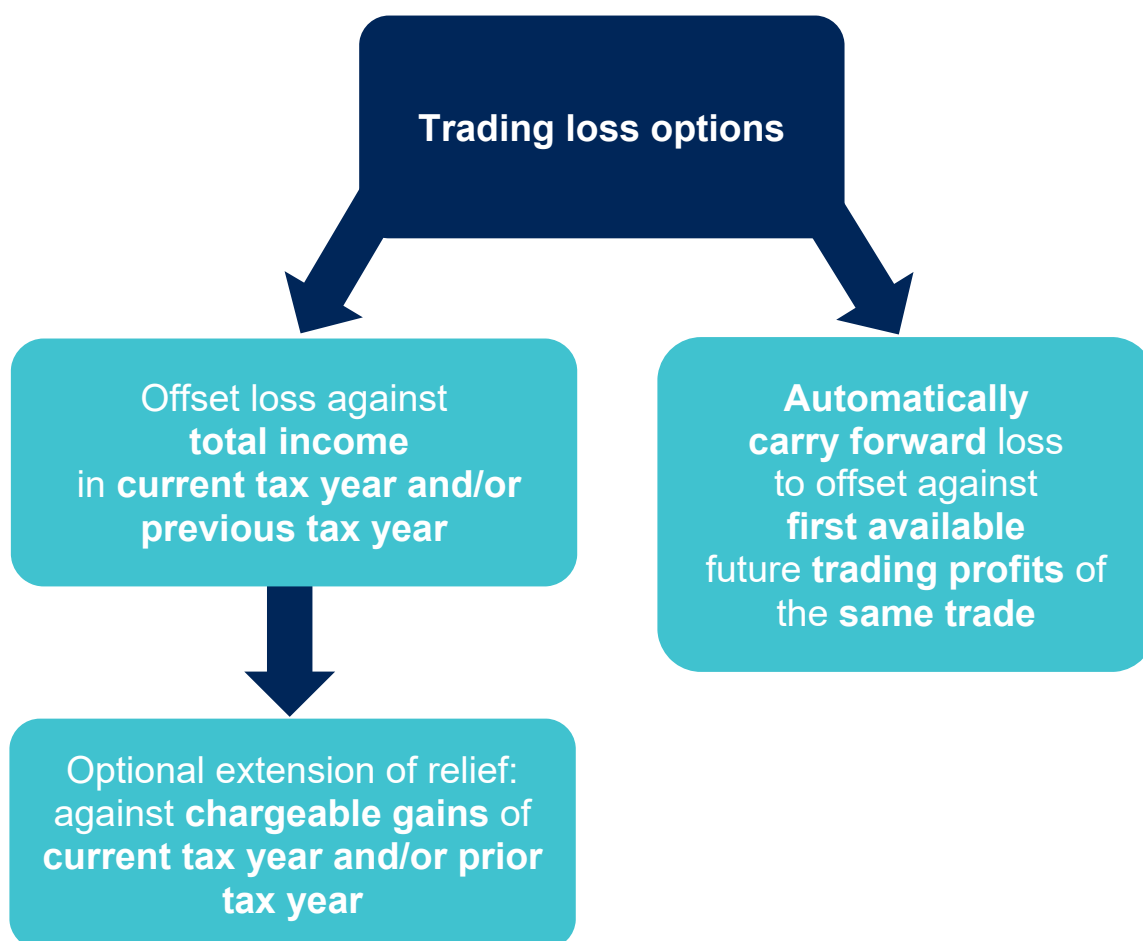
- A trading loss arises when:  $(\text{Adjusted profit} - \text{Capital allowances}) = \text{Negative}$ .
- The trading income assessment in the tax computation is £Nil.
- Tax year of loss = the tax year in which the accounting period of the loss ends (e.g. a loss made in the year ended 31 December 2020 = loss for 2020/21).

## Notes

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### 1.2 Relief options in ongoing years



Notes



### 1.3 Exam technique



The following procedure should be adopted when answering questions:

- (1) Determine the tax adjusted profits and losses after capital allowances for each accounting period.
- (2) Determine when losses arise and therefore when loss relief is available (i.e. in which tax years).
- (3) Set up a pro forma income tax computation for each tax year side by side and leave spaces for the loss relief to be inserted later.
- (4) Set up a loss memo working for each loss to show how it is utilised.
- (5) If there is more than one loss, consider them in chronological order.
- (6) Set off losses according to the requirements of the question.

## Notes



# 2 Carry forward of trading losses

## 2.1 Carry forward

- **Automatic** after other claims (if any)
- Against the **first available future trading profits** of the same trade
- Set off **maximum possible**, which may waste the personal allowance
- Carry forward is indefinite.



- Must claim to establish the amount of loss with HMRC, within **four years of the end of the tax year** of loss.

## Notes





## Example 1

Avraham has had the following recent tax adjusted trading results:

Year to 31 December 2020	Loss	£(18,000)
--------------------------	------	-----------

He estimates his future results will be as follows:

Year to 31 December 2021	Profit	£4,500
Year to 31 December 2022	Profit	£11,000
Year to 31 December 2023	Profit	£52,700

Avraham received bank interest income of £6,000 in the tax year 2020/21 and estimates his future interest income will be £8,500 in the tax year 2021/22; £11,700 in the tax year 2022/23 and £2,600 in the tax year 2023/24.

Avraham wishes to carry all of his trading losses forward.

**Calculate Avraham's taxable income for all relevant tax years (assume the rates and allowances for the tax year 2020/21 continue in the future).**

### Avraham

	2020/21	2021/22	2022/23	2023/24
	£	£	£	£
Trading income	0	4,500	11,000	52,700
Less: Loss b/f		(4,500)	(11,000)	(2,500)
	0	0	0	50,200
Interest income	6,000	8,500	11,700	2,600
	6,000	8,500	11,700	52,800
Net income	6,000	8,500	11,700	52,800
Less: PA				
* restricted	(6,000)*	(8,500)*	(11,700)*	(12,500)
Taxable income	0	0	0	40,300

### Notes:

The loss cannot be restricted to preserve Avraham's personal allowance in 2021/22 – 2022/23.

Years cannot be skipped so as to offset loss against highest rate tax (e.g. in the tax year 2023/24).

### Working – loss memorandum

	£
Trading loss arising in the tax year 2020/21	18,000
Less: Offset against trading income in the tax year 2021/22	(4,500)
Less: Offset against trading income in the tax year 2022/23	(11,000)
Less: Offset against trading income in the tax year 2023/24	(2,500)
	<hr/>
Unrelieved trading loss c/f	0
	<hr/>

## Notes





### 3 Loss relief against total income

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#### 3.1 Relief against total income

- A taxpayer may elect to offset a trading loss against total income in the current tax year and/or the previous tax year, in either order.
- As with carry forward, the relief is all or nothing: the taxpayer must reduce total income as far as possible, which may waste the personal allowance. It may also waste the savings and dividend nil rate bands (see section 5).



- The taxpayer must claim the relief within **12 months from 31 January following the end of the tax year** in which the loss arose.

## Notes

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## Example 2

Maureen prepares accounts to 30 April each year. Her recent results have been:

Year ended 30 April 2019	Profit	£26,500
Year ended 30 April 2020	Loss	£(41,200)
Year ended 30 April 2021	Profit	£9,200

Maureen has property income of £6,200 in the tax year 2019/20, and £7,800 in the tax year 2020/21 and £9,100 in the tax year 2021/22.

**Show the different ways in which relief for Maureen's loss could be obtained.**

**Assume the rates and allowances for the tax year 2020/21 continue in the future.**

**Maureen**

**Loss relief options for £41,200 trading loss in the tax year 2020/21:**

- (1) Carry forward only

**The loss will be offset against trading profits in the tax year 2021/22 (£9,200), with the remaining (£41,200 – £9,200) = £32,000 of loss being offset against the first available trading profits in subsequent years.**

- (2) Current year and carry forward

**Maureen has other income of £7,800 in the current year (the tax year 2020/21). A claim can be made to offset £7,800 of the trading loss against this income. The remaining loss will be carried forward, with £9,200 being offset against the trading profits in the tax year 2021/22. The balance (£41,200 – £7,800 – £9,200) = £24,200 will be carried forward indefinitely. This claim would not be worth making since the income in the tax year 2020/21 would otherwise be covered by Maureen's personal allowance.**

- (3) Prior year and carry forward

**Maureen could elect to carry back £32,700 of loss to the tax year 2019/20 to offset against her total income. The remaining loss of (£41,200 – £32,700) = £8,500 will be carried forward and offset against trading profits in the tax year 2021/22.**

### (4) Current year and prior year offset

Maureen could elect to offset the loss against both current year and prior year total income:

	£
Loss (2020/21)	(41,200)
Current year total income (2020/21)	7,800
Prior year total income (2019/20)	32,700
	<hr/>
Balance to c/f	700
	<hr/>

### (5) Prior year and current year offset

The claim in (4) can be made in reverse order, however the end result is the same:

	£
Loss (2020/21)	(41,200)
Prior year total income (2019/20)	32,700
Current year total income (2020/21)	7,800
	<hr/>
Balance to c/f	700
	<hr/>

**Note:** A current year claim is not beneficial as Maureen's income is already covered by her personal allowance.

## Notes



## Chapter 15

### 3.2 Restriction on reliefs against other income

- There is a restriction on the amount by which loss reliefs can reduce other (i.e. non-trade) income.
- The maximum deduction against total income (other than trading income) is the **greater of:**



- £50,000, or
- 25% of the adjusted total income (ATI) of the year of offset.



#### **Adjusted total income (ATI)**

= total income – gross personal pension contributions.

**Note** that unless  $ATI > £200,000$ , the maximum = £50,000.

- The restriction applies to:
  - current year total income, and
  - earlier years if set against income other than profits of the same trade(i.e. does not apply to losses offset against trading profits, so in prior years the maximum relief is £50,000 plus the trading profits of that year).

## Notes





## Example 3

Marcus is a sole trader and has adjusted trading results as follows:

Year ended 31 August 2019	Profit	£22,000
Year ended 31 August 2020	Loss	£(117,480)

He also has property income of £84,200 each year but no other income. He contributes £7,800 cash into a personal pension scheme each year.

Marcus wishes to offset the trading loss against his total income for the tax years 2019/20 and 2020/21, using the earliest of the two years first.

**Calculate Marcus' net income for the tax years 2019/20 and 2020/21, after all loss reliefs have been taken into account.**

### Marcus

#### Marcus' net income

	2019/20	2020/21
	£	£
Trading profits	22,000	0
Property income	84,200	84,200
<b>Total income</b>	<b>106,200</b>	<b>84,200</b>
Less: Trading losses offset against trading income	(22,000)	
Less: Trading losses offset against total income (W)	(50,000)	(45,480)
<b>Net income</b>	<b>34,200</b>	<b>38,720</b>

Trading loss arising in the tax year 2020/21	117,480
Offset against trading income in the tax year 2019/20	(22,000)
Offset against other income in the tax year 2019/20	(50,000)
<b>Loss remaining to offset in the tax year 2020/21</b>	<b>45,480</b>

## Chapter 15

### Workings

#### Adjusted total income – 2019/20

	£
Total income	106,200
Less: Pension contributions ( $£7,800 \times 100/80$ )	(9,750)
	<hr/>
Adjusted total income	96,450
	<hr/>

Loss relief is therefore limited to greater of:

(i) £50,000

(ii)  $25\% \times £96,450 = £24,113$

Therefore, the maximum loss that can be offset against non-trading income in the tax year 2019/20 is £50,000.

#### Adjusted total income – 2020/21:

	£
Total income	84,200
Less: Pension contributions ( $£7,800 \times 100/80$ )	(9,750)
	<hr/>
Adjusted total income	74,450
	<hr/>

Loss relief is therefore limited to greater of:

(i) £50,000

(ii)  $25\% \times £74,450 = £18,613$

Therefore, the maximum loss that can be offset in the tax year 2020/21 is £50,000 (since there are only losses of £45,480 remaining, they can all be offset).

## Notes



### 3.3 Relief for trading losses against chargeable gains

- After a claim to offset trading losses against total income, a taxpayer can then offset any remaining trading loss against chargeable gains in the same year.
- This claim can therefore only be made for the current and/or prior year, and **only** once trading losses have been set against total income for that same year.
- The amount of trading loss that can be offset against gains is the **lower of**:

- Loss remaining after income claim = the 'relevant amount'.
- The 'maximum amount':

	£
Total capital gains for year	X
Less: Total capital losses for year	(X)
Less: Total capital losses b/f	(X)
	—
Maximum amount	X
	—

- The trading loss is set against the current year net chargeable gains, before considering capital losses brought forward.

**Note:** Capital losses b/f are used in the calculation of the maximum amount, but may not actually be offset in the current year, as the trading loss is set off first followed by the AEA. If there are still net gains after the AEA then b/f capital losses will be utilised to reduce the net gains further. (See Chapter 18).

- The restriction of offset to a maximum amount of £50,000 or 25% of ATI does not apply to the offset against capital gains.



The taxpayer must claim the relief **within 12 months from 31 January following the end of the tax year** in which the loss arose.

## Notes





## Example 4

Karima is a sole trader and has adjusted trading results as follows:

Year ended 30 September 2019	Profit	£4,000
Year ended 30 September 2020	Loss	£(25,500)

Karima has other income of £6,000 in the tax year 2019/20 and also realised chargeable gains of £31,000 and capital losses of £2,000 in that tax year.

At 6 April 2019 Karima has capital losses brought forward of £11,000.

**Calculate the amounts that remain in charge to tax for the tax year 2019/20, assuming that Karima claims relief against both income and gains for the tax year 2019/20 only. Show any unrelieved losses carried forward.**

Assume the rates and allowances for the tax year 2020/21 apply throughout.

### Karima

#### Taxable income – 2019/20

	£
Trading profit	4,000
Other income	6,000
	<hr/>
Total income	10,000
Less: Trading loss relief	(10,000)
	<hr/>
Net income	0
	<hr/>

## Notes





### Offset of trading losses against chargeable gains in 2019/20

Lower of:

(1) **Relevant amount = trading loss less amount relieved against income**

$$(\pounds 25,500 - \pounds 10,000) = \pounds 15,500$$

(2) **Maximum amount**

**= chargeable gains less current and b/f capital losses**

$$= (\pounds 31,000 - \pounds 2,000 - \pounds 11,000) = \pounds 18,000$$

Offset is therefore £15,500

### Taxable gains – 2019/20

	£
Capital gains in current year	31,000
Less: Capital losses in current year	(2,000)
Less: Trading losses treated as capital losses	(15,500)
	<hr/>
	13,500
Less: AEA	(12,300)
	<hr/>
Chargeable gains	1,200
Less: Capital losses b/f	(1,200)
	<hr/>
Taxable gains	0
	<hr/>

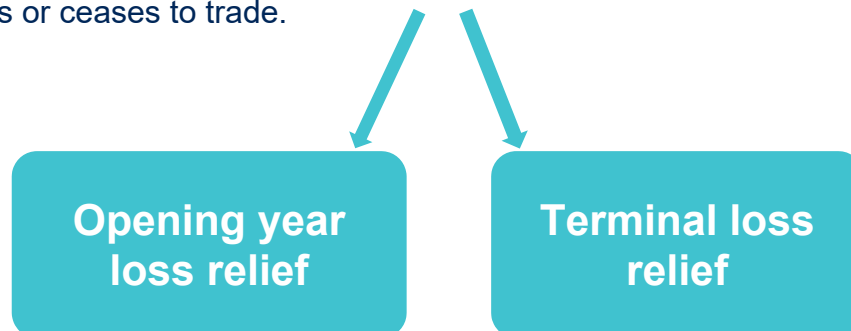
### Working – loss memorandum

	£
Trading loss	25,500
Less: Offset against income – 2019/20	(10,000)
Less: Offset against gains – 2019/20	(15,500)
	<hr/>
Unrelieved trading loss c/f	0
	<hr/>
Capital loss brought forward	11,000
Less: Utilised in the tax year 2019/20	(1,200)
	<hr/>
Unrelieved capital loss c/f	9,800
	<hr/>

# 4 Special circumstances

### 4.1 Special circumstances

In addition to the basic loss relief options, there are special reliefs available when a trader begins or ceases to trade.



### 4.2 Calculating a trading loss in the opening years

- The normal opening year basis of assessment rules apply to profits and losses.
- However, there are no overlap losses – losses can only be relieved once.
- Where the same loss appears in two tax years, it will be a trading loss for the earlier tax year only.

## Notes



## Example 5



Mansoor started to trade on 1 August 2019 and has the following results:

6 months ended 31 January 2020	£(4,500)
Year ended 31 January 2021	£(12,000)

**Show the trading losses for the tax years 2019/20 and 2020/21.**

### Mansoor

#### 2019/20

Basis period (actual)

1 August 2019 to 5 April 2020

Loss: £(4,500) + (2/12 × £(12,000))

£(6,500)

#### 2020/21

Basis period = (1 February 2020 to 31 January 2021) = CYB

Loss (y/e 31 January 2021)

£  
(12,000)

Add back: Used in the tax year 2019/20 (2/12 × £(12,000))

2,000  
  
(10,000)

## Notes



### 4.3 Opening year loss relief against total income

- A special loss relief for losses arising in the **first four tax years** of trade.
- Loss is carried back **three tax years** on a **FIFO basis**, against **total income**.
- One claim applies to all three years and may generate a refund of income tax.
- The relief is all or nothing: it cannot be restricted to preserve the PA.



The taxpayer must claim the relief **within 12 months from 31 January following the end of the tax year** in which the loss arose.

### Example 6



Greta started a business on 1 January 2020. Her taxable trade profits are:

	£
Year ended 31 December 2020 – Loss	(29,470)
Year ended 31 December 2021 – Profit	16,000

Prior to commencing in business, Greta had been employed as an accounts assistant. Her remuneration from this employment was:

	£
2016/17	24,800
2017/18	16,700
2018/19	9,650

In addition, she has savings income amounting to £1,980 each year.

**Calculate the taxable income for all tax years up to, and including, 2020/21 after claiming special opening year loss relief.**

**Assume the rates and allowances for the tax year 2020/21 apply throughout.**

## Greta

### Trading income assessment

#### 2019/20

Basis period: Actual basis  
(1 January 2020 – 5 April 2020)  
Loss:  $3/12 \times £29,470$

£                      £

(7,368)

Trading income assessment

0

#### 2020/21

Basis period: y/e 31 December 2020  
Loss:  
Add back: used in 2019/20

(29,470)

7,368

(22,102)

Trading income assessment

0

#### 2021/22

Basis period: CYB y/e 31 December 2021

16,000

	2016/17	2017/18	2018/19	2019/20	2020/21
	£	£	£	£	£
Trading profits				0	0
Employment income	24,800	16,700	9,650		
Savings income	1,980	1,980	1,980	1,980	1,980
Total income	26,780	18,680	11,630	1,980	1,980
Loss relief (2019/20)	(7,368)				
Loss relief (2020/21)		(18,680)	(3,422)		
Net income	19,412	0	8,208	1,980	1,980
Less: PA	(12,500)	Wasted	(8,208)	(1,980)	(1,980)
Taxable income	6,912	0	0	0	0

### Working – loss memorandum

	£
Trading loss arising in the tax year 2019/20	7,367
Less: Offset against total income in the tax year 2016/17	(7,367)
	<hr/>
Unrelieved trading loss c/f	0
	<hr/>
Trading loss arising in the tax year 2020/21	22,102
Less: Offset against total income in the tax year 2017/18	(18,680)
Less: Offset against total income in the tax year 2018/19	(3,422)
	<hr/>
Unrelieved trading loss c/f	0
	<hr/>

## Notes



### 4.4 Terminal loss relief

- Losses made in the **final 12 months** to the cessation of trade cannot be carried forward as there are no future trading profits. There are two options available:
  - offset against total income of the current year and/or preceding year
  - terminal loss relief.
- A terminal loss relief claim sets the 'terminal loss' against:
  - **trading profit**
  - **of the last tax year, and then**
  - **carried back three tax years on a LIFO basis.**



The taxpayer must claim the relief **within four years of the end of the final tax year of trade.**

The 'terminal loss' is calculated as follows:

	£
<b>6 April before cessation to date of cessation:</b>	
Actual trading loss of the last tax year (ignore if a profit)	X
Add: Overlap profits not yet relieved	X
<b>12 months before cessation to 5 April before cessation:</b>	
Actual trading loss (ignore if a profit)	X
	<hr/>
Terminal loss	X
	<hr/>

## Notes





## Example 7

Jones started to trade as a business on 1 May 2010, preparing accounts to 30 September each year, and ceased trading on 30 June 2020.

The most recent results were:

		£
Year ended 30 September 2017	Profit	28,000
Year ended 30 September 2018	Profit	10,000
Year ended 30 September 2019	Profit	4,000
Period ended 30 June 2020	Loss	(27,000)

**Show how the loss will be relieved under the terminal loss provisions, assuming overlap profits from commencement are £3,000.**

**Jones**

**Terminal loss**

	£	£
<b>6 April 2020 – 30 June 2020</b>		
Actual loss ( $3/9 \times £27,000$ )		9,000
Add: Overlap profits not yet relieved		3,000
<b>1 July 2019 – 5 April 2020</b>		
Actual loss for the period:		
1 July 2019 – 30 September 2019:		
( $3/12 \times £4,000$ ) profit	1,000	
1 October 2019 – 5 April 2020:		
( $6/9 \times £27,000$ ) loss	(18,000)	
		17,000
<b>Terminal loss</b>		29,000



## Trading losses for individuals

	2017/18	2018/19	2019/20	2020/21
	£	£	£	£
Trading income	28,000	10,000	4,000	0
Less: Terminal loss relief			(4,000) <sup>1</sup>	
		(10,000) <sup>2</sup>		
	(15,000) <sup>3</sup>			
Trading profits	13,000	0	0	0

## Notes



# 5 Choice of loss reliefs

## 5.1 Factors to take into account when thinking about optimum use of losses

**Primary aim for loss relief = to save as much tax as possible.**

(e.g. if profits are increasing it may make sense to carry losses forward to offset against future trading profits when tax is possibly being paid at a greater rate)

However, also need to consider



- Cash flow – the opportunity to carry losses back will generate tax repayments.
- Wastage – try to avoid wastage, as far as possible, of things like the PA, savings income and dividend nil rate bands, and AEA especially when overall tax savings are small in comparison.

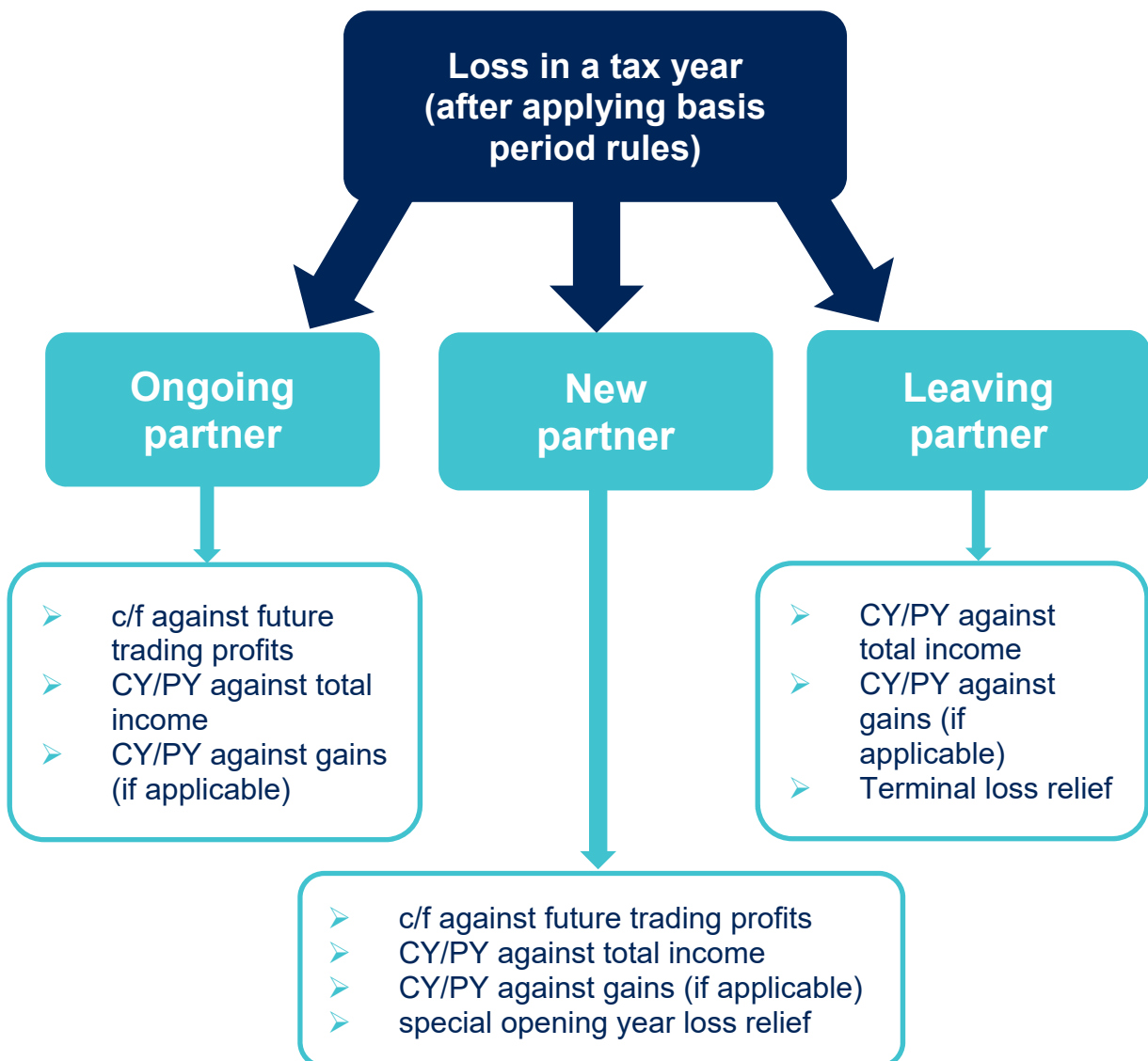
## Notes



## 6 Partnerships

### 6.1 Partnership loss relief

- Partners are allocated losses in the same way as profits.
- Each partner decides how to deal with his/her share of the loss.



Notes



# Questions



You should now be able to answer TYU questions 1 to 11 from the Study Text Chapter 11 as well as the questions 'Lucifer' and 'Oprah' from Chapter 27.

Knowledge Check Test: Trading losses for individuals on MyKaplan.

For further reading, visit Chapter 11 of the Study Text.

# Chapter 16

## Groups of companies



### Outcome

Upon completion of this Chapter you will be able to:

- define a 75% group, and recognise the reliefs that are available to members of such a group
- define a 75% chargeable gains group, and recognise the reliefs that are available to members of such a group

and answer questions relating to these areas.



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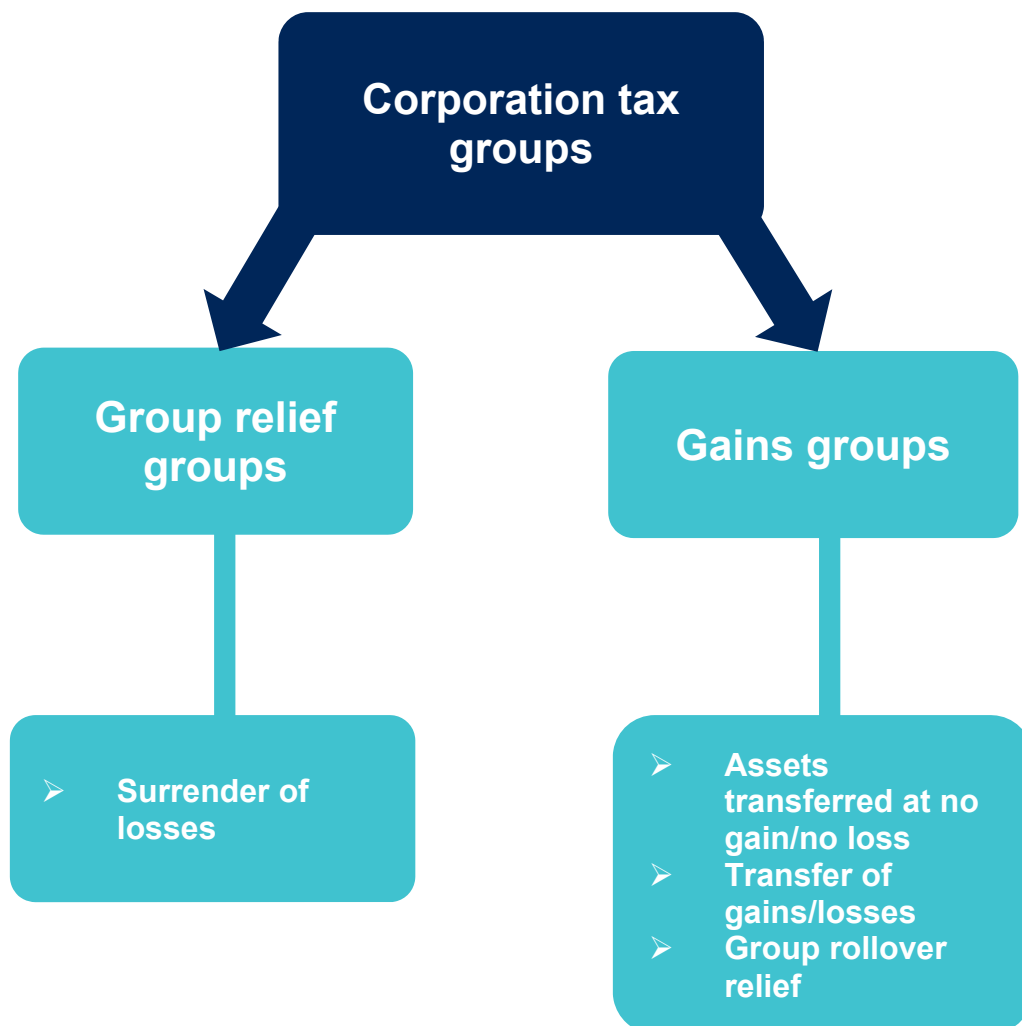
One of the PER performance objectives (PO15) is to prepare computations of taxable amounts and tax liabilities according to legal requirements. Another objective (PO17) is to advise on mitigating and deferring liabilities through legitimate tax planning measures. Working through this chapter should help you understand how to demonstrate those objectives.

The underpinning detail for this Chapter in your Kaplan Integrated Workbook can be found in Chapter 17 of the Study Text.



### Overview

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# 1 Group loss relief

## 1.1 Group definition



Group loss relief is available to members of a **75% losses group**. Two companies are members of a 75% group where

- one company is the 75% subsidiary of the other, or
  - both companies are 75% subsidiaries of a third company.
- A company has a 75% or greater subsidiary if:
    - it owns  $\geq 75\%$  of the ordinary share capital, and
    - it has the right to  $\geq 75\%$  of the distributable profits, and
    - it has the right to  $\geq 75\%$  of the assets on a winding up.
  - Sub-subsidiaries will be in the group if the parent company's **effective interest is also  $\geq 75\%$** .
  - Groups can be created through companies resident overseas, but losses can't be claimed or surrendered by them in TX.

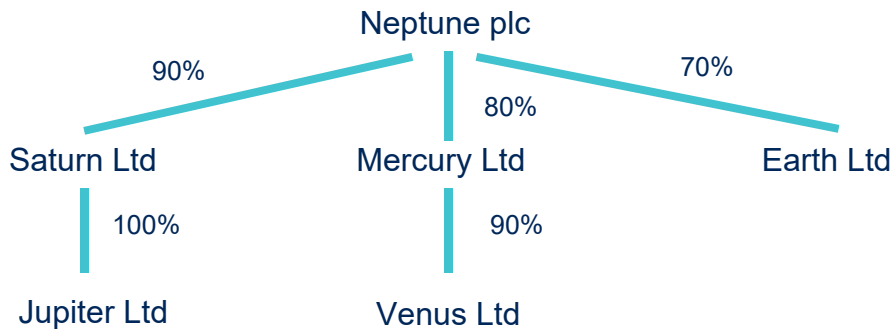
## Notes



## Example 1



The following is the structure of the Neptune Group:



- (a) State which companies form a group for group relief purposes.
- (b) Assuming that Saturn Ltd is Saturn Inc (an overseas resident company), which companies form a loss relief group and between which companies can losses be surrendered?

## Notes





### Neptune group

(a) Neptune plc is in a loss relief group with all of its direct 75% holdings:

- Saturn Ltd (Neptune plc directly owns 90%)
- Mercury Ltd (Neptune plc directly owns 80%)

Neptune plc only owns 70% of Earth Ltd, so Earth Ltd is not in the loss relief group.

Also included in the group are any 75% indirect holdings of Neptune plc:

- Jupiter Ltd (Neptune plc indirectly holds  $90\% \times 100\% = 90\%$ ).

Venus Ltd is not included as Neptune only indirectly holds  $80\% \times 90\% = 72\%$ .

Mercury Ltd owns 90% of Venus Ltd so they form a second separate group.

Therefore, the groups are:

- Neptune plc, Saturn Ltd, Jupiter Ltd and Mercury Ltd
- Mercury Ltd and Venus Ltd.

(b) The groups will still be as stated in (a) as groups can be formed through an overseas resident company.

However, because Saturn Inc is resident overseas, it will not be able to transfer losses to or claim losses from any of the other group companies.

## Notes



## Chapter 16

### 1.2 Mechanics of group relief



Companies which form part of the same group relief group can transfer losses.



The **surrendering company** is the company that surrenders its loss. The company to which the loss is surrendered is known as the **claimant company**.



**Group relief is claimed** on the claimant company's corporation tax return within **two years of the end of its AP**. It requires a notice of consent from the surrendering company.

- If **payment** is made for **group relief**, this is
  - not tax deductible for the payer
  - not taxable for the recipient.

## Notes



### 1.3 The surrendering company

- The losses which can be surrendered are:
  - trading losses
    - current period
    - brought forward to the extent they cannot be used against the surrendering company's own total profits (see below)
  - unrelieved qualifying charitable donations
  - unrelieved property losses
    - current period and brought forward.
- Brought forward losses can only be surrendered if the loss-making company cannot utilise the losses itself.  
Loss available for group relief = loss remaining after deducting the maximum possible claim by the loss-making company (even if the company does not actually make this claim).
- Capital losses cannot be surrendered under group relief but are dealt with under gains groups (see later).
- QCDs and property losses are 'unrelieved' if they exceed other income and gains **before** the deduction of any losses (current year, brought forward or carried back).

## Notes



## Example 2



Angel Ltd is part of a loss relief group and has the following results for the year:

	£
Chargeable gain	50,000
Property losses	(60,000)

**How much of the property loss is available to surrender?**

### Angel Ltd – corporation tax computation

	£
Chargeable gain	50,000
Property income	0
	<hr/>
Total profits	50,000
Property loss	(50,000)
	<hr/>
TTP	0
	<hr/>

### Loss memo – property loss

	£
Current year loss	60,000
Less: Automatic offset against total profits	(50,000)
	<hr/>
Loss available to surrender	10,000
	<hr/>

## Notes



## 1.4 The claimant company

- The group can choose any amount of group relief up to the maximum, which is the lower of:

- the available loss of the surrendering company (see above), and
- the available profits of the claimant company.

- The maximum loss which can be claimed by the claimant company is:

Total profits	X
Less: Losses brought forward (full amount – even if full relief is not actually claimed)	(X)
Current year losses (current year loss is deducted, even if relief is not actually claimed)	(X)
QCD relief	(X)
	—
Maximum loss relief in claimant company	X
	—

- The claimant company offsets the surrendered loss against the TTP (i.e. after QCDs) of its corresponding accounting period.

## Notes





## Example 3

Xylophone Ltd is a 75% subsidiary of Zither Ltd. The companies had the following results for the year:

	<b>Xylophone Ltd</b>	<b>Zither Ltd</b>
	£	£
Trading profit/(loss)	(66,000)	90,000
Trading loss b/f (post April 2017 losses)	(16,000)	(25,000)
Interest income	5,000	7,000
Chargeable gains	7,500	6,000
Qualifying charitable donation	—	(10,000)

**Compute the maximum group relief claim that can be made by Zither Ltd for the year.**

### **Xylophone Ltd – available losses**

	£
Current period trading loss in full	66,000
B/f trading loss to the extent it cannot be offset against Xylophone's total profits (£16,000 – £5,000 – £7,500)	3,500
	<hr/>
Total losses available for group relief	69,500
	<hr/>

### **Zither Ltd – available profits**

	£
Trading profits	90,000
Interest income	7,000
Chargeable gains	6,000
	<hr/>
Total profits	103,000
Less: Trading losses b/f	(25,000)
Qualifying charitable donations	(10,000)
	<hr/>
Available profits	68,000
	<hr/>

The maximum group relief claim is therefore £68,000 as this is lower than the available loss of £69,500.

### 1.5 Corresponding accounting periods

- Losses surrendered for group relief must be set against the TTP of the claimant company for a corresponding accounting period.



A **corresponding accounting period** is any accounting period falling wholly, or partly, within the surrendering company's accounting period.

- Where the companies have different year ends, the profits and losses of the companies must be time apportioned.

### Example 4



Buckingham Ltd is a 100% subsidiary of Windsor plc.

Buckingham Ltd incurs a trading loss of £52,300 in its 12-month accounting period to 31 January 2021.

The TTP of Windsor Ltd for the 12-month accounting periods to 30 September 2020 and 2021 are £59,000 and £19,700 respectively.

**Identify the maximum group relief claims that can be made by Windsor plc.**

### Notes



### Buckingham Ltd

The loss making period for Buckingham Ltd runs

from 1 February 2020

to 31 January 2021

This falls into the following accounting periods of Windsor plc:

y/e 30 September 2020: 1 February 2020 – 30 September 2020 (8 months)

y/e 30 September 2021: 1 October 2020 – 31 January 2021 (4 months)

The maximum group relief claim that can be made is therefore:

#### y/e 30 September 2020

	£
Buckingham Ltd available loss: $(8/12 \times £52,300)$	34,867
Windsor plc available profit: $(8/12 \times £59,000)$	39,333
	<hr/>
Maximum claim	34,867
	<hr/>

#### y/e 30 September 2021

Buckingham Ltd available loss: $(4/12 \times £52,300)$	17,433
Windsor plc available profit: $(4/12 \times £19,700)$	6,567
	<hr/>
Maximum claim	6,567
	<hr/>

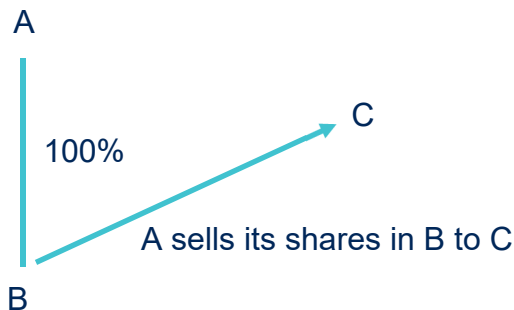
## Notes





## 1.6 Companies joining/leaving a loss group

### Scenario



- Group relief is only available for the corresponding accounting period, i.e. when both companies were members of the same group.
- Profits and losses should therefore be time apportioned.

## 1.7 Group relief planning



A company can choose to use its losses against its own profits or to group relieve them, or both.

- Group relief is **more flexible** because it is not “all or nothing” – any amount up to the maximum can be surrendered.
- To avoid wastage of QCDs when offsetting losses against its own profits:
  - claim group relief first
  - this can “fix” the amount which remains to be offset by the company when it does its own current year claim.
- Alternatively, to retain enough losses to make a carry back claim (generating a repayment of corporation tax already paid):
  - claim group relief first, then
  - make a current year claim (possibly wasting QCDs), then
  - make a loss carry back (prior year QCDs can be preserved).

## Example 5



Herts Ltd has the following results for the years ended 31 December 2019 and 31 December 2020:

	y/e 31 December 2019	y/e 31 December 2020
	£	£
Trading profits/ (losses)	367,200	(726,000)
Property income	91,400	67,300
Chargeable gains	11,900	29,800
QCDs	(28,100)	–

Herts Ltd has its own 100% subsidiary, Essex Ltd, with a TTP in excess of £1,000,000 for all relevant years.

Herts Ltd aims to use its losses to enhance cash flow, as much as possible.

**What is the most beneficial use of the losses of Herts Ltd?**

## Notes



**Herts Ltd**

If Herts Ltd wants to maximise its cash flow this would suggest a current year/carry back claim with respect to the losses. It currently has total profits of £97,100 (£67,300 + £29,800) for the year ended 31 December 2020 and total profits (before QCDs) of £470,500 (see below) for the year ended 31 December 2019. Therefore, if it were to make the current year/ prior year claim immediately it would utilise £567,600 of its losses and waste relief for the QCDs paid in the year ended 31 December 2019. This would leave a residual amount of losses of £158,400 (for group relief, or for carry forward).

A more efficient use of the losses would be to group relieve £186,500 to Essex Ltd first of all.

This would then leave £539,500 of losses in Herts Ltd. A current year claim would then be made to utilise £97,100 of the losses with the remainder, £442,400 being carried back.

When the losses of £442,400 are offset against the total profits for the year ended 31 December 2019, there is still enough left to avoid wastage of the QCDs. The computation for the year ended 31 December 2019 would therefore look as follows:

	£
Trading profits	367,200
Property income	91,400
Chargeable gains	11,900
	<hr/>
Total profits	470,500
Less: Losses carried back – previous 12 months	(442,400)
	<hr/>
	28,100
Less: QCDs	(28,100)
	<hr/>
TTP	0
	<hr/>

Use of the losses in this way avoids wastage of QCDs and maximises the amount which can be group relieved.

# 2 Capital gains groups

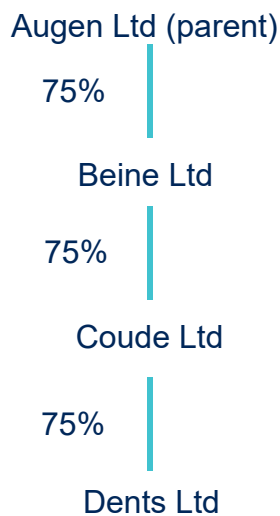
### 2.1 Group definition



A **capital gains group** is a parent company and its **≥ 75% subsidiaries** and the **≥ 75% subsidiaries** of the first subsidiaries, etc. The parent company must have an **effective interest > 50%** in ALL companies.

- Subsidiaries cannot be a parent company of a separate gains group.
- The shares of overseas companies can be taken into account, but those companies cannot take advantage of the reliefs available in a gains group.

## Example 6



- Which companies form a capital gains group?
- Which companies form a group relief group?

### Augen Ltd

#### (a) Gains group

Augen Ltd, Beine Ltd and Coude Ltd = same gains group as all direct holdings are  $\geq 75\%$  and all indirect holdings are  $> 50\%$ .

Augen Ltd does not indirectly hold  $> 50\%$  of Dents Ltd ( $75\% \times 75\% \times 75\% = 42.19\%$ ).

Coude Ltd and Dents Ltd cannot form a separate gains group as Coude Ltd is a subsidiary in the Augen Ltd gains group and cannot therefore be itself a 'parent' company and form a separate gains group.

#### (b) Loss relief group

Augen Ltd and Beine Ltd; Beine Ltd and Coude Ltd; and Coude Ltd and Dents Ltd each form two company loss relief groups.

## Notes



## 2.2 Implications of being in a gains group

There are various special tax rules to consider within a capital gains group:

- Transfer of assets within the group at no gain/no loss (NGNL)
- Reallocation of gains or losses around the group
- Rollover relief on a group basis.

## 2.3 NGNL transfers

- Chargeable assets are automatically transferred between group companies at no gain/no loss (NGNL).



- Any actual proceeds received are ignored.
  - deemed proceeds = cost plus indexation up to the date of the transfer (or December 2017 if earlier).
  - deemed cost for the recipient = deemed proceeds above.
- This treatment of intra-group transfers is mandatory and **automatic**.
- If the recipient later sells the asset outside the group, the deemed cost is indexed from the date of transfer up to the date of disposal (or December 2017 if earlier):

	£
Proceeds	X
Less: Cost (original cost plus IA to date of NGNL transfer*)	(X)
Less: IA (from date of NGNL transfer to date of disposal*)	(X)
	—
Gain/(loss)	X/(X)
	—

\* or December 2017 if earlier

## Notes

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### Example 7



Goodman Ltd owns 90% of Arlene Ltd.

On 15 December 2007 a property was transferred from Goodman to Arlene for £300,000 when its market value was £500,000.

This property had cost Goodman Ltd £53,000 in March 1999.

**What are the tax implications if Arlene Ltd sells the property for £800,000 in September 2020?**

Assume the indexation factors are as follows:

March 1999 to September 2020	0.810
March 1999 to December 2007	0.285
March 1999 to December 2017	0.695
December 2007 to December 2017	0.319
December 2007 to September 2020	0.408

### Notes





**Goodman Ltd****Intra-group transfer**

	£
Cost	53,000
IA from Mar 1999 to Dec 2007	
$0.285 \times £53,000$	15,105
	<hr/>
Base cost to Arlene Ltd	68,105
	<hr/>

**Sale outside the group**

	£
Proceeds	800,000
Less: Base cost	(68,105)
	<hr/>
Unindexed gain	731,895
IA from Dec 2007 to December 2017 (Note)	
$0.319 \times £68,105$	(21,725)
	<hr/>
Chargeable gain	710,170
	<hr/>

**Note:** Indexation is not permitted after December 2017.

## Notes

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### 2.4 Reallocation of gains or losses



Companies within a gains group can make a joint election to **reallocate** all/part of a current period **chargeable gain/allowable loss** between group companies.



The election must be made within **2 years of the end of the accounting period** of the disposal of the asset outside the group.

- This allows
  - gains and losses to be matched in the same company, and
  - gains to be transferred to companies with capital losses brought forward.

- Note that it is not possible to reallocate brought forward capital losses.

## Notes



## Example 8



During the year ended 31 March 2021 Violet Ltd disposed of a factory, which resulted in a capital loss of £75,000. Mauve Ltd, a 100% subsidiary of Violet Ltd, disposed of a warehouse, which resulted in chargeable gain of £100,000.

The only other taxable income of the companies was trading income of £30,000 for Mauve Ltd and £250,000 for Violet Ltd.

- (a) **Show the taxable total profits for the year ended 31 March 2021 for each group company assuming the group wants to minimise the corporation tax of the group as a whole.**
- (b) **Explain how your answer would differ if the loss made by Violet Ltd had actually arisen in the previous accounting period.**

## Notes



## Violet Ltd

### (a) Taxable total profits for year ended 31 March 2021

The group should make an election by 31 March 2023 to reallocate the capital loss in Violet Ltd to Mauve Ltd. As a result, the chargeable gain and capital loss are treated as being realised by Mauve Ltd.

	Mauve Ltd	Violet Ltd
	£	£
Trading income	30,000	250,000
Chargeable gain	100,000	—
Transferred capital loss	(75,000)	
TTP	55,000	250,000

### Loss memo working (Violet Ltd)

y/e 31 March 2021 capital loss	75,000
Less: Transferred to Mauve Ltd	(75,000)
Loss c/f against first available chargeable gains	0

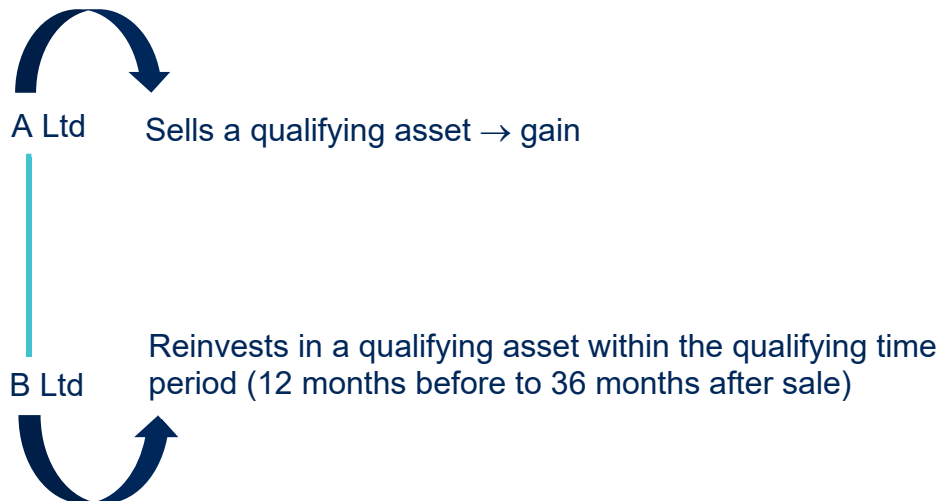
The same result could be achieved by transferring the chargeable gain to Violet Ltd. As both companies are subject to corporation tax at 19% it makes no difference to the overall tax liability which company the net gain of £25,000 is taxed on.

### (b) If the loss had arisen in the previous accounting period

If the loss made by Violet Ltd had actually arisen in the previous accounting period, it could not be transferred to Mauve Ltd. However, the gain arising in Mauve Ltd (or £75,000 of the gain i.e. enough to utilise the b/f capital loss) could be transferred to Violet Ltd, this would achieve the same end result as in (a).

### 2.5 Group rollover relief

- For the purposes of rollover relief, a gains group is **treated as a single trade**.
- Therefore, a gain on the disposal of a qualifying asset in one group company can be rolled over against the purchase of qualifying assets, within the permitted time period, by another group company.



- A Ltd can rollover the gain against the base cost of B Ltd's new asset.
- Same conditions as for normal rollover relief (see Chapter 22).

## Notes



# Questions



You should now be able to answer TYU questions 1 to 11 from the Study Text Chapter 17 as well as the questions 'Gold Ltd' and 'Apple Group' from Chapter 27.

Knowledge Check Test: Corporation tax on MyKaplan.

For further reading, visit Chapter 17 of the Study Text and review the TX article on 'groups' at [www.accaglobal.com](http://www.accaglobal.com).

# Chapter 17

## Tax administration for a company



### Outcome

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Upon completion of this Chapter you will be able to:

- explain and apply the features of the self-assessment system as it applies to companies, including the use of iXBRL
- recognise the time limits that apply to the filing of returns and the making of claims
- explain how large companies are required to account for corporation tax on a quarterly basis and compute the quarterly instalment payments
- list the information and records that taxpayers need to retain for tax purposes
- explain the circumstances in which HM Revenue and Customs can make a compliance check into a self-assessment tax return
- explain the procedures for dealing with appeals and First and Upper Tier Tribunals
- calculate late payment interest and state the penalties that can be charged

and answer questions relating to these areas.



**PER**

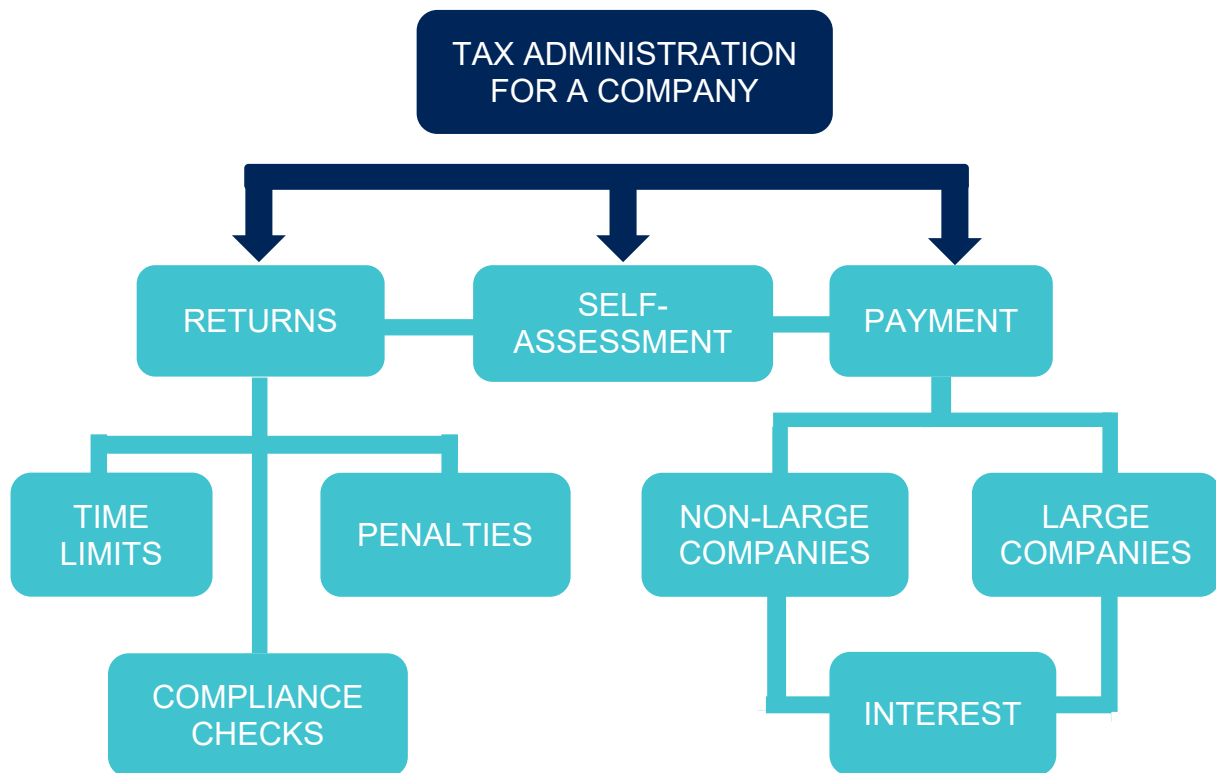
One of the PER performance objectives (PO16) is to make sure that individuals and entities comply with their tax obligations – on time, and in the spirit and letter of the law. Working through this chapter should help you understand how to demonstrate that objective.

The underpinning detail for this Chapter in your Integrated Workbook can be found in Chapter 18 of your Study Text.





### Overview



# 1 Corporation tax returns

## 1.1 Submission of the corporation tax return

- Companies must inform HMRC within 3 months of the start of their first accounting period (AP), stating when the period begins.
- HMRC then send a notice to the company requiring them to complete a tax return. This notice is usually issued shortly after the accounting year end.
- If the notice is not issued, the company must notify HMRC within 12 months of the period end that it has taxable total profits or face a penalty (see below).

## 1.2 Online filing

- All companies must submit returns online.



- Must be submitted by later of:
  - 12 months after the end of period of account
  - 3 months after issue of notice to file the return.

- Companies cannot ask HMRC to calculate their tax; they must include a self-assessment of the amount of corporation tax payable.
- Tax computations and accounts supporting the return must be submitted in 'Inline eXtensible Business Reporting Language' (iXBRL).

## 1.3 Claims

- Any claims must be included within the corporation tax return and must quantify the amount involved.

## Notes



### 1.4 Late filing penalties

The following penalties will apply if a company fails to file its return by the due filing date:

- within 3 months late – fixed penalty = £100 (£500 if third consecutive late filing)
- 3 months late – fixed penalty = £200 (£1,000 if third consecutive late filing)
- 6 – 12 months late – fixed penalty above plus a further penalty of 10% of tax outstanding 6 months after filing date
- More than 12 months late – fixed penalty above plus a further penalty of 20% of tax outstanding 6 months after filing date.

## Example 1



Wildman Ltd has a 31 December year end. It files its return for the year ended 31 December 2020 on 18 July 2022. The tax due of £80,000 is paid on the same day.

All previous returns have been filed on time.

**What is the penalty due as a result of the late filing?**

#### **Wildman Ltd**

The return should have been filed on 31 December 2021, and was filed more than 3 months late so a fixed penalty of £200 applies.

The return was filed on 18 July 2022 which is more than 6 months but less than 12 months late.

Therefore, an additional penalty of 10% of the unpaid tax, as at 30 June 2022, is due ( $10\% \times £80,000 = £8,000$ ).

So the maximum penalty is  $£200 + £8,000 = £8,200$ .

## Chapter 17

### 1.5 Amendments to returns



- HMRC has the right to amend obvious errors/mistakes (e.g. arithmetical errors or errors of principle)

- within **9 months** of the **actual filing date**.

- The company has the right to:



- amend the return for any reason within **12 months of due filing date**

- if an error is discovered later than that, to make an overpayment relief claim within **4 years of the end of the AP** in order to recover any excess corporation tax paid.

### 1.6 Record keeping periods

Companies must keep all records necessary to make a correct return. These will include records of:

- all receipts and expenses
- all goods purchased and sold
- all other related documentation in support of the other transactions of the business.



- Records should be kept until the later of

- **6 years from the end of the relevant AP**

- **the completion of a compliance check that has been conducted into the return**

- **the date on which it becomes impossible for a compliance check to be opened.**

A penalty of up to **£3,000 per AP** can be charged for failure to keep adequate records.

## Notes



## 2 Payment of corporation tax

### 2.1 Augmented profits

- Corporation tax is charged on TTP (taxable total profits), but a company's **augmented profits** are used to determine when the tax is due for payment.



**Augmented profits** are calculated as:

TTP

X

Plus: Dividends received from non-group companies

X

Augmented profits

X

- A group company = a holding of 51% or more (see section 2.3).
- Dividends received:
  - Not taxed (exempt from corporation tax).
  - Include **cash** dividends received from non-group UK and overseas companies in augmented profits.
  - Dividends from 51% group companies are excluded for all purposes (TTP and augmented profits).

## Notes





## Example 2

Teasel Ltd has TTP of £640,000 and receives dividends from a 15% subsidiary of £25,000 and dividends from a wholly owned subsidiary of £9,000.

**Calculate the augmented profits of Teasel Ltd.**

### Teasel Ltd

	£
TTP	640,000
Dividends from non-group companies	25,000
	<hr/>
Augmented profits	665,000
	<hr/>

**Note:** Dividends received from 51% or greater subsidiaries are not included within the calculation of augmented profits.

## Notes



## 2.2 Due dates for payment

To determine the due date augmented profits are compared to the profits threshold (often referred to as the profits limit).



The **profits threshold** for FY20 = £1,500,000 for a 12-month AP. Threshold is time apportioned if AP < 12 months.



If augmented profits exceed the threshold a company is **large** for corporation tax purposes and tax is due in instalments (see below).



If company is **not large**, corporation tax is due in one single payment **nine months and one day** after the end of the AP.

All companies must pay their corporation tax electronically.

## 2.3 Related 51% group companies

The profits threshold is divided by the number of related 51% group companies.



Companies are, for tax purposes, in a **related 51% group** if:

- one of the companies is a 51% subsidiary of the other, or
- if they are both 51% subsidiaries of another company.



A **51% subsidiary** = where >50% of a company's issued ordinary share capital, voting power, distributable income or assets on wind up are held directly or indirectly.

- In determining the number of 51% related group companies:

Include:	Exclude:
– Overseas companies	– Dormant companies

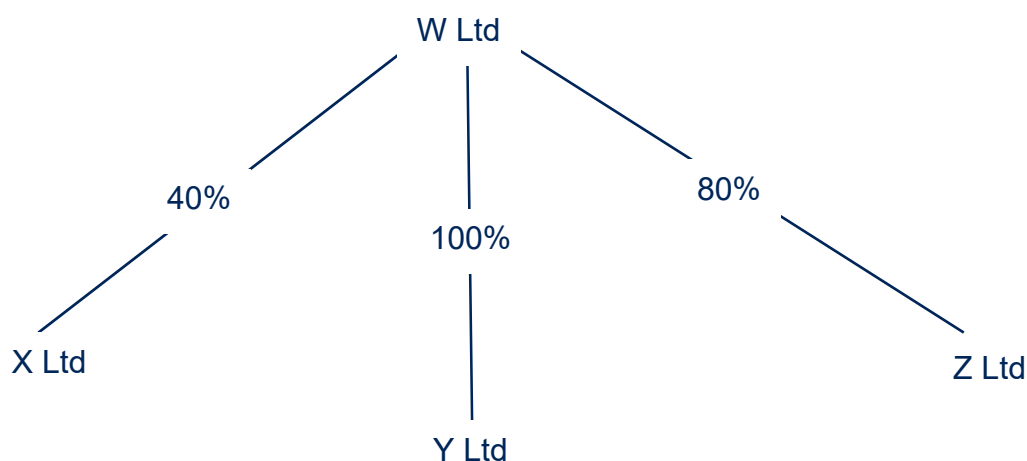
- The number of 51% group companies is counted at the end of the previous AP, therefore if the group has joiners or leavers:

	Current period	Next period
Joiners	Exclude	Include
Leavers	Include	Exclude

## Notes



### Example 3



All of the companies are UK resident except for Y Ltd, which is resident outside the UK and all its trading activities are conducted outside the UK.

Z Ltd is a dormant company.

X Ltd was bought part way through the year.

**How many related 51% group companies are there for tax purposes?**

#### **W Ltd Group**

W Ltd is related to Y Ltd only.

W Ltd is not related to Z Ltd, as it is a dormant company.

W Ltd is not related to X Ltd, as it only owns 40%. Even if W Ltd controlled X Ltd they would not be related until the accounting period following the one in which control was obtained.

Therefore, there are two related companies.

## Notes







## Example 4

The structure of the Epsilon group is as follows;



**Which companies are related 51% group companies of Epsilon Ltd?**

### **Epsilon group**

Epsilon's interest in Gamma is 80% and its effective interest in Delta is 60% ( $80\% \times 75\%$ ) so there are three related 51% group companies in total.

## Notes



## Chapter 17

### Implications of being related

- Divide the profits threshold by the number of 51% group companies.
- Dividends from 51% group companies are excluded from augmented profits.

### 2.4 Quarterly instalment payments for large companies



A large company = one with augmented profits > profit threshold

#### Exception

A large company will not have to pay tax by instalments if:

- its tax liability is <£10,000, or
- it was **not large in the previous AP** and its augmented profits are ≤ £10 million in this AP.

The £10 million limit is:

- scaled down for short APs
- divided by the number of related 51% group companies at the end of the previous AP.



#### Instalment dates

For a 12 month AP:

- Four quarterly instalments are paid on the **14th day of months 7, 10, 13 and 16** following the **start** of the AP.
- The amounts paid will be based on the estimated **current year** tax liability at that date.
- However, interest (see below) will be charged based on the **actual** corporation tax due.

## Notes





### Example 5

As at 31 March 2020, Nectarine Ltd owns 60% of Orange Ltd which in turn owns 60% of Peach Ltd.

All of the companies are active trading companies. There have been no changes to the group structure for many years.

In its year ended 31 March 2021, Nectarine Ltd had taxable total profits of £1,000,000 and in its year ended 31 March 2020 its taxable total profits were £800,000. It received no dividends in either year.

**When will Nectarine Ltd's corporation tax fall due for payment for the year ended 31 March 2021?**

#### **Nectarine Ltd**

Only Nectarine Ltd and Orange Ltd are related 51% companies, as the indirect holding in Peach Ltd is less than 51% ( $60\% \times 60\% = 36\%$ ).

The profits limit for corporation tax payment dates will be divided by two to give a limit of £750,000.

As Nectarine Ltd has no dividend income its TTP = augmented profits.

Since the augmented profits of Nectarine Ltd exceed £750,000 in the year ended 31 March 2021 and also exceeded £750,000 in the previous year, the company will be paying tax in quarterly instalments as follows:

14 October 2020 (month 7)

14 January 2021 (month 10)

14 April 2021 (month 13)

14 July 2021 (month 16)

### Example 6



Quince Ltd has no related 51% companies. The company's augmented profits for the year ended 31 December 2020 are £2,312,272. Quince Ltd was a large company in the previous accounting period.

**State the due date(s) for the payment of corporation tax by Quince Ltd for the year ended 31 December 2020.**

#### **Quince Ltd**

Quince Ltd is large for corporation tax purposes; therefore corporation tax is due in quarterly instalments.

The accounting period starts on 1 January 2020, therefore instalments are due on:

14 July 2020 (month 7)

14 October 2020 (month 10)

14 January 2021 (month 13)

14 April 2021 (month 16)

### Notes



## 2.5 Short APs

The profit threshold for corporation tax payment dates must be time apportioned for periods shorter than 12 months.

### Example 7



Radish Ltd has no 51% group companies. The results for the nine months ended 31 March 2021 are as follows:

	£
Tax adjusted trading profit	140,000
Chargeable gain	60,000
Dividends from non-group UK companies	50,000

**Calculate the corporation tax liability and state the payment date(s).**

#### Radish Ltd

	£
Tax adjusted trading profit	140,000
Chargeable gain	60,000
	<hr/>
TTP	200,000
	<hr/>
Corporation tax (£200,000 × 19%)	38,000
	<hr/>
Profits limit for corporation tax payment dates for nine month period (£1,500,000 × 9/12)	£1,125,000

#### Augmented profits

	£
TTP	200,000
Dividends from non-group companies	50,000
	<hr/>
Augmented profits	250,000
	<hr/>

This is below the profits limit for corporation tax payment dates so the corporation tax is due on 1 January 2022 (nine months and one day after the end of the accounting period).

## Chapter 17

### 2.6 Instalments for short accounting periods

Where corporation tax is payable by instalments and the AP is less than 12 months, the first instalment is the lower of:

- $3/n \times CT$                        $CT = \text{corporation tax for AP}$   
    $n = \text{number of months in AP}$
- the total corporation tax for the AP.

Subsequent instalments are calculated in same way until the liability is paid.

For large companies the due dates are as follows:



- The first instalment is due by the 14th day of the 7th month following the start of the AP; subsequent instalments are due every three months.
- The last instalment is due by the 14th day of the 4th month after the end of the AP.

### Example 8



Thirst Ltd has TTP of £750,000 in its eight months to 31 March 2021. The company received dividends from a wholly owned subsidiary of £85,000 (the shares were acquired in 2013).

Thirst Ltd was a large company in the previous period.

**Show the amount and due date of each instalment.**

## Notes



### Thirst Ltd

The profits limit of £1,500,000 must be adjusted for the short accounting period and the fact there are two related 51% group companies.

$$(\text{£1,500,000} \times 8/12)/2 = \text{£500,000}$$

Thirst Ltd's augmented profits for the eight months to 31 March 2021 are the same as its TTP (£750,000).

Augmented profits exceed the limit therefore Thirst Ltd must pay corporation tax in instalments. The first instalment is due by the 14th day of the 7th month following start of the accounting period; the second is due three months later; the last is due by the 14th day of the 4th month following the end of the accounting period.

$$\text{Corporation tax due} = \text{£750,000} \times 19\% = \text{£142,500}$$

#### First instalment

$3/8 \times \text{£142,500}$	£53,438
Due 14 February 2021	

#### Second instalment

$3/8 \times \text{£142,500}$	£53,437
Due 14 May 2021	

#### Third instalment

$2/8 \times \text{£142,500}$	£35,625
Due 14 July 2021	

## Notes



### 2.7 Interest on late paid corporation tax



Interest is charged at the rate of 2.75% if corporation tax is paid late.

- Interest runs from the due date to the date of payment.
- Interest paid by companies on overdue tax is deductible from interest income.

### Example 9



Tikva Ltd has a corporation tax liability of £92,000 for the year ended 30 June 2020. The company is not large for corporation tax purposes.

Tikva Ltd does not pay the amount due until 30 September 2021.

**Calculate the interest on the late paid corporation tax.**

#### **Tikva Ltd**

Since the company is not large, its corporation tax is due nine months and one day after the end of the accounting period, i.e. 1 April 2021.

It is paid on 30 September 2021, six months late.

Interest payable = £1,265 ( $6/12 \times £92,000 \times 2.75\%$ ).

## Notes





### 2.8 Repayment interest



Repayment interest is paid by HMRC at the rate of 0.5% on any overpayment of corporation tax.

- Interest runs from the later of:
  - the due date, and
  - the date of actual payment

to the date of repayment.

- For the purposes of corporation tax, repayment interest is taxable interest income.

## Notes

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## 3 Other penalties

### 3.1 Standard penalties

- A standard penalty system applies across all taxes for failure to notify liability to tax and errors in returns.
- Penalties = % × Potential Lost Revenue (PLR)  
(i.e. % × the tax unpaid as a result of the error/failure to notify).

The % = dependent on the taxpayer's behaviour and penalties can be reduced for disclosure by the taxpayer.



The following table is given in the tax tables:

Taxpayer behaviour	Maximum penalty	Minimum penalty – unprompted disclosure	Minimum penalty – prompted disclosure
Deliberate and concealed	100%	30%	50%
Deliberate but not concealed	70%	20%	35%
Careless	30%	0%	15%

- Note that there is greater reduction given for unprompted disclosure
  - i.e. disclosure at a time when there is no reason to suppose HMRC have discovered, or are about to discover, the error.

## Notes



## 4 HMRC powers and rights of appeal

### 4.1 Compliance checks

- Written notice must be issued if HMRC enquire into the completeness or accuracy of any tax return (known as a compliance check) by:



- 12 months after the actual filing date, if the return is filed on time
- the quarter day following the 12 month anniversary of the actual filing date if the return is filed late.



The **quarter days** are 31 January, 30 April, 31 July and 31 October.

- HMRC:
  - does not have to state the reason for the compliance check
  - must limit the information requested to that connected with the tax return
  - gives written notice once the check is completed and notifies the taxpayer of any proposed amendments to the self-assessment return.
- The taxpayer has **30 days to appeal** in writing against the amendments.

### 4.2 Discovery assessments

- A discovery assessment can be raised by HMRC if they come into possession of information about a taxpayer's tax affairs **after the normal time limit** for starting a compliance check has passed.



The time limits for issuing a discovery assessment are:

	Date from the end of the AP
Basic time limit	4 years
Careless behaviour	6 years
Deliberate behaviour	20 years

### Questions



You should now be able to answer TYU questions 1 to 9 from the Study Text Chapter 18 as well as the question 'Ramble Ltd' from Chapter 27.

For further reading, visit Chapter 18 of the Study Text.

# Chapter 18

## Computation of gains and tax payable



### Outcome

Upon completion of this Chapter you will be able to:

- describe the scope of capital gains tax
- recognise those assets which are exempt
- compute and explain the treatment of capital gains
- compute and explain the treatment of capital losses
- compute the amount of capital gains tax payable
- basic capital gains tax planning

and answer questions relating to these areas.



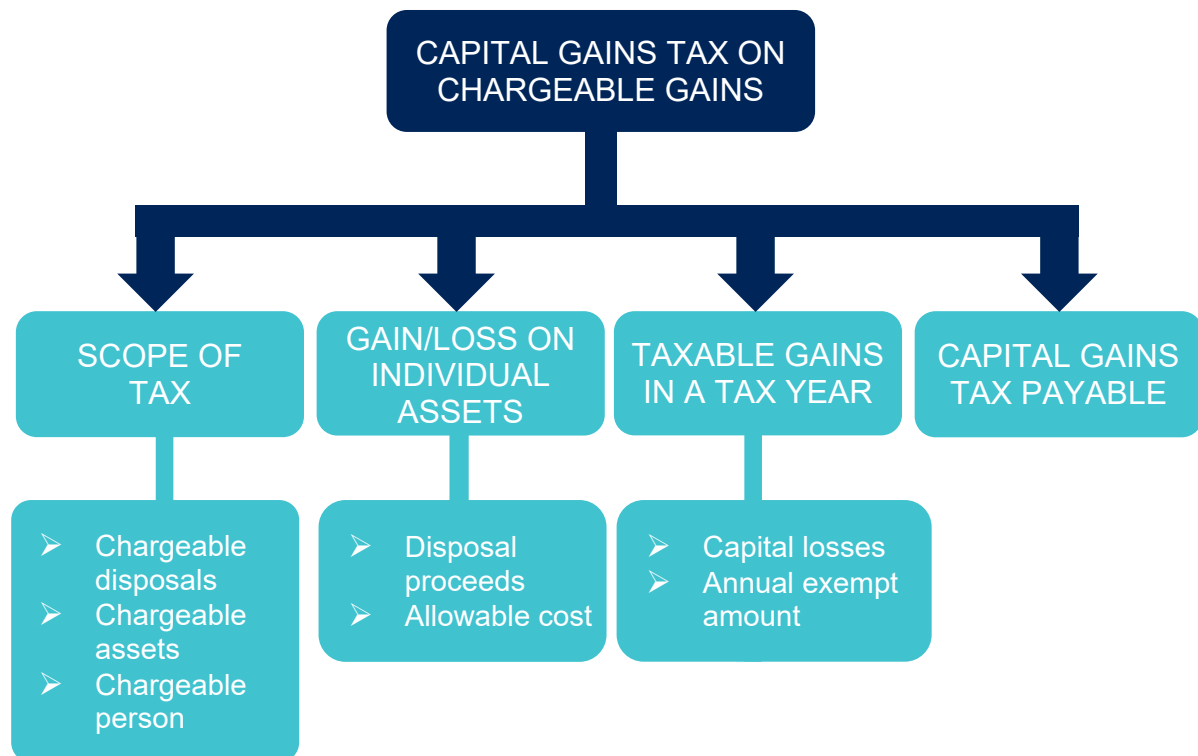
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One of the PER performance objectives (PO15) is to prepare computations of taxable amounts and tax liabilities according to legal requirements. Another objective (PO17) is to advise on mitigating and deferring liabilities through legitimate tax planning measures. Working through this chapter should help you understand how to demonstrate those objectives.

The underpinning detail for this Chapter in your Integrated Workbook can be found in Chapter 19 of your Study Text.



### Overview



## 1 Scope of capital gains tax

### 1.1 Scope of capital gains tax



**Capital gains tax (CGT)** = charged on gains arising on:

- chargeable disposals
- of chargeable assets
- by chargeable persons.

### 1.2 Chargeable persons



Chargeable persons include:

- individuals, who pay capital gains tax (CGT)
- companies – which pay corporation tax on their gains, not capital gains tax. The rules for calculating chargeable gains for companies are considered separately in Chapter 22.

UK resident individuals pay CGT on worldwide chargeable assets.

Non-UK resident individuals only pay UK CGT on disposals of certain assets situated in the UK. These rules are not examinable in TX.

The definition of residence is the same as for income tax purposes – see Chapter 2.

### 1.3 Chargeable disposals

Chargeable disposals include:

Include:	Exclude:
<ul style="list-style-type: none"> <li>➤ sale or gift of the whole, or part, of an asset</li> <li>➤ loss or destruction of an asset</li> <li>➤ exchange of an asset</li> <li>➤ receipt of a capital sum derived from an asset (e.g. compensation for damage or receipt for the surrender of rights)</li> </ul>	<ul style="list-style-type: none"> <li>➤ gifts to charities</li> <li>➤ disposals on death.</li> </ul>

## Notes



## Chapter 18

### 1.4 Chargeable assets



**All assets are chargeable** unless specifically exempted, in which case they are outside the scope of capital gains tax.

This means that:

- gains are not taxable, and
- losses are not allowable.

**Exempt assets** include:

- cash (including foreign currency for personal use)
- main residence (see Chapter 21)
- motor cars (including vintage cars)
- gilt edged securities and qualifying corporate bonds
- NS&I Certificates/premium bonds
- prizes and betting winnings
- assets held in Individual Savings Accounts (ISAs)
- trading inventory
- receivables
- wasting chattels (see Chapter 19)
- non-wasting chattels bought and sold for  $\leq$  £6,000 (see Chapter 19).

## Notes





## 2 Calculation of chargeable gain/loss on individual disposals

### 2.1 Pro forma – disposal of a single asset

The first step in calculating CGT payable is to calculate the gains or losses arising on each chargeable asset separately.

The following basic pro forma should be used for all disposals by an individual.

	£	£
Disposal proceeds	X	
Less: Allowable selling costs	(X)	
	—	
Net disposal proceeds		X
Less: Allowable expenditure		
Cost of acquisition	X	
Incidental costs of acquisition	X	
Additional enhancement expenditure	X	
	—	
		(X)
		—
Chargeable gain/(allowable loss)		X/(X)
		—

### 2.2 Disposal consideration

- The disposal consideration is usually the proceeds received for the asset.
- However, market value must be substituted for actual proceeds where:
  - a disposal is not made at arm's length, (e.g. a gift)
  - this includes disposals made to connected parties – i.e. close relatives (parents, siblings and children).
- Incidental costs of disposal (e.g. auctioneer's fees, estate agent fees and legal costs) may be deducted from the consideration to give net proceeds.

## Notes



### 2.3 Allowable expenditure

The following types of allowable expenditure may be deducted from net proceeds:

- The acquisition cost of the asset:
  - generally the purchase cost
  - if the asset was inherited, the probate value (i.e. the market value at the date of the death)
  - if the asset was received as a gift, the market value at the date of the gift.
- Expenditure on enhancing the value of the asset (capital expenditure) e.g. new extensions, associated architect's fees.
- Incidental costs of acquisition e.g. legal fees, surveyor's fees, stamp duty.

## Notes

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## Example 1

Betsy sold an asset for £25,000 incurring auctioneer's fees of £2,000. She had bought the asset for £7,500 incurring legal fees of £250.

**Calculate the chargeable gain on the sale.**

**Betsy**

	£	£
Gross proceeds	25,000	
Less: Incidental costs of disposal	(2,000)	
	<hr/>	
Net disposal consideration		23,000
Less: Acquisition cost	(7,500)	
Incidental costs of acquisition	(250)	
	<hr/>	
		(7,750)
		<hr/>
Chargeable gain		15,250
		<hr/>

### 2.4 Net gains for the tax year

A capital loss will arise if the total allowable costs exceed the net proceeds.

The second step in calculating CGT is to calculate the net chargeable gains arising in the tax year, i.e. chargeable gains less allowable losses.

## Example 2



Janet sold an investment property for £500,000, which she had inherited in May 1983 when its market value was £100,000. An extension was built in June 1987 at a cost of £30,000 and in May 1991 she spent £2,000 repairing the roof.

In the same tax year, she sold a painting for £8,000, which had been given to her by her mother in September 2011. The market value at the date of the gift was £15,000.

**Calculate the net chargeable gains on these disposals.**

#### Janet

	£	£
<b>Investment property</b>		
Proceeds	500,000	
Less: Acquisition cost (= probate value)	(100,000)	
Extension	(30,000)	
Chargeable gain		370,000
 <b>Painting</b>		
Proceeds	8,000	
Less: Acquisition cost (= market value)	(15,000)	
Allowable loss		(7,000)
Net chargeable gains		363,000

**Note:** The expenditure on the roof of the investment property was a repair and did not enhance the value of the asset.

## 3 Capital gains tax payable

### 3.1 Capital gains tax computation

	£
Net chargeable gains for the tax year	X
Annual exempt amount (2020/21)	(12,300)
Less: Capital losses brought forward (see below)	(X)
	<hr/>
Taxable gains	X
	<hr/>
CGT liability at relevant rates	X
Less: Payment on account re residential property disposals	(X)
	<hr/>
CGT payable	<hr/>

### 3.2 Annual exempt amount

Every individual is entitled to an **annual exempt amount (AEA)** for each tax year. Gains up to this amount are not chargeable to tax, and gains above the AEA will only be taxed on the excess.



For the tax year 2020/21 the **AEA** is **£12,300**.

Any unused AEA is wasted, it cannot be carried forwards or backwards.

## Notes



## Chapter 18

### 3.3 Current year capital losses

Current year capital losses are set off:

- against current year chargeable gains.
- to the maximum possible extent, which may lead to the AEA being wasted.

Any excess capital losses are carried forward for offset against future chargeable gains.

### Example 3



Beth makes the following gains and losses in the tax year 2020/21.

Shares in quoted company	Gain of £2,000
Antique table	Loss of £6,500
Gold necklace	Gain of £12,500

**Calculate Beth's taxable gains.**

**Beth**

	£
Shares	2,000
Necklace	12,500
Table	(6,500)
	<hr/>
Net chargeable gains	8,000
Less: AEA (restricted)	(8,000)
	<hr/>
Taxable gains	0
	<hr/>

## Notes



## 3.4 Capital losses brought forward

- Capital losses brought forward are deducted after current year capital losses and the AEA.
- They must be offset against the **first available** net gains.
- Any remaining brought forward loss is carried forward.
- If the gains are already covered by the AEA, then no capital losses brought forward will be offset and they will all continue to be carried forward.

### Example 4



Marko has the following gains and losses in the tax year 2020/21.

Platinum ring	Gain of £13,200
Antique wardrobe	Loss of £500

In addition, he has brought forward capital losses of £6,000.

**Calculate Marko's taxable gains.**

**Marko**

	£
Gains in year	13,200
Less: Current year losses	(500)
Less: AEA	(12,300)
	<hr/>
	400
Less: Losses b/f (Note)	(400)
	<hr/>
Taxable gains	0
	<hr/>
Loss c/f (£6,000 – £400)	5,600
	<hr/>

**Note:** Even though there are £6,000 of losses b/f, only £400 is used to offset the net gains after deduction of the AEA.

The balance of £5,600 (£6,000 – £400) continues to be carried forward against future gains.

## Chapter 18

### 3.5 Rate of capital gains tax

The rate of CGT depends on an individual's taxable income (i.e. after PA).



For **higher/additional rate taxpayers**, CGT is at **20%**.

For **basic rate taxpayers**, CGT is:

- **10% on gains falling within the unused basic rate band**
- **20% on the excess.**

For UK **residential property**, the 10% rate of tax is replaced with **18%**, and the 20% rate is replaced with **28%**.



In exam questions, income tax should always be calculated first, and capital gains tax calculated separately afterwards.

### 3.6 Payment of capital gains tax



- **Payment of CGT is due in full by 31 January following the end of the tax year**  
(i.e. 31 January 2022 for tax year 2020/21).
- Payments on account are only required if the taxpayer has disposed of residential property in the year (see section 3.7). This is not related to income tax payments on account.

## Notes







## Example 5

Ahmed has chargeable gains from selling quoted shares of £33,900 for the tax year 2020/21.

**Calculate Ahmed's capital gains tax liability for the tax year 2020/21 and state the due date for payment:**

(a) assuming Ahmed has taxable income of £4,370

(b) assuming Ahmed has taxable income of £27,855.

**Ahmed**

	£
Chargeable gains for the tax year	33,900
Less: AEA	(12,300)
	<hr/>
Taxable gains	21,600
	<hr/>
(a) CGT liability:	
£21,600 × 10%	2,160
	<hr/>

All of Ahmed's taxable gains fall within his unused basic rate band of £33,130 (£37,500 – £4,370).

(b) CGT liability:

£		£
9,645	(W) × 10%	965
11,955	× 20%	2,391
<hr/>		
21,600		
<hr/>		
		<hr/>
		3,356
		<hr/>

(W) Unused basic rate band = £37,500 – £27,855 = £9,645

In both cases (a) and (b) Ahmed must pay his CGT liability by 31 January 2022.

### 3.7 Tax on residential property

If a taxpayer disposes of residential property they must submit a return and pay the related tax within 30 days of completion. This treatment applies unless the disposal is exempt, e.g. under private residence relief (see Chapter 21).

To calculate the tax due on the disposal:

- Deduct
  - current year capital losses from disposals prior to this one
  - any unused capital losses brought forward, and
  - the AEA.
- Ignore any subsequent disposals (whether gains or losses).
- A reasonable estimate of the taxpayer's taxable income is used to determine the relevant rate of tax.



When calculating the final CGT payable for the year:

- Include any residential property gains
- Deduct any payments on account in relation to residential property from the CGT liability.

Calculations of payments on account on multiple residential property disposals are not examinable.

### 3.8 Tax planning – use of losses and annual exempt amount

- A taxpayer can offset the AEA and losses against whichever gains he/she chooses. In order to maximise the relief, they should firstly be offset against residential property gains, as they are taxable at higher rates than other gains.
- In the answers in your material the unused basic rate band has firstly been offset against other gains, although the tax saving would be the same regardless of the gains it is used against.
- The two types of gains should be shown in separate columns in the computation.



### Example 6

In October 2020, Gino made a gain on a painting of £60,000 and in November 2020, he made a gain on a UK residential property, which was not his main home, of £21,200.

Gino made a payment on account of capital gains tax of £2,492 in relation to the residential property disposal.

**Calculate Gino's capital gains tax payable for the tax year 2020/21 assuming he has taxable income in the year of £30,500.**

### Notes



## Chapter 18

### Gino

	Other gains £	Residential property £
Painting	60,000	
Residential property		21,200
Less: AEA		(12,300)
Taxable gains	60,000	8,900

### CGT

			£
BRB (W) other gains	7,000	× 10%	700
Balance of other gains	53,000	× 20%	10,600
	60,000		
Residential property gains:	8,900	× 28%	2,492
CGT liability			13,792
Less: Payment on account			(2,492)
CGT payable			11,300

### Working – basic rate band

	£
Basic rate band	37,500
Taxable income	(30,500)
BRB remaining	7,000

# 4 Capital gains planning

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### 4.1 Planning opportunities

Consider:

- Delaying some disposals to the next tax year to take advantage of a further AEA and the cash flow advantages in terms of having to pay tax at a later date.
- If possible, making disposals on a piecemeal basis to take advantage of another year's AEA (e.g. shares).
- If the individual is a basic rate taxpayer, crystallising more disposals in years when taxable income is lower to access more of the basic rate band for capital gains tax rates.

## Notes

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# Questions



You should now be able to answer TYU questions 1 to 11 from the Study Text Chapter 19 as well as the question 'Amina' from Chapter 27.

For further reading, visit Chapter 19 of the Study Text.

# Chapter 19

## Computation of gains: Special rules



### Outcome

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Upon completion of this Chapter you will be able to:

- understand the treatment of transfers between a husband and wife or between a couple in a civil partnership
- understand the amount of allowable expenditure for a part disposal
- recognise the treatment where an asset is damaged, lost or destroyed, and the implications of receiving insurance proceeds and reinvesting such proceeds
- identify when chattels and wasting assets are exempt
- compute the chargeable gain when a chattel or a wasting asset is disposed of
- basic capital gains tax planning

and answer questions relating to these areas.



PER

One of the PER performance objectives (PO15) is to prepare computations of taxable amounts and tax liabilities according to legal requirements. Another objective (PO17) is to advise on mitigating and deferring liabilities through legitimate tax planning measures. Working through this chapter should help you understand how to demonstrate those objectives.

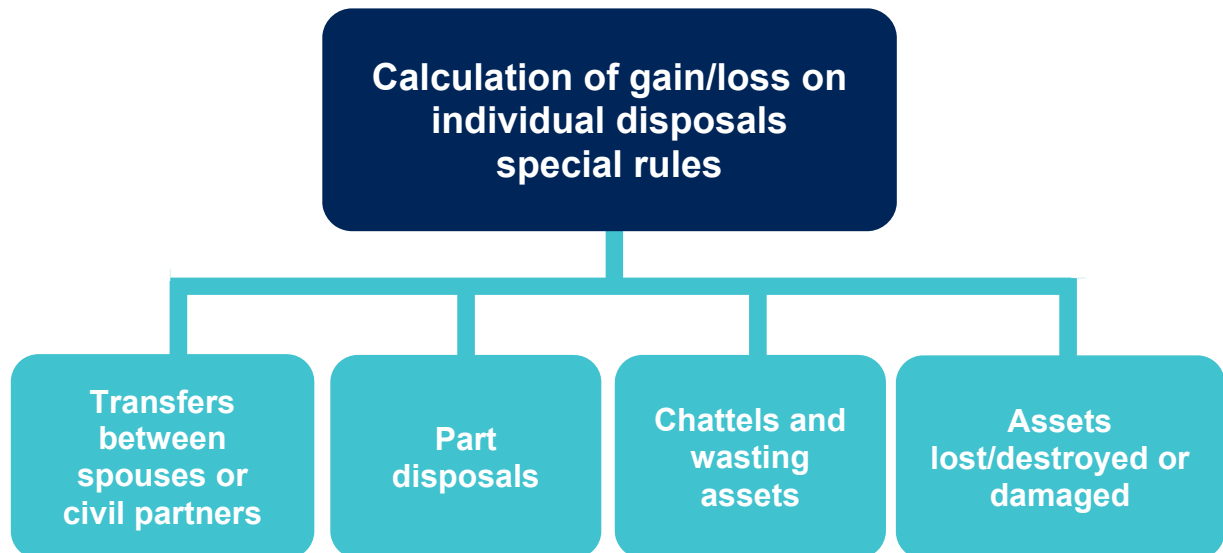
The underpinning detail for this Chapter in your Kaplan Integrated Workbook can be found in Chapter 20 of the Study Text





### Overview

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# 1 Transfers of assets between spouses

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## 1.1 Transfers between spouses/civil partners

A husband and wife (or civil partners) are taxed as separate individuals, e.g. each is entitled to their own AEA.

When assets are transferred between married couples:

- no gain or loss arises: (known as a no gain/no loss (NGNL) transfer)
- any actual proceeds are ignored
- the transferor is deemed to dispose of the asset at its acquisition cost
- the deemed proceeds of the transferor  
= treated as the deemed acquisition cost (base cost) for the transferee
- therefore, when the transferee sells the asset to a third party deemed acquisition cost = original cost to the first spouse.

These rules only apply whilst the couple are living together (i.e. not separated).

## Notes

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## Example 1

Eva bought some investment land on 1 August 2004 for £100,000. She gave the land to her civil partner, Santiago, on 12 December 2020 when it was worth £125,000.

Santiago sold the land on 13 February 2021 for £130,000.

**Calculate the gain(s) arising in the tax year 2020/21 and show on whom they are taxable.**

### Eva and Santiago

#### Eva

Dec 2020: No gain/no loss transfer

Deemed proceeds/base cost

£  
100,000

#### Santiago

Feb 2021: Proceeds

Less: Deemed cost

130,000  
(100,000)

Chargeable gain

30,000

## 1.2 Tax planning opportunities

The NGNL rules can be used to minimise capital gains tax liabilities as follows:

- utilisation of both individual's AEA's
- utilisation of any unrelieved capital losses
- utilisation of both individual's basic rate bands.

## Notes



# 2 Part disposals

## 2.1 Part disposals

- Where only part of an asset is sold, the acquisition cost needs to be apportioned between the part being disposed of and the part retained.

The deemed cost re the part sold is calculated using the following formula:

$$\text{Cost} \times A/(A+B)$$

Where      A = market value of part disposed of

                 B = market value of part retained.

- Incidental costs or enhancement expenditure are treated as follows:
  - if they relate solely to the part sold = deducted in full
  - if they relate to the whole asset = apportioned in the same way as cost.

## Notes





## Example 2

Alice bought 15 hectares of land in September 2003 for £21,000. The incidental costs of purchase were £600.

In June 2020, she disposed of 4 hectares for £22,500 incurring incidental costs of disposal of £2,500. The market value of the remaining land in June 2020 was £45,000.

**Calculate the chargeable gain on sale and the base cost of the remaining land.**

**Alice**

	£
Gross proceeds	22,500
Less: Incidental costs	(2,500)
	<hr/>
Net disposal consideration	20,000
Less: Acquisition cost	
$(22,500 / (22,500 + 45,000)) \times £21,000$	(7,000)
Less: Incidental costs of acquisition	
$(22,500 / (22,500 + 45,000)) \times £600$	(200)
	<hr/>
Chargeable gain	12,800
	<hr/>

The costs carried forward for future disposals are:

Cost of £14,000 (£21,000 – £7,000)

Incidental costs of £400 (£600 – £200)

## Notes



# 3 Chattels and wasting assets

## 3.1 Chattels



**Chattels** = tangible movable property, e.g. a picture or a table.

Note that the asset must be:

- movable – therefore a building is not a chattel.
- tangible – therefore shares are not chattels.

## 3.2 Wasting and non-wasting chattels

There are two types of chattel:

- wasting chattels
- non-wasting chattels.

	Wasting chattels	Non-wasting chattels
Expected life	Not exceeding 50 years	More than 50 years
Examples	Caravan	Antiques
	Boat	Jewellery
	Animals	Paintings
Tax treatment	Exempt from CGT	Special rules apply

## Notes





### Example 3

Dimitri has made the following disposals in the tax year:

- (1) August – sold an antique vase for £10,000. Dimitri had paid £8,000 for the vase.
- (2) September – sold a piece of land for £5,000. Dimitri had bought the land for £2,000 (as an investment).
- (3) October – sold a parrot for £5,000, which he had acquired for £4,000.
- (4) November – sold a vintage car for £25,000. The car had cost him £5,500.
- (5) December – disposed of some qualifying corporate bonds held in X plc. He had acquired them for a cost of £22,000 and he disposed of them for £37,700.

**For each of the above transactions, state whether or not they are chargeable disposals for capital gains purposes.**

#### **Dimitri**

- (1) The vase is a non-wasting chattel and is chargeable to CGT.
- (2) Land is not movable property and is therefore not a chattel. The disposal is chargeable to CGT.
- (3) The parrot is a wasting chattel and is therefore exempt from CGT.
- (4) Cars are always exempt assets for CGT purposes.
- (5) Qualifying corporate bonds are not chattels but they have their own specific exemption for capital gains purposes.

## Notes



## Chapter 19

### 3.3 Non-wasting chattels

The following special rules apply to non-wasting chattels.

Proceeds	Cost	Effect
$\leq \text{£}6,000$	$\leq \text{£}6,000$	Exempt
$> \text{£}6,000$	$> \text{£}6,000$	Chargeable gain/(loss) as normal
$\leq \text{£}6,000$	$> \text{£}6,000$	Allowable loss restricted: gross proceeds deemed = $\text{£}6,000$
$> \text{£}6,000$	$\leq \text{£}6,000$	Gain is lower of: <ul style="list-style-type: none"><li>➤ normal gain</li><li>➤ <math>5/3 \times (\text{gross proceeds} - \text{£}6,000)</math></li></ul>

### Example 4



Cian sold a sculpture for  $\text{£}10,000$ . He had acquired it on for  $\text{£}900$ . Costs of disposal amounted to  $\text{£}300$

**Calculate the chargeable gain arising on the disposal.**

**Cian**

As proceeds  $> \text{£}6\text{k}$  but cost  $\leq \text{£}6\text{k}$  = marginal gain situation.

	£
Gross proceeds	10,000
Less: Cost of sale	(300)
	<hr/>
Net disposal proceeds	9,700
Less: Cost	(900)
	<hr/>
Gain	<b>8,800</b>
	<hr/>

But gain cannot exceed:

$$5/3 \times (10,000 - 6,000) = \text{£}6,667$$

Therefore, the chargeable gain is the lower gain of  $\text{£}6,667$





## Example 5

Darcy bought an antique chair for £6,500 and sold it for £5,600. She incurred £250 to advertise it for sale.

**Calculate the allowable loss arising on the disposal.**

**Darcy**

As proceeds < £6k and cost was ≥ £6k: marginal loss situation.

The allowable loss is restricted as follows:

	£
Gross proceeds (deemed)	6,000
Less: Expenses of sale	(250)
	<hr/>
Net disposal proceeds	5,750
Less: Acquisition cost	(6,500)
	<hr/>
Allowable loss	(750)
	<hr/>



## Example 6

Eli bought an antique table for £16,250 a few years ago and sold it for £26,400.

**Calculate the chargeable gain arising on this disposal.**

**Eli**

Non-wasting chattel sold for more than £6,000 and bought for more than £6,000 therefore normal gain arises:

	£
Gross proceeds	26,400
Less: Cost	(16,250)
	<hr/>
Chargeable gain	10,150
	<hr/>

## Notes





## Example 7

Fatima bought a sculpture for £10,000 plus additional costs of acquisition of £500. When she disposed of it, tastes in home furnishings had changed and she was only able to sell it for £8,200, less disposal costs of £50.

**Calculate the allowable loss arising on the disposal.**

### Fatima

Non-wasting chattel sold for more than £6,000 and bought for more than £6,000 therefore normal loss arises:

	£
Gross proceeds	8,200
Less: Selling costs	(50)
	<hr/>
Net sales proceeds	8,150
Less: Original Cost	(10,000)
Incidental costs of acquisition	(500)
	<hr/>
Allowable loss	(2,350)
	<hr/>

## Notes



### 3.4 Plant and machinery

Plant and machinery is deemed to have a useful life  $\leq 50$  years, therefore it is always wasting and is usually exempt from CGT.

However, there is an exception if it has been used for the purposes of a trade and was eligible for capital allowances. In this situation:

- if sold at a gain: a normal gain will arise, subject to the £6,000 rules above.
- If sold at a loss: no capital loss will arise as relief for that loss will have already been obtained through the capital allowances regime.

### 3.5 Structures and buildings

Disposal proceeds in the capital gains computation must be increased by allowances claimed in relation to qualifying structures and buildings.

### 3.6 Wasting assets

For wasting assets which are not chattels the allowable cost is deemed to have wasted away on a straight-line basis.

When calculating the allowable cost, we take the original full cost and multiply it by:

Remaining life at disposal/Estimated useful life at acquisition.



## Example 8

Eva bought a wasting asset (not a chattel) for £82,000. When she acquired it, it had an estimated useful life of 22 years.

She sold it 7 years later for £77,500.

**Calculate the allowable gain/loss arising on the disposal.**

**Eva**

	£
Sales proceeds	77,500
Less: Cost ( $£82,000 \times 15/22$ ) (Note)	(55,909)
	<hr/>
Chargeable gain	21,591
	<hr/>

**Note:** There are still 15 years of its original 22-year life remaining.

# 4 Assets which are lost or destroyed or damaged

## 4.1 Complete loss or destruction of an asset

- If an asset is lost or destroyed, a capital gains calculation still needs to be carried out and the proceeds = insurance proceeds received.
- If **no insurance proceeds are received** = capital loss for tax purposes.
- If **insurance proceeds = fully used to replace the asset within 12 months**
  - the taxpayer can elect to treat the disposal on a no gain/no loss basis (i.e. the deemed proceeds will equal the original cost).
  - any insurance proceeds in excess of the deemed disposal proceeds = deducted from the allowable cost of the replacement asset.
- If **insurance proceeds = partially used to replace asset within 12 months**
  - an immediate chargeable gain re the excess proceeds not reinvested arises.
  - the remainder of gain is deferred under no gain/no loss treatment above.

## Notes





## Example 9

Jack bought an antique table for £35,000.

It was destroyed in a fire and Jack received insurance proceeds of £67,000.

**Calculate the capital gain on the disposal assuming:**

- (a) Jack does not acquire a replacement
- (b) Jack acquires a replacement within one year for £92,000, and all available reliefs are claimed
- (c) Jack acquires a replacement within one year for £61,000, and all available reliefs are claimed.

**For part (b) and (c), what would be the allowable cost of the replacement for capital gains purposes?**

**Jack**

**(a) Normal capital gain is performed**

	£
Proceeds (= insurance proceeds)	67,000
Less: Original Cost	(35,000)
Chargeable gain	32,000

**(b) Original asset is deemed to be a no gain/no loss disposal**

Proceeds (deemed)	35,000
Less: Original cost	(35,000)
Chargeable gain	0

Excess proceeds received (£67,000 – 35,000) = £32,000

The excess is deducted from the cost of the replacement asset.

**Base cost of new table:**

Purchase price	92,000
Less: Deferred gain	(32,000)
	60,000

**(c) Gain chargeable immediately**

Insurance proceeds	67,000
Less: Original cost	(35,000)
	<hr/>
	32,000
Gain deferred (balancing figure)	(26,000)
	<hr/>
Chargeable gain	
(proceeds not reinvested = £67,000 – £61,000)	6,000
	<hr/>
<b>Base cost of new table:</b>	
Purchase price	61,000
Less: Deferred gain	(26,000)
	<hr/>
	35,000
	<hr/>

## Notes





### 4.2 Asset is damaged

➤ If **no compensation** is received = no capital gains consequences

➤ If **compensation is received** = a part disposal calculation

i.e.  $\text{Cost} \times A/(A+B)$

Where                      A = compensation received

                                    B = market value of damaged asset.

➤ If **all compensation is used for the purpose of restoring the asset**

- the taxpayer can elect not to do a part disposal calculation
- instead, deduct the proceeds received from the cost of the asset going forward.

## Notes

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## Example 10

Valeria bought a painting for £320,000

There was some water damage to the painting and the insurance company paid £45,000 in respect of this. The value of the damaged painting at that time was £365,000.

**Calculate the gain that arises at the time the insurance company pays Valeria £45,000 and explain the impact of any claims that could be made if Valeria were to use the amount of £45,000 to restore the painting back to its original condition.**

### Valeria

	£
Proceeds (= insurance proceeds)	45,000
Less: Original Cost	
$£320,000 \times (£45,000 / (£45,000 + £365,000))$	(35,122)
Chargeable gain	9,878

Since the disposal proceeds are all being used to repair the damage that has occurred, it would be possible to avoid the part disposal calculation and claim to reduce the original cost of the asset by the disposal proceeds received.

Thus, the allowable cost of the asset going forward would become:

	£
Original cost	320,000
Less: Insurance proceeds received	(45,000)
Plus: Restoration expenditure	45,000
Revised base cost	320,000

## Notes

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### Questions



You should now be able to answer TYU questions 1 to 12 from the Study Text Chapter 20 as well as the question 'Lethabo and Faith' from Chapter 27.

For further reading, visit Chapter 20 of the Study Text and review the TX article on 'chargeable gains part 1' at [www.accaglobal.com](http://www.accaglobal.com) (excluding the aspects on CGT reliefs).

# Chapter 20

## CGT: Shares and securities for individuals



### Outcome

Upon completion of this Chapter you will be able to:

- recognise the value of quoted shares where they are disposed of by way of a gift
- explain and apply the identification rules as they apply to individuals including the same day and 30 day matching rules
- explain and apply the pooling provisions
- explain and apply the treatment of bonus issues, rights issues, takeovers and reorganisations
- identify the exemption available for gilt-edged securities and qualifying corporate bonds

and answer questions relating to these areas.



PER

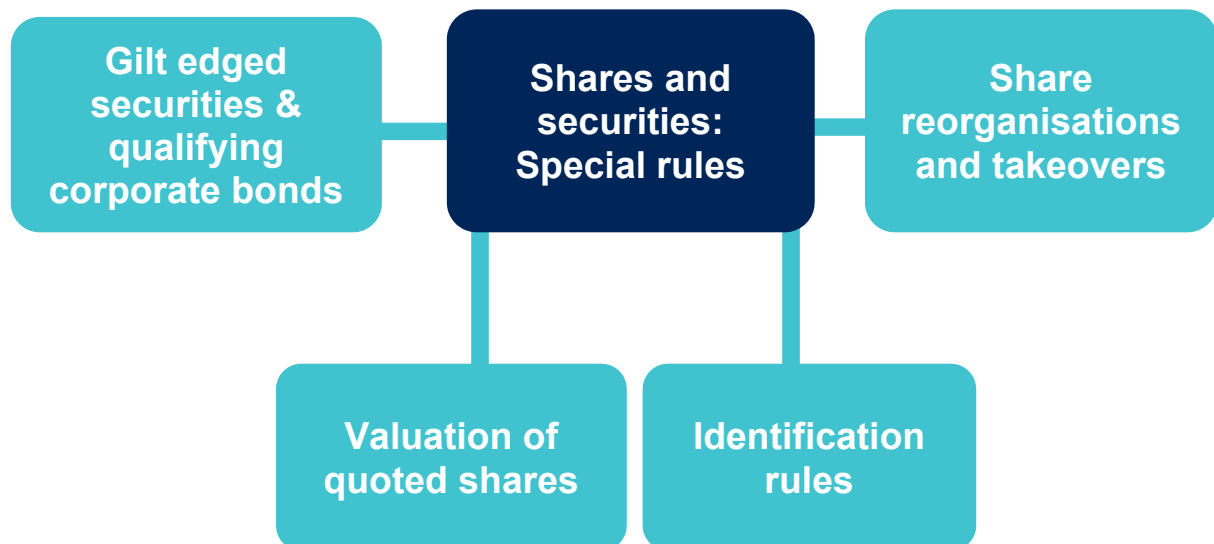
One of the PER performance objectives (PO15) is to prepare computations of taxable amounts and tax liabilities according to legal requirements. Working through this chapter should help you understand how to demonstrate that objective.

The underpinning detail for this Chapter in your Kaplan Integrated Workbook can be found in Chapter 21 of the Study Text.



### Overview

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# 1 Disposal of shares by an individual

## 1.1 Exempt shares and securities

The following shares and securities are exempt from CGT:

- listed government securities (gilts) (e.g. Treasury stock, Exchequer stock)
- qualifying corporate bonds (company debentures or loan notes)
- shares held in ISAs.



A qualifying corporate bond is one that:

- represents a normal commercial loan, and
- is expressed in sterling, and
- was acquired after 13 March 1984.

## 1.2 Valuation of quoted shares

- When quoted shares are gifted or transferred to a connected party, the market value of the shares at the date of the gift is used as the proceeds.
- For unquoted shares the MV will be given.
- For quoted shares, the MV of the shares  
= **mid-price** (i.e. average) of the prices quoted on the Stock Exchange Daily Official List on the disposal date.

## Notes





### Example 1

Karim gifts 10,000 shares in Peck plc to his daughter.

The shares were quoted at 280p – 296p on the date of the gift.

**For capital gains tax purposes, calculate the value of the shares transferred.**

**Karim**

Valued of each share gifted = average quoted price:

= (highest quoted price + lowest quoted price)  $\times \frac{1}{2}$

= (£2.96 + £2.80)  $\times \frac{1}{2}$  = £2.88

Value of shares gifted = (£2.88  $\times$  10,000) = £28,800

Karim will use £28,800 as the proceeds in his CGT computation.

This will also be the deemed cost for his daughter when she disposes of the shares.

## Notes





### 1.3 Share matching rules

Identification (matching) rules are needed to determine which shares are being sold because:

- shares of the same class in the same company are not distinguishable from each other
- the prices paid on different dates will vary.

In order to work out the allowable cost to use in the CGT computation, disposals of shares are therefore matched with acquisitions in the following order:

- (1) acquisitions on the same day as the disposal
- (2) acquisitions within the **following** 30 days on a FIFO basis
- (3) the share pool (all shares bought prior to the disposal date).

## Notes

---





## Example 2

Malcolm had the following transactions in the shares of Fastline plc, a quoted company.

15 October 1994	Bought	100 shares for	£350
18 September 1998	Bought	900 shares for	£38,340
3 January 1999	Bought	350 shares for	£15,400
7 February 2003	Bought	270 shares for	£14,120
15 December 2020	Sold	1,220 shares for	£68,320
19 December 2020	Bought	300 shares for	£15,450

**Identify which acquisitions the shares sold on 15 December 2020 will be matched with.**

### Malcolm

	Number	Number
Shares sold		1,220
(1) Shares acquired on same day		0
(2) Shares acquired in following 30 days (19 December 2020)		(300)
		<hr/>
		920
(3) Share pool – shares acquired prior to 15 December 2020		
15 October 1994	100	
18 September 1998	900	
3 January 1999	350	
7 February 2003	270	
	<hr/>	
	1,620	
	<hr/>	
The disposal from the share pool is 920 shares out of 1,620 shares		(920)
		<hr/>
		0
		<hr/>

**Note:** 700 shares (1,620 – 920) still remain in the share pool.

## 1.4 Calculating the gain on disposal of shares by an individual

- Separately calculate the gain for each set of shares matched with the disposal.
- When shares are disposed out of the share pool the appropriate proportion of the cost is calculated, i.e. they are sold at the average cost.

### Example 3



Using the information for example 2, calculate the gain arising on the disposal of the shares in December 2020.

**Malcolm continued**

	£	£
<b>Gain – shares acquired next 30 days</b>		
Proceeds ( $\text{£}68,320 \times \frac{300}{1,220}$ )	16,800	
Less: Cost	(15,450)	
	<hr/>	
Chargeable gain		1,350
<b>Gain – share pool</b>		
Proceeds ( $\text{£}68,320 \times \frac{920}{1,220}$ )	51,520	
Less: Cost (W1)	(38,737)	
	<hr/>	
Chargeable gain		12,783
		<hr/>
Total chargeable gains		14,133
		<hr/>

### (W1) Share Pool

	No.	£ Cost
15 October 1994 – acquisition	100	350
18 September 1998 – acquisition	900	38,340
3 January 1999 – acquisition	350	15,400
7 February 2003 – acquisition	270	14,120
	<hr/>	<hr/>
	1,620	68,210
15 December 2020 – disposal	(920)	(38,737)
	<hr/>	<hr/>
c/f	700	29,473
	<hr/>	<hr/>

## Notes



## 1.5 Bonus issues



A **bonus issue** = an issue of free shares to existing shareholders in proportion to their existing holdings.

Add the extra shares into the share pool at nil cost.

### Example 4



Gustave made the following acquisitions of shares in Bovary Ltd:

Date	No. acquired	Cost £
4 November 1985	2,000	3,800
22 October 1996	500	1,000
7 March 2003	3,500	6,500

On 1 June 2006, the company made a 1 for 4 bonus issue.

On 14 December 2020, Gustave sold 5,350 of his shares in Bovary Ltd for £8 per share.

**Calculate the chargeable gain on the disposal.**

**Gustave**

**Share Pool**

	No.	Cost £
<b>4 November 1985</b> – acquisition	2,000	3,800
<b>22 October 1996</b> – acquisition	500	1,000
<b>7 March 2003</b> – acquisition	3,500	6,500
	<hr/>	<hr/>
	6,000	11,300
<b>1 June 2006</b> – bonus issue 1 for 4	1,500	0
	<hr/>	<hr/>
	7,500	11,300
<b>14 December 2020</b> – disposal	(5,350)	(8,061)
	<hr/>	<hr/>
c/f	2,150	3,239
	<hr/>	<hr/>

### Calculation of chargeable gain:

	£
Proceeds $£8 \times 5,350$	42,800
Less: Cost	(8,061)
	<hr/>
Chargeable gain	34,739
	<hr/>

## Notes



### 1.6 Rights issue



A **rights issue** = where the existing shareholders buy new shares in proportion to their existing holding at a price (usually below market rate).

Add the new shares and their cost into the share pool.

### Example 5



Justin acquired the following shares in Elastic Ltd:

Date	No. acquired	Cost
12 October 1989	500	1,800
23 March 1990	2,000	7,000
29 June 1998	1,000	5,000
17 November 2003	3,000	15,000

On 1 June 2007, the company made a 1 for 5 rights issue at £7 per share. Justin took up all his rights.

On 21 January 2021, Justin sold 7,000 shares in Elastic Ltd for £10 per share.

**Calculate the chargeable gain on the disposal.**

## Notes



### Justin

#### Share Pool

	No.	Cost £
12 October 1989 – acquisition	500	1,800
23 March 1990 – acquisition	2,000	7,000
29 June 1998 – acquisition	1,000	5,000
17 November 2003 – acquisition	3,000	15,000
	<hr/>	<hr/>
	6,500	28,800
1 June 2007 – Rights 1 for 5 @ £7	1,300	9,100
	<hr/>	<hr/>
	7,800	37,900
21 January 2021 – disposal	(7,000)	(34,013)
	<hr/>	<hr/>
c/f	800	3,887
	<hr/>	<hr/>

#### Calculation of chargeable gain:

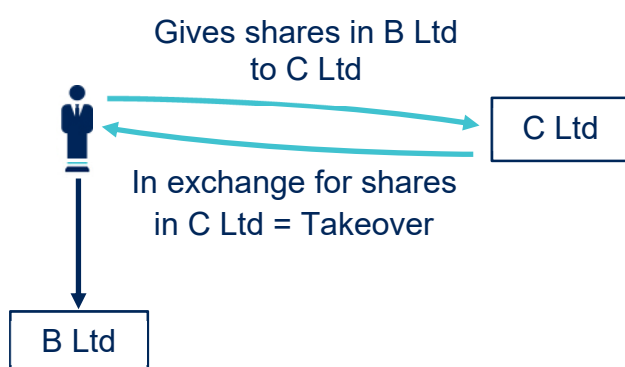
	£
Proceeds $£10 \times 7,000$	70,000
Less: Cost	(34,013)
	<hr/>
Chargeable gain	35,987
	<hr/>



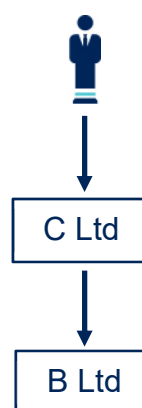
## 2 Reorganisations and takeovers

### 2.1 Scenario

#### BEFORE:



#### AFTER:



- This is called a 'paper for paper' or 'share for share' exchange.
- Individual has disposed of his/her shares therefore a gain would normally arise.
- As there are no cash proceeds the gain is deferred.

### 2.2 Operation of the relief

- New shares 'stand in the shoes' of the old shares.  
= the cost of the old shares becomes the cost of the new shares.
- This treatment is **automatic**
- If different types of new shares (e.g. ordinary and preference shares) are received, the cost of the old shares  
= apportioned between the new shares based on their market values at the point of takeover.

## Notes



### Example 6



Dante acquired 2,300 ordinary shares in W Ltd on 8 October 2005 for £29,540.

W Ltd was taken over by Z plc in May 2020. Dante received 5 ordinary shares and 1 preference share in Z plc for each share that he held in W Ltd.

The values of the shares in Z plc at the date of the takeover were as follows:

	Value per share
Ordinary shares	£5.20
Preference shares	£2.80

In December 2020, Dante sold 10,000 ordinary shares in Z plc for £78,000.

**Calculate the chargeable gain on the sale in December 2020.**

### Notes



## Dante

### Chargeable gain on disposal of Z plc ordinary shares – December 2020

	£
Disposal proceeds	78,000
Less: Cost (W)	(23,190)
	<hr/>
Chargeable gain	54,810
	<hr/>

## Workings

### Consideration received on takeover:

	No of shares	MV £
Ordinary shares in Z plc (5 × 2,300)	11,500	59,800
Preference shares in Z plc (1 × 2,300)	2,300	6,440
		<hr/>
		66,240
		<hr/>

### Apportionment of original cost:

	Takeover consideration	Apportioned cost
To ordinary shares in Z plc	59,800	
£29,540 × (59,800/66,240)		26,668
To preference shares in Z plc	6,440	
£29,540 × (6,440/66,240)		2,872
	<hr/>	<hr/>
	66,240	29,540
	<hr/>	<hr/>

### Z plc ordinary shares – pool:

May 2020	Takeover	11,500	26,668
December 2020	Disposal	(10,000)	(23,190)
		<hr/>	<hr/>
Pool c/f		1,500	3,478
		<hr/>	<hr/>

### 2.3 Mixed consideration

If mixed consideration is received (i.e. a mixture of cash and shares)

- the original cost of the old shares needs to be apportioned between the different forms of consideration based on market values at the date of takeover.

#### Receive new shares

- The new shares take on the apportioned original cost and acquisition date of the old shares.
- No gain arises until the new shares are sold.

#### Receive cash

- A gain will arise based on the cash received compared to the apportioned part of the original cost.

## Notes

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## Example 7

Honey owns 5,000 shares in Hive Ltd, which she bought six months ago for £30,000. She accepts a takeover bid by Bees plc receiving the following consideration for each share held in Hive Ltd:

- 2 shares in Bees plc valued at £9.90 each
- £7.20 cash

**What are the tax consequences of the takeover?**

### Honey

Takeover consideration	Value £	Allocated cost £	Treatment
Shares (5,000 × 2 × £9.90)	99,000	22,000	No gain now Base cost of new shares = £22,000
Cash (5,000 × £7.20)	36,000	8,000	Chargeable gain now (see below)
	<hr/>	<hr/>	
	135,000	30,000	
	<hr/>	<hr/>	

### Gain on receipt of cash

	£
Proceeds (cash received)	36,000
Less: Cost (above)	(8,000)
	<hr/>
Chargeable gain	28,000
	<hr/>

### Questions



You should now be able to answer TYU questions 1 to 10 from the Study Text Chapter 21 as well as the question 'Jasper' from Chapter 27.

For further reading, visit Chapter 21 of the Study Text.

# Chapter 21

## CGT: Reliefs for individuals



### Outcome

Upon completion of this Chapter you will be able to:

- calculate the chargeable gain when a private residence is disposed of
- explain and apply business asset disposal relief
- explain and apply investors' relief
- explain and apply capital gains tax reliefs:
  - (i) rollover relief
  - (ii) holdover relief for the gift of business assets
- basic capital gains tax planning

and answer questions relating to these areas.



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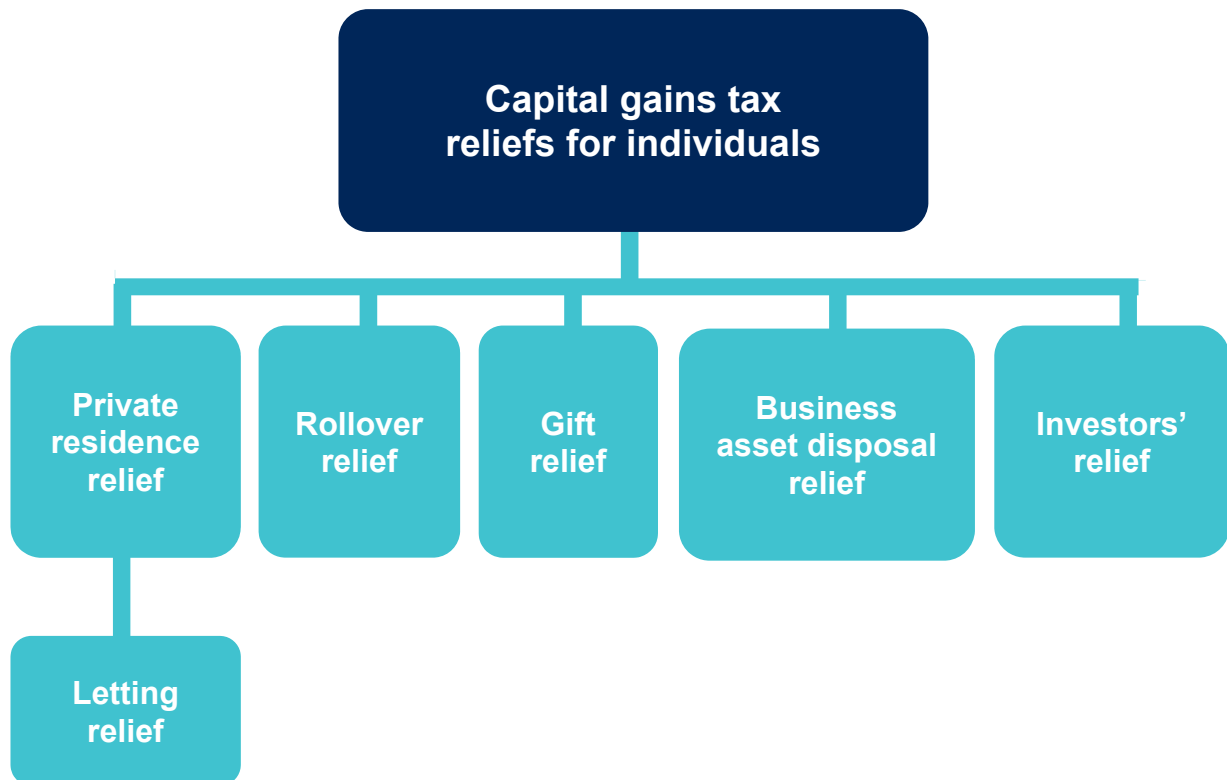
One of the PER performance objectives (PO15) is to prepare computations of taxable amounts and tax liabilities according to legal requirements. Another objective (PO17) is to advise on mitigating and deferring liabilities through legitimate tax planning measures. Working through this chapter should help you understand how to demonstrate those objectives.

The underpinning detail for this Chapter in your Kaplan Integrated Workbook can be found in Chapter 22 of the Study Text



### Overview

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# 1 Private residence relief

## 1.1 Private residence



Private residence relief is available on disposal of a property, which is:

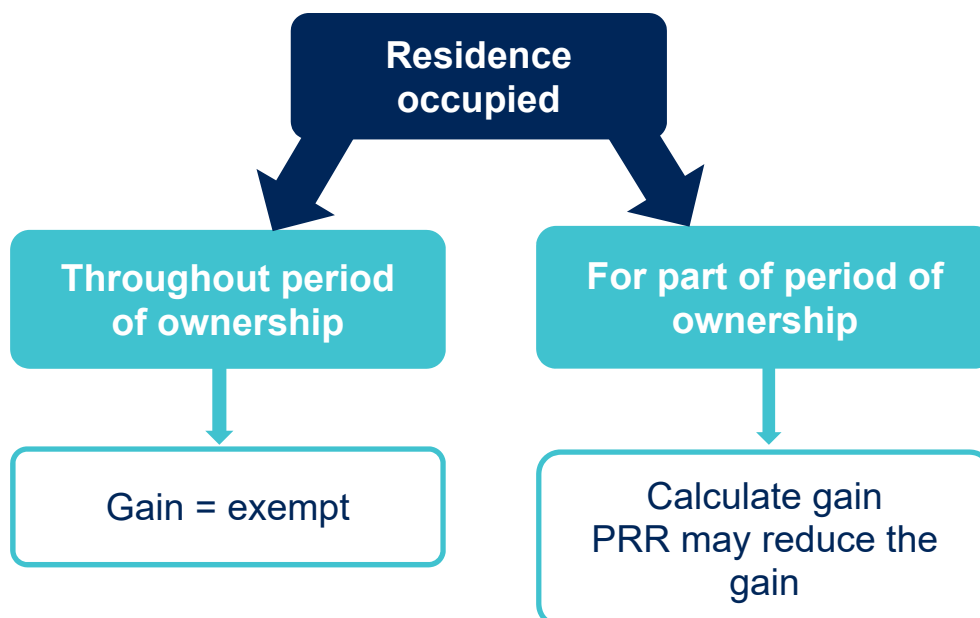
- a dwelling house (including normally up to half a hectare of adjoining land)
- which has at some time during its ownership been his or her only, or main, private residence.

An individual can only have one private residence for the purposes of PRR at any time, and an individual owning more than one property can **elect** which one is to be his or her private residence:

- in writing
- within two years of the acquisition of the second property.

## 1.2 Calculating PRR

The relief applies where the residence has been occupied for either the whole, or part, of the period of ownership:



## Chapter 21

Where there has been a period of absence:

- Calculate the gain on the property.
- Compute the total period of ownership.
- Calculate the periods of deemed and actual occupation (see below).
- Calculate the PRR exemption as follows:

$$\text{Gain} \times \text{Periods of occupation} / \text{Total period of ownership.}$$

- Then consider letting relief (section 1.5).

## Notes

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### 1.3 Deemed occupation

Unconditional periods of deemed occupation:

- The **last nine months of ownership** = always treated as deemed occupation.

Conditional periods of deemed occupation:

- Other periods of non-occupation may also be classed as deemed occupation:
  - (a) **up to three years** of absence for any reason
  - (b) **any period** spent living overseas due to employment
  - (c) **up to four years** of absence whilst working in the UK (employed or self-employed).
- Each of the above periods must be **preceded and followed by** a period of **actual occupation**
  - but the condition to reoccupy after a period of absence under (b) or (c) does not apply if an employer requires the individual to work elsewhere immediately, making it impossible to resume occupation.



In the examination you should provide **explanatory notes** for periods of deemed occupation in PRR questions.

## Notes



### Example 1



Zahra bought a house in London on 1 January 1996, sold it on 31 December 2020, and made a gain of £341,200.

She occupied the house as follows:

1 January 1996 – 30 June 1998	Lived in house
1 July 1998 – 31 December 1998	Backpacking around Thailand
1 January 1999 – 31 December 2000	Lived in the house
1 January 2001 – 30 September 2006	Sent by her employer to work in Newcastle
1 October 2006 – 31 December 2006	On an “around the world” cruise
1 January 2007 – 31 December 2016	Lived in the house
1 January 2017 – 31 December 2020	Moved in with boyfriend

**Calculate Zahra’s chargeable gain in respect of the disposal.**

### Notes



**Zahra**

	£
Gain (given)	341,200
Less: PRR (W)	(296,844)
	<hr/>
Chargeable gain	44,356
	<hr/>

**Working: PRR**

	Total	Exempt	Chargeable
<b>1 January 1996 – 30 June 1998:</b>	30		
Actual occupation		30	
<b>1 July 1998 – 31 December 1998:</b>	6		
Travelling overseas			
Up to 3 years for any reason		6	
<b>1 January 1999 – 31 December 2000:</b>	24		
Actual occupation		24	
<b>1 January 2001 – 30 September 2006:</b>	69		
Up to 4 years working elsewhere in UK		48	
Rest of period from 3 years for any reason		21	
<b>1 October 2006 – 31 December 2006</b>	3		
World cruise – from 3 years for any reason		3	
<b>1 January 2007 – 31 December 2016</b>	120		
Actual occupation		120	
<b>1 January 2017 – 31 December 2020</b>	48		
Living with boyfriend			
No return = can't use rest of 3 years any reason			
Last 9 months always PRR		9	39
	<hr/>	<hr/>	<hr/>
<b>Total number of months</b>	300	261	39
	<hr/>	<hr/>	<hr/>

$$\text{PRR} = 261/300 \times £341,200 = £296,844$$

**Note:** The periods of occupation before and after deemed occupation do not need to be immediately before and after (for example the employment in Newcastle ended on 30 September 2006 and is followed by actual occupation which did not start until 1 January 2007).

## Chapter 21

### 1.4 Business use

- PRR is **not** available for a part of a property that has been used exclusively for business purposes.
- The **last nine months** exemption:
  - **is not available** if the business part of the property has **always** been used for business purposes.
  - **is available** if the business part has in the past been used for non-business purposes (even if that part of the property was used for business purposes during the last nine months of ownership).

### Example 2



Irina owns a house for 80 months. One third of the house is used exclusively for business purposes throughout the period of ownership.

Irina sells the house and makes a gain of £45,000.

**State the amount of PRR available.**

<b>Irina</b>	£
PRR: $\frac{2}{3} \times £45,000$	£30,000

There is no PRR for the business part (including the last nine months of ownership).

## Notes



### 1.5 Letting relief

Where a property has been a main residence yet some of the gain remains chargeable, letting relief may be available to further reduce the chargeable gain.



**Letting relief** applies when the owner:

- lets part of the property whilst still occupying the remainder.

If the owner has one lodger, living as a member of their family, sharing the home and meals with them, full PRR is available and letting relief is not considered. In the examination, if it states that a percentage of the home is exclusively let out, it should be taken that the lodger is not living as part of the family.

Letting relief **does not apply** to let property that is not the owner's main residence (e.g. buy to let properties).

Letting relief is the lowest of:

- £40,000
- PRR given
- the gain relating to the let period (which is still in charge after PRR).

## Notes



### Example 3



Mariya bought a house in Manchester on 1 September 2014, sold it on 31 August 2020, and made a gain of £240,000.

She occupied the house as follows:

1 September 2014 – 29 February 2016	Occupied the entire house
1 March 2016 – 28 February 2018	Occupied two-thirds of the house, rented one-third out to tenants
1 March 2018 – 31 August 2020	Moved in with her grandparents

**Calculate the chargeable gain arising on Mariya.**

### Notes





## Mariya

	£
Gain	240,000
Less: PRR (W)	(143,333)
	<hr/>
	96,667
Less: Letting relief (W)	(26,667)
	<hr/>
Chargeable gain	70,000
	<hr/>

## Working: PRR

	Total	Exempt	Chargeable
<b>1 September 2014 – 29 February 2016:</b>	18		
Actual occupation		18	
<b>1 March 2016 – 28 February 2018:</b>	24		
Two thirds occupied;		16	
One third let			8
<b>1 March 2018 – 31 August 2020:</b>	30		
Living with grandparents			21
Last 9 months always PRR		9	
	<hr/>	<hr/>	<hr/>
<b>Total number of months</b>	72	43	29
	<hr/>	<hr/>	<hr/>

$$\text{PRR} = 43/72 \times £240,000 = £143,333$$

## Working: Letting relief

One third of the property is let out between 1 March 2016 and 28 February 2018. The let period represents 8 of the 29 months that remains in charge after PRR.

Letting relief = Lowest of:

— Max	£40,000
— PRR given	£143,333
— Gain after PRR relating to the letting period 8/29 × £96,667	£26,667

# 2 Business asset disposal relief and investors' relief

## 2.1 Business asset disposal relief



**Business asset disposal relief (BADR)** allows:

- the **first £1,000,000** of gains in an individual's lifetime
- that arise on the disposal of **qualifying assets**
- to be **taxed at 10%** (even for higher and additional rate taxpayers).



The following are **qualifying disposals** for BADR:

- all, or a substantial part (capable of independent operation), of an unincorporated trading businesses
- assets of a business within three years of ceasing to trade
- shares in a personal trading company (individual owns  $\geq 5\%$ ), and individual is an employee of the company (full or part-time).

The asset must have been **owned for at least 2 years**. Additionally, for shares, the individual must have been working for the company and held  $\geq 5\%$  for 2 years.



BADR must be claimed within **12 months of 31 January following the tax year** in which the qualifying disposal is made.  
(For 2020/21 = 31 January 2023).

## Notes



### 2.2 Operation of the relief

BADR is calculated as follows:

- Calculate the gain(s) on the disposal of the qualifying asset(s)
  - if an unincorporated business net off gains and losses.
- Separate gains qualifying for BADR from those that don't qualify (ideally using separate columns in your computation)
  - remember the lifetime limit of £1,000,000 for qualifying gains for BADR.
- To maximise the relief:
  - deduct losses and the AEA from gains not qualifying for BADR first (residential property gains, then other non-qualifying gains).
- Tax the remaining gains qualifying for BADR at 10%.
- BADR gains use the remaining basic rate band before non-qualifying gains, so any other gains in the tax year are likely to be taxed at 20% (or 28% for residential gains).

## Notes



### Example 4



Fernanda sold her business in August 2020. She had run the business since January 1990.

The following gains arose:

	Gain/(loss)
	£
Freehold factory	120,000
Retail outlet	(10,000)
Goodwill	22,000

Fernanda also sold a UK residential investment property in the year realising a gain of £78,300. £14,459 of capital gains tax has already been paid in respect of the residential property.

Fernanda has capital losses brought forward of £6,200.

Her only source of income is trading profits of £27,150.

**Calculate her CGT payable for the tax year 2020/21, assuming she has not previously claimed business asset disposal relief.**

## Notes



## Fernanda

### Capital gains tax – 2020/21

	£	BADR gains £	Other gains £
Factory	120,000		
Retail outlet	(10,000)		
Goodwill	22,000		
Net gain on business		132,000	
Investment property (residential)			78,300
Chargeable gains		132,000	78,300
Less: AEA			(12,300)
			66,000
Less: Capital losses b/f			(6,200)
Taxable gains		132,000	59,800
Capital gains tax:			
Qualifying for BADR: (£132,000 × 10%)		13,200	
Not qualifying for BADR: (£59,800 × 28%)		16,744	
CGT liability		29,944	
Less: Payment on account		(14,459)	
CGT payable		15,485	

### Working: Basic rate band remaining

	£
BRB	37,500
Less: Taxable income (£27,150 Trading income – £12,500 PA)	(14,650)
Remaining BRB	22,850

Even though Fernanda has £22,850 BRB available, this is used up by her gains qualifying for BADR since these are taxed before her other gains in the tax year.



## Example 5

Tianna is the managing director and sole shareholder of Polka Dot Ltd, a trading company. On 11 November 2020, she sold her entire shareholding resulting in a gain of £565,000. She had subscribed for the shares in July 1993.

Her only other disposal in the tax year 2020/21 was of a painting on 1 August 2020, resulting in a gain of £32,600.

Tianna has capital losses brought forward from the tax year 2019/20 of £1,600 and has made no previous claims for business asset disposal relief (BADR).

Tianna has taxable income of £31,500 in the tax year 2020/21.

**Calculate the capital gains tax payable by Tianna for the tax year 2020/21, assuming all claims for relief are made.**

### Tianna

	BADR gains £	Other gains £
Shares (≥ 5% holding, employee, held ≥ 24 months)	565,000	
Painting		32,600
Less: AEA		(12,300)
Less: Losses b/f		(1,600)
Taxable gains	565,000	18,700
CGT		
£565,000 × 10%	56,500	
£18,700 × 20% (Note)	3,740	
	60,240	

**Note:** The part of the basic rate band not used by Tianna's taxable income is used in full by the gain qualifying for business asset disposal relief.

### 2.3 Investors' relief

BADR is only available on shares if they are in the individual's personal company ( $\geq 5\%$  of the shares) and the individual is an employee of the company.

Investors' relief extends the benefits of BADR to certain investors who would not meet the conditions for BADR.

Investors' relief applies to the disposal of:

- **unlisted ordinary shares in a trading company** (including AIM shares)
- **subscribed** for (i.e. newly issued shares) on/after 17 March 2016
- which have been held for a **minimum period of 3 years** starting on 6 April 2016
- by an individual who is **not an employee** of the company.

Investors' relief is subject to a separate **lifetime limit** from BADR. This allows relief on the first **£10,000,000** of qualifying gains.

## Notes

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## Example 6



On 12 December 2020 Nidhi sold all the shares she had held in Arch Ltd, making a chargeable gain of £12 million on their disposal.

Nidhi purchased the shares on 7 April 2017 when Arch Ltd issued new shares to raise money to fund a new warehouse. Nidhi subscribed for the shares in cash.

Nidhi has never been employed by Arch Ltd and is a higher rate taxpayer.

**Calculate the capital gains tax payable by Nidhi for the tax year 2020/21, assuming all claims for relief are made.**

### Nidhi

	IR gain £	Other gain £
Shares (held > 3 years, subscribed for in cash, not an employee)	10,000,000	
Shares (gain above the £10m lifetime limit)		2,000,000
Less: AEA		(12,300)
	10,000,000	
Taxable gains		1,987,700
<b>CGT</b>	1,000,000	
£10,000,000 × 10%	397,540	
£1,987,700 × 20%		
	1,397,540	

## Notes





## 3 Replacement of business assets relief

### 3.1 Rollover relief



Replacement of business assets relief (rollover relief) (ROR) allows:

- the gain arising on the disposal of a **qualifying business asset**
- to be rolled over (**deferred**)
- when the sale proceeds are reinvested in **new qualifying business assets**
- within the **qualifying time period**.

#### Qualifying business assets

Both the old and replacement assets must be one of the following in TX:

- Goodwill (for unincorporated businesses only)
- Land and buildings
- Fixed plant and machinery (not movable).



Note that shares are **not** qualifying assets for rollover relief.



#### Qualifying time period

- The replacement asset must be purchased:
  - within a period **beginning one year before and ending three years after** the date of sale of the old asset.



#### Claim date

Rollover relief must be **claimed** within **4 years of the later of** the end of the tax year in which the:

- the old asset is disposed, or
- the new asset is purchased.

### 3.2 Operation of the relief

- The gain is deferred by deducting the deferred gain arising on the disposal of the old asset from the acquisition cost of the new asset.
- The gain can be rolled over a number of times.
- Ultimately, the gain on the disposal of the replacement asset is increased, as its base cost has been reduced by the deferred gain. Therefore, the gain that was deferred will eventually crystallise on the disposal of the replacement asset.

### Example 7



Diana bought a factory in June 2004 for £250,000. She added an extension to the factory in July 2007 for £190,000 and then sold it in September 2008 for £989,000.

In October 2007, another factory was bought for £1,130,000 and this was sold in November 2020 for £2,340,000. Both factories were used in her sole trade business.

**Calculate the chargeable gain arising on the disposal of the second building in the tax year 2020/21 assuming all available reliefs are claimed.**

## Notes



**Diana****Gain on disposal of first factory (September 2008)**

	£
Proceeds	989,000
Less: Acquisition cost	(250,000)
Enhancement	(190,000)
	<hr/>
Gain	549,000
Less: ROR	(549,000)
	<hr/>
Chargeable gain	0
	<hr/>

**Base cost of new factory**

	£
Cost	1,130,000
Less: ROR (see above)	(549,000)
	<hr/>
Base cost	581,000
	<hr/>

**Disposal of replacement (November 2020)**

	£
Proceeds	2,340,000
Less: Acquisition cost (see above)	(581,000)
	<hr/>
Chargeable gain	1,759,000
	<hr/>

### 3.3 Partial reinvestment of proceeds

- Full ROR is only available when **all** of the **net proceeds** from the sale of the old asset are reinvested.
- If only some of the net proceeds are reinvested, part of the gain is chargeable at the time of the first disposal.

Chargeable gain now (i.e. gain that cannot be deferred) = **lower** of:

- the amount of the proceeds not reinvested, and
- the full gain.

## Notes

---



## Example 8



Elisa sold an office block, which was always used for the purposes of her trade, in September 2020 for £975,000. It had been originally purchased in June 2007 for £569,000.

She no longer needed the office space but, with the proceeds of the sale, expanded her business in January 2021 by taking over the unincorporated business of her main competitor. She consequently made a significant payment for the goodwill of the competitor business.

**Calculate the chargeable gain, if any, arising on the sale of the office block (assuming all available reliefs are claimed), and the base cost of the goodwill if the cost of the goodwill was:**

(a) £910,000

(b) £515,000.

## Notes



### Elisa

#### Chargeable gain – 2020/21

	(a)	(b)
	£910,000	£515,000
	£	£
Proceeds	975,000	975,000
Less: Cost	(569,000)	(569,000)
Gain before relief	406,000	406,000
Less: ROR (balancing figure)	(341,000)	(0)
Chargeable gain (W)	65,000	406,000

#### Working: Chargeable gain now

= Lower of:

Proceeds not reinvested:

(£975,000 – £910,000)

(£975,000 – £515,000)

Gain before relief (above)

**65,000**

460,000

406,000

**406,000**

#### Base cost of goodwill

	£	£
Cost	910,000	515,000
Less: ROR	(341,000)	(0)
Base cost of new goodwill	569,000	515,000

### 3.4 Non-business use

- If an asset has been used for business and non-business purposes:
  - only the gain relating to the business proportion is eligible for ROR.

## Example 9



Michael purchased a factory on 1 November 2004 for £300,000 and sold it on 1 November 2020 for £1,450,000. The factory was used throughout the whole period of ownership for the purposes of Michael's trade with the exception of the period from 1 January 2008 to 31 December 2009 when, as a result of a trial period of outsourcing his manufacturing arrangements, Michael let his own factory out.

In February 2021 Michael bought another factory for £1,400,000 which he used 100% for business purposes.

**Calculate the gain on the disposal of the factory in November 2020 and the base cost of the replacement factory, assuming all available reliefs are claimed.**

## Notes



### Michael

#### Gain on disposal of factory (November 2020)

	Total	Business 14 years	Non- business 2 years
	£	£	£
Proceeds ( $^{14}/_{16} : ^{2}/_{16}$ )	1,450,000	1,268,750	181,250
Cost ( $^{14}/_{16} : ^{2}/_{16}$ )	(300,000)	(262,500)	(37,500)
Split of gain ( $^{14}/_{16} : ^{2}/_{16}$ )	1,150,000	1,006,250	143,750
Less: ROR	(1,006,250)	(1,006,250)	0
Chargeable gain	143,750	0	143,750

The amount reinvested, within the qualifying time period, is the full sale proceeds received on the first building relating to the trade use of the building (i.e. £1,268,750), therefore ROR is available in full on the business portion of the gain. ROR is not available on the non-business element of the gain.

#### Base cost of replacement factory

	£
Cost	1,400,000
Less: ROR	(1,006,250)
Base cost	393,750



### 3.5 Depreciating assets



A **depreciating asset** = an asset with an expected life of  $\leq 60$  years.

- For TX, depreciating assets are:
  - fixed plant and machinery
  - a lease for qualifying land and buildings with  $\leq 60$  years left to run.
- If the replacement asset is a depreciating asset, the gain is not deducted from the cost of the new asset, it is 'frozen' and deferred until it crystallises on the **earliest of**:
  - disposal of the depreciating asset
  - ten years from the acquisition of the depreciating asset
  - the date the depreciating asset ceases to be used in the trade.



Maximum deferral into a depreciating asset = **10 years**

- CGT is charged at the appropriate rate applicable on the date the gain crystallises.
- A gain deferred following the purchase of a depreciating asset can be rolled into a non-depreciating asset, if it is acquired before the gain becomes chargeable.

## Notes



### Example 10



Zameer purchased a freehold factory on 28 August 1990 and on 26 July 2007 he sold it for £1,200,000 realising a chargeable gain of £585,000.

On 1 November 2008 Zameer bought fixed plant and machinery for £1,260,000. Any available capital allowances were claimed on the plant and machinery.

On 2 February 2021, he sold the fixed plant and machinery for £1,105,000.

**Calculate the chargeable gains arising in respect of the sale of the freehold factory and the fixed plant and machinery, assuming Zameer claims to roll over the gains where possible.**

### Notes



**Zameer****Disposal of factory (July 2007) – 2007/08**

	£
Gain	585,000
Less: Gain deferred	(585,000)
	<hr/>
Chargeable gain (proceeds not reinvested)	0
	<hr/>

- Amount reinvested (£1,260,000) > SP received for the factory (£1,200,000).
- Reinvestment = within the qualifying period and a qualifying business asset (fixed plant and machinery).
- Therefore, all of the gain of £585,000 can be deferred.
- However, as reinvestment is in a depreciating asset, the deferred gain is not deducted from the base cost of the plant and machinery:  
It is 'frozen' and becomes chargeable on the earliest of:
  - the sale of the fixed plant and machinery (February 2021)
  - ceasing to use the plant and machinery in the trade (likely to be February 2021)
  - ten years from the acquisition of the plant and machinery (November 2018).

**Chargeable event (earliest date = November 2018) – 2018/19**

The deferred gain of £585,000 becomes chargeable in November 2018.

**Disposal of plant and machinery (February 2021) – 2020/21**

There is no allowable loss on the disposal of the plant and machinery as the fall in value will have been relieved by the capital allowances claimed.

# 4 Gift relief

## 4.1 Gift relief

The gift of an asset may give rise to a CGT liability for the donor, even though the donor has not received any funds with which to pay the tax.



Gift relief (GR) allows the gain on the gift of certain assets to be held over (**deferred**) until the asset is eventually **sold by the donee**.

As a result:

- there is no gain (or a reduced gain) arising on the donor at the time of the gift, and
- the chargeable gain arises on the donee later and will be taxed at the appropriate rate of CGT applicable on the date of that disposal.

Provided a **claim is made**, gift relief is available:

- on the outright gift, or sale at undervaluation
- by an **individual**
- of the following **qualifying assets**:
  - Assets used in the trade of the donor (i.e. where he/she is a sole trader or a partner in a partnership); or the donor's personal company
  - Unquoted trading shares/securities (regardless of the number of shares held)
  - Quoted shares/securities of donor's personal trading company.



Remember that a donor's **personal company** is one in which he or she has at least 5% of the voting rights.

## Notes



## 4.2 Operation of the relief

Donor	Donee												
<ul style="list-style-type: none"> <li>➤ Gain = calculated using MV at date of gift as proceeds.</li> <li>➤ The deferred gain is not chargeable: it is deducted from the 'acquisition cost' for the donee.</li> </ul>	<ul style="list-style-type: none"> <li>➤ Acquisition cost = MV at date of gift</li> <li>➤ Base cost: <table> <tr> <td></td><td>£</td></tr> <tr> <td>MV at date of gift</td><td>X</td></tr> <tr> <td>Less: Gain deferred by donor</td><td>(X)</td></tr> <tr> <td></td><td>—</td></tr> <tr> <td>Base cost to donee</td><td>X</td></tr> <tr> <td></td><td>—</td></tr> </table> </li> </ul>		£	MV at date of gift	X	Less: Gain deferred by donor	(X)		—	Base cost to donee	X		—
	£												
MV at date of gift	X												
Less: Gain deferred by donor	(X)												
	—												
Base cost to donee	X												
	—												



A **joint claim** (i.e. donor and donee must both sign) for relief must be made **within four years of the end of the tax year** in which the gift takes place (i.e. by 5 April 2025 for 2020/21 gifts).

## Notes





## Example 11

Elias is a greengrocer. He gifted his shop to his son and at that date the shop was worth £978,000. Elias had bought the shop ten years ago for £225,000 and had subsequently spent £96,000 adding a storeroom at the back.

**Show Elias' capital gains tax position on the gift to his son and calculate his son's base cost of the asset, assuming all available reliefs are claimed.**

**Elias**

**Elias' gain:**

	£
Market value of asset	978,000
Less: Cost	(225,000)
Enhancement expenditure	(96,000)
	<hr/>
	657,000
Less: GR	(657,000)
	<hr/>
Chargeable gain	0
	<hr/>

**Base cost to son:**

	£
Market value of asset acquired	978,000
Less: GR claimed	(657,000)
	<hr/>
Base cost	321,000
	<hr/>

## Notes



### 4.3 Planning points to consider with regard to GR

- Gift relief = optional and must be claimed.
- It may be advantageous not to claim GR and to leave the gain in charge to CGT on the donor. Consideration should therefore be given to the following factors when deciding whether, or not, it is advisable to claim GR:
  - the amount of gain being deferred:  
if is small, it may otherwise be covered by the AEA of the donor
  - the rates of tax for donor and subsequently for donee:  
if the donor would qualify for BADR or IR, but the donee would not, it may be preferable to leave the gain in charge at the time the gift is made
  - whether the donor wants to achieve a certain result:  
for example, to leave gains in charge to cover the AEA and/or losses b/f.

Note that partial GR claims cannot be made, however the desired result can be achieved by selling the asset to the donee for an amount in excess of the donor's original cost (see below).

### 4.4 Sales at an undervalue

GR applies to both outright gifts and sales at undervalue, as there is an element of gift in the transaction.

The chargeable gain and gift relief calculations are as follows:

- The MV at the date of the sale at undervalue is used as the proceeds in calculating the gain (i.e. the actual proceeds received is ignored).
- If the actual proceeds received  $\leq$  original cost of the asset:
  - gift relief available = all of the gain (as if it were an outright gift)
- If the actual proceeds received  $>$  original cost of the asset:
  - any excess = chargeable to CGT at the date of the sale at undervaluation
  - gift relief available = the remainder of the gain.

## Notes





## Example 12

Glenn sold a freehold shop to his grandson, Paul, for £180,000. The shop cost £150,000 five years ago and has been used by Glenn for the purposes of trade throughout the period of ownership. The current market value of the shop is £480,000.

Glenn and Paul make a joint gift relief claim.

**Calculate the chargeable gain arising for Glenn and the base cost of the shop for Paul.**

### Glenn

#### Sale at undervalue – gain for Glenn

	£
Proceeds (= market value)	480,000
Less: Cost	(150,000)
	<hr/>
Gain	330,000
Less: GR (β)	(300,000)
	<hr/>
Chargeable gain (W)	30,000
	<hr/>

### Working

	£
Actual proceeds	180,000
Less: Cost	(150,000)
	<hr/>
Chargeable gain	30,000
	<hr/>

### Base cost for Paul

	£
Market value of asset acquired	480,000
Less: GR	(300,000)
	<hr/>
Base cost	180,000
	<hr/>



#### 4.5 Assets not used wholly for trade purposes

The relief is restricted if part of the asset is used for non-trading purposes, in the same way as ROR is restricted. The restriction does not apply to shares unless they are shares in the personal trading company of the donor (see below).

#### 4.6 Shares in a personal trading company

➤ Where the assets being gifted are shares in donor's personal trading company:

- Gift relief is restricted to = **Total gain × (CBA/CA)**

Where CBA = MV of chargeable business assets of the company

CA = MV of chargeable assets of the company



**Chargeable assets** = assets which would give rise to a chargeable gain on disposal (excludes exempt assets, e.g. cars)

**Chargeable business assets** = chargeable assets (defined above) used for the trade (excludes investments, e.g. shares)

## Notes



### Example 13



In October 2020 James makes a gift of 2,500 shares (representing a 25% holding) in Spofford Ltd, a trading company, to his daughter Gemma when they were worth £30 each. He acquired the shares in August 2007 at a cost of £5 each.

James and Gemma make a joint claim for gift relief.

In October 2020, the market value of the company's total assets was £800,000 of which £150,000 represented net current assets (inventory, receivables and cash), £550,000 represented land & buildings and £100,000 represented investment properties.

**Calculate the gain chargeable on James in the tax year 2020/21 and the base cost of the shares for Gemma.**

### Notes



## James

### Chargeable gain – 2020/21

	£
Proceeds = MV (2,500 × £30)	75,000
Less: Cost (2,500 × £5)	(12,500)
Gain before relief	62,500
Less: GR (W1)	(52,885)
Chargeable gain	9,615

### Base cost for Gemma

	£
Market value	75,000
Less: GR	(52,885)
Base cost	22,115

## Workings

### (W1) Gift relief

$$\text{GR} = \text{Gain before relief} \times (\text{CBA}/\text{CA})$$

$$= £62,500 \times (£550,000/£650,000) \text{ (W2)} = £52,885$$

### (W2) CBA and CA

	CA £	CBA £
Land and buildings	550,000	550,000
Inventory, receivables and cash	n/a	n/a
Investments	100,000	n/a
	650,000	550,000

### Questions



You should now be able to answer TYU questions 1 to 17 from the Study Text Chapter 22 as well as the question 'Takunda' from Chapter 27.

Knowledge Check Test: Capital gains tax on MyKaplan.

For further reading, visit Chapter 22 of the Study Text and review the TX article on 'chargeable gains part 1' at [www.accaglobal.com](http://www.accaglobal.com).

# Chapter 22

## Chargeable gains for companies



### Outcome

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Upon completion of this Chapter you will be able to:

- compute and explain the treatment of chargeable gains
- explain and compute the indexation allowance available using a given indexation factor
- explain and compute the treatment of capital losses
- understand the treatment of disposals of shares by companies and apply the identification rules including the same day and nine day matching rules
- explain and apply the pooling provisions
- explain and apply the treatment of bonus issues, rights issues, takeovers and reorganisations
- explain and apply rollover relief

and answer questions relating to these areas.



PER

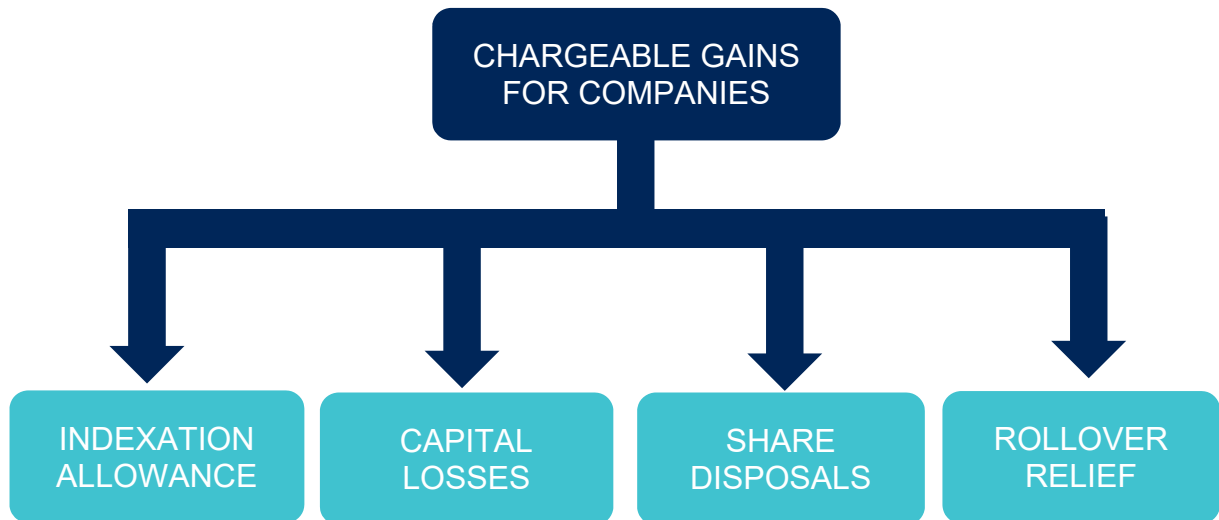
One of the PER performance objectives (PO15) is to prepare computations of taxable amounts and tax liabilities according to legal requirements. Another objective (PO17) is to advise on mitigating and deferring liabilities through legitimate tax planning measures. Working through this chapter should help you understand how to demonstrate those objectives.

The underpinning detail for this Chapter in your Integrated Workbook can be found in Chapter 23 of your Study Text



### Overview

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# 1 Chargeable gains for a company

## 1.1 Introduction

Corporation tax is charged on any chargeable gains made by a company.

The net chargeable gains made in an accounting period (after deduction of current year and brought forward losses) form part of TTP.

The pro forma chargeable gains calculation for companies is as follows:

	£
Disposal proceeds (or MV if gift)	X
Less: Incidental disposal costs	(X)
	<hr/>
Net proceeds	X
Less: Allowable expenditure:	
Acquisition cost	(X)
Incidental costs of acquisition	(X)
Enhancement expenditure	(X)
	<hr/>
Unindexed gain/(allowable loss)	X/(X)
Less: Indexation allowance (see below)	(X)
	<hr/>
Chargeable gain/(allowable loss)	X/(X)
	<hr/>

The calculation of chargeable gains is the same as for individuals except:

- Companies receive an **indexation allowance**, which gives relief for inflation between the month of acquisition and the month of disposal (or December 2017 if earlier).
- Companies are not entitled to the AEA.
- Some other differences exist with regard to the treatment of capital losses, the treatment of shares and securities and the availability of reliefs.

## Notes





# 2 Indexation allowance

## 2.1 Calculation of indexation allowance



**Indexation allowance (IA)** uses the rise in the retail price index (RPI) as an allowance for the effects of inflation.

To calculate the IA for each asset use:

Relevant indexation factor × capital expenditure

- The relevant indexation factors will be given in a question if necessary.
- The indexation factor is applied to the **acquisition cost** (including incidental costs of acquisition) and **enhancement costs** separately (as these will be incurred on a different date).
- You should use the indexation factor provided in the question for the movement from the month of expenditure to the month of disposal (or December 2017 if earlier).
- The IA is deducted from the gain but **cannot create or increase a loss**. Unused indexation allowance is wasted.
- If the RPI falls, rather than increases, between the date of acquisition and the date of disposal, then the indexation allowance is £Nil.

## Notes





## Example 1

Iceberg Ltd bought an office block for £215,000 on 1 May 1993, incurring additional £6,700 legal costs on the acquisition.

On 29 July 1995 the company spent £46,100 on extending it.

The office block was sold on 31 August 2020 for £695,000, from which costs of disposal of £7,500 were deducted.

Assume that the relevant indexation factors are as follows:

May 1993 to December 2017	0.971
May 1993 to August 2020	1.099
July 1995 to December 2017	0.865
July 1995 to August 2020	0.987

**Calculate the chargeable gain arising on the disposal of the factory by Iceberg Ltd.**

### Iceberg Ltd

	£	£
Disposal proceeds		695,000
Less: Incidental costs of disposal		(7,500)
		<hr/>
Net disposal proceeds		687,500
Less: Cost	215,000	
Incidental costs of acquisition	6,700	
	<hr/>	
		(221,700)
Enhancement expenditure		(46,100)
		<hr/>
Unindexed gain		419,700
Less: Indexation allowance		
On cost:		
$0.971 \times £221,700$ (Note)		(215,271)
On enhancement expenditure:		
$0.865 \times £46,100$ (Note)		(39,877)
		<hr/>
Chargeable gain		164,552
		<hr/>

**Note:** Indexation allowance was frozen at December 2017.



## Example 2

Acute plc bought a factory £472,000 on 1 September 1985.

It sold it for £711,000 on 31 August 2020.

Assume that the relevant indexation factors are as follows:

September 1985 to December 2017      1.914

September 1985 to August 2020          2.104

- (a) Calculate the chargeable gain or allowable loss arising on the disposal of the factory by Acute plc.
- (b) What difference would it have made had the factory been sold for £360,000?

### Acute Ltd

#### (a) Chargeable gain/allowable loss

	£
Disposal proceeds	711,000
Less: Cost	(472,000)
	<hr/>
Unindexed gain	239,000
Less: Indexation allowance	
$1.914 \times £472,000 = £903,408$ , but restricted to	(239,000)
	<hr/>
Chargeable gain	0
	<hr/>

**Note:** Indexation allowance is restricted because it can only be used to reduce a gain and not to create, or increase a loss. In addition, indexation allowance was frozen at December 2017.

### (b) Chargeable gain/allowable loss

If the asset had been sold for £360,000, no indexation allowance would have been available since there is a loss before deducting the indexation allowance. Thus the result would become:

	£
Disposal proceeds	360,000
Less: Cost	(472,000)
	<hr/>
Unindexed loss	(112,000)
Less: Indexation allowance	0
	<hr/>
Capital loss	(112,000)
	<hr/>

## Notes



### 3 Capital losses

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#### 3.1 Use of capital losses by companies

- Capital losses must be offset against current year chargeable gains.
- Any remaining loss is carried forward and offset against future gains.
- As for individuals, capital losses cannot be carried back.



Capital losses can only be offset against chargeable gains; they cannot be offset against other types of income.

## Notes

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# 4 Shares and securities

### 4.1 Matching rules

The matching rules for companies are different from those for individuals.

Where shares are sold by companies, they are matched against acquisitions in the following order:

- (1) Shares acquired on the **same day**
- (2) Shares acquired during the **nine days before** the sale (on a FIFO basis)
- (3) Shares in the **share pool**.



The **share pool** contains all of the shares bought more than nine days before the sale.

If a bonus or rights issue occurs, these new shares attach to those already held within the pool.

## Notes



### 4.2 Indexation

No indexation is available on the shares acquired during the nine days before the sale, even if the purchase was in the previous month.

In the share pool, indexation must be calculated at each operative event.



An **operative event** occurs when shares are bought or sold (e.g. a rights issue). A bonus issue is not an operative event since no cost is involved.

To calculate the indexation on the share pool, take the following steps:

- (1) Record the first acquisition of shares.
- (2) Index the pool up to the date of the next operative event (or December 2017 if earlier).
- (3) Record the operative event.
- (4) Repeat steps 2 + 3 until you have recorded the disposal of shares.
- (5) Calculate the cost of shares being disposed.

## Notes

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## Chapter 22

### 4.3 Pro forma for a company's share pool and gain calculation

	Number of shares	Cost £	Indexed cost £
Purchase	X	X	X
Index to next operative event (or December 2017 if earlier)			X
Purchase	X	X	X
	<hr/>	<hr/>	<hr/>
	X	X	X
Index to next operative event (or December 2017 if earlier)			X
	<hr/>	<hr/>	<hr/>
	X	X	X
Sale	(X)	(X) W1	(X) W2
	<hr/>	<hr/>	<hr/>
Pool balance carried forward	X	X	X
	<hr/>	<hr/>	<hr/>
(W1) Calculates average pool cost of shares disposed of			
(W2) Calculates average indexed cost of shares disposed of			
<b>Chargeable gain:</b>			
		£	
Sale proceeds		X	
Less: Cost (W1)		(X)	
		<hr/>	
Unindexed gain		X	
Less: Indexation allowance (W2 – W1)		(X)	
		<hr/>	
Chargeable gain		X	
		<hr/>	

## Notes







## Example 3

Chapman Ltd had the following acquisitions of shares in Green Ltd:

	Shares acquired	Cost £
16 September 1989	1,750	1,925
1 October 1996	5,250	5,500
28 September 2020	100	390

On 3 October 2020 Chapman Ltd sold 6,000 shares for £28,250.

Assume the indexation factors are as follows:

September 1989 to October 1996	0.319
September 1989 to December 2017	1.385
September 1989 to October 2020	1.554
October 1996 to December 2017	0.808
October 1996 to October 2020	0.936

**Calculate the chargeable gain on the sale in October 2020.**

### Chapman Ltd

#### Matching

Last 9 days shares	100
Share pool	5,900
	<hr/>
	6,000
	<hr/>

#### Calculation of the gain on disposal of 100 shares acquired in last 9 days

	£
Proceeds ( $£28,250 \times 100/6,000$ )	471
Less: Cost	(390)
	<hr/>
Chargeable gain	81
	<hr/>

### Calculation of the gain on disposal of 5,900 shares from the pool

Proceeds ( $\pounds 28,250 \times 5,900/6,000$ )	27,779
Less: Cost (W)	(6,258)
	<hr/>
Unindexed gain	21,521
Less: Indexation ( $\pounds 12,251 - \pounds 6,258$ ) (W)	(5,993)
	<hr/>
Chargeable gain	15,528
	<hr/>

**Total gain on disposal of 6,000 shares =  $\pounds 81 + \pounds 15,528 = \pounds 15,609$**

### Working: Share pool

	No.	Cost	Indexed cost
		£	£
<b>September 1989</b> – acquisition	1,750	1,925	1,925
Indexed rise			
$0.319 \times \pounds 1,925$			614
<b>October 1996</b> – acquisition	5,250	5,500	5,500
	<hr/>	<hr/>	<hr/>
	7,000	7,425	8,039
Indexed rise			
$0.808 \times \pounds 8,039$ (Note)			6,496
	<hr/>	<hr/>	<hr/>
	7,000	7,425	14,535
<b>October 2020</b> – disposal	(5,900)	(6,258)	(12,251)
	<hr/>	<hr/>	<hr/>
c/f	1,100	1,167	2,284
	<hr/>	<hr/>	<hr/>

**Note:** The indexation allowance was frozen at December 2017.

## Notes



## Example 4



Formosa Ltd had the following transactions in Ria plc:

March 1997      Acquired 3,600 shares for £6,400

February 2002      Rights issue: 1 for 3 acquired at £4.10 per share

In July 2020 Formosa Ltd sold all the shares for £7 per share.

Assume the indexation factors are as follows:

March 1997 to February 2002	0.118
March 1997 to December 2017	0.790
March 1997 to July 2020	0.901
February 2002 to December 2017	0.600
February 2002 to July 2020	0.700

- (a) Calculate the chargeable gain on the sale.
- (b) Calculate the chargeable gain on the sale as if the rights issue had been a bonus issue.

## Notes



## Chapter 22

### Formosa Ltd

#### (a) Gain with rights issue

	£
Disposal proceeds ( $4,800 \times £7$ )	33,600
Less: Cost (W)	(11,320)
	<hr/>
Unindexed gain	22,280
Less: Indexation ( $£19,320 - £11,320$ ) (W)	(8,000)
	<hr/>
Chargeable gain	14,280
	<hr/>

#### Working: Share pool

	No.	Cost £	Indexed cost £
<b>March 1997</b> – acquisition	3,600	6,400	6,400
Indexed rise $0.118 \times £6,400$			755
<b>February 2002</b> – rights 1:3 @ £4.10	1,200	4,920	4,920
			<hr/>
			12,075
Indexed rise $0.600 \times £12,075$ (Note)			7,245
	<hr/>	<hr/>	<hr/>
	4,800	11,320	19,320
<b>July 2020</b> – disposal	(4,800)	(11,320)	(19,320)
	<hr/>	<hr/>	<hr/>
c/f	0	0	0
	<hr/>	<hr/>	<hr/>

**Note:** The indexation allowance was frozen at December 2017.

## (b) Gain with bonus issue

	£
Disposal proceeds (4,800 × £7)	33,600
Less: Cost (W)	(6,400)
	<hr/>
Unindexed gain	27,200
Less: Indexation (£11,456 – £6,400) (W)	(5,056)
	<hr/>
Chargeable gain	22,144
	<hr/>

## Working: Share pool

	No.	Cost £	Indexed cost £
<b>March 1997</b> – acquisition	3,600	6,400	6,400
<b>February 2002</b> – bonus issue 1:3			
Not an operative event	1,200	0	0
Indexed rise			
0.790 × £6,400 (Note)			5,056
	<hr/>	<hr/>	<hr/>
	4,800	6,400	11,456
<b>July 2020</b> – disposal	(4,800)	(6,400)	(11,456)
	<hr/>	<hr/>	<hr/>
c/f	0	0	0
	<hr/>	<hr/>	<hr/>

**Note:** The indexation allowance was frozen at December 2017.

# 5 Takeovers/reorganisations

---

## 5.1 Impact of indexation

The rules on takeovers and reorganisations are the same for companies as they are for individuals:

- the new shares stand in the shoes of the old shares
- if there is a mixture of cash and shares, then the original cost has to be apportioned between the different elements, and a gain for the cash consideration must be performed.

The only difference is that indexation allowance must be taken into account.

## Notes

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## Example 5

Melon Ltd acquired 4,000 shares in Pear Ltd in August 2003 at a cost of £6,000. The company was taken over in July 2012 by Banana Ltd and for each share in Pear Ltd, Melon Ltd acquired 3 ordinary shares and 2 preference shares in Banana Ltd. At the time of the takeover, each ordinary share in Banana Ltd was valued at £0.85 and each preference share at £0.65.

In March 2021 Melon Ltd sold 4,000 of its ordinary shares in Banana Ltd for £14,400.

Relevant indexation factors are as follows:

August 2003 to July 2012	0.333
August 2003 to December 2017	0.531
August 2003 to March 2021	0.662
July 2012 to December 2017	0.149
July 2012 to March 2021	0.247

- (a) Calculate the chargeable gain in March 2021.
- (b) Calculate the gain arising in July 2012 if Melon Ltd had received cash of £1.30 per share rather than the preference shares and show the revised cost and indexed cost of the ordinary shares at that date.

## Melon Ltd

### (a) Chargeable gain for ordinary shares

	£
Disposal proceeds	14,400
Less: Cost (W3)	(1,325)
	<hr/>
Unindexed gain	13,075
Less: Indexation (£2,029 – £1,325) (W3)	(704)
	<hr/>
Chargeable gain	12,371
	<hr/>

### Workings

#### (W1) Share pool – Pear Ltd shares

	No.	Cost	Indexed cost
		£	£
<b>August 2003</b> – acquisition	4,000	6,000	6,000
Indexed rise to takeover (0.333)			1,998
		<hr/>	<hr/>
Balance at takeover		6,000	7,998
		<hr/>	<hr/>

#### (W2) Allocation of cost of shares in Pear Ltd

	MV	Cost	Indexed cost
	£	£	£
<b>Melon Ltd acquired:</b>			
Ordinary shares ( $4,000 \times 3 = 12,000 \times £0.85$ )	10,200	3,974	5,297
( $10,200/15,400 \times £6,000/£7,998$ )			
Preference shares ( $4,000 \times 2 = 8,000 \times £0.65$ )	5,200	2,026	2,701
( $5,200/15,400 \times £6,000/£7,998$ )			
	<hr/>	<hr/>	<hr/>
	15,400	6,000	7,998
	<hr/>	<hr/>	<hr/>
		(W1)	(W1)



## (W3) Share pool – Ordinary shares in Banana Ltd

	No.	Cost	Indexed cost
		£	£
<b>July 2012</b> – Takeover (W2)	12,000	3,974	5,297
Indexation July 2012 – Dec 2017 (0.149 × £5,297) (Note)			789
	12,000	3,974	6,086
<b>March 2021</b> – disposal	(4,000)	(1,325)	(2,029)
c/f	8,000	2,649	4,057

## (b) Chargeable gain for cash received in July 2012

	£
Disposal proceeds (= cash received)	5,200
Less: Cost (W4)	(2,026)
Unindexed gain	3,174
Less: Indexation (£2,701 – £2,026) (W4)	(675)
Chargeable gain	2,499

## (W4) Allocation of cost of shares in Pear Ltd

Melon Ltd acquired	MV	Cost	Indexed cost
	£	£	£
Ordinary shares (as in (a))	10,200	3,974	5,297
Cash (£1.30 × 4,000)	5,200		
(5,200/15,400) × £6,000/£7,998		2,026	2,701
	15,400	6,000	7,998
		(W1)	(W1)

**Note:** Indexation allowance has been frozen at December 2017.

# 6 Reliefs available to companies

## 6.1 Rollover relief

The only capital gains relief available to companies is rollover relief

- Relief can be claimed for:
  - gains on disposal of qualifying business assets (QBAs):
    - land and buildings used in the trade
    - fixed plant and machinery
  - where proceeds are reinvested in new QBAs
  - within the time period:
    - 12 months before disposal to 3 years after disposal.

The rules work in the same way as individuals (Chapter 21), subject to the following:

- Goodwill is not a qualifying asset for companies.
- The gain deferred is the indexed gain.



- The time limit for claiming the relief is four years from the later of the end of the accounting period in which the asset is
  - sold
  - replaced.

## Notes





## Example 6

Davies plc bought a factory for £329,000 on 1 May 1993. The factory was sold on 31 August 2020 for £713,000 and a replacement factory was acquired for £1,250,000 at the end of 2020.

Both the old factory and the new factory were used for the purposes of the trade of Davies plc.

Assume that the relevant indexation factors are as follows:

May 1993 to December 2017	0.971
May 1993 to August 2020	1.099

**Calculate the chargeable gain arising on the disposal of the factory by Davies plc and the base cost of the replacement, assuming all available reliefs are claimed.**

### Davies plc

	£
Disposal proceeds	713,000
Less: Cost	(329,000)
	<hr/>
Unindexed gain	384,000
Less: Indexation allowance	
On cost:	
0.971 × £329,000	(319,459)
	<hr/>
Gain	64,541
Less: Rollover relief	(64,541)
	<hr/>
Chargeable gain	0
	<hr/>

Cost of replacement = £1,250,000 – £64,541 = £1,185,459

Full rollover is possible because the net disposal proceeds are fully reinvested in another qualifying asset within the requisite period of time.

### Questions



You should now be able to answer TYU questions 1 to 11 from the Study Text Chapter 23 as well as the question 'Earth Ltd' from Chapter 27.

For further reading, visit Chapter 23 of the Study Text and review the TX article on 'chargeable gains part 2' at [www.accaglobal.com](http://www.accaglobal.com).

# Chapter 23

## Inheritance tax



### Outcome

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Upon completion of this Chapter you will be able to:

- identify the persons chargeable
- understand and apply the meaning of transfer of value, chargeable transfer and potentially exempt transfer
- demonstrate the diminution in value principle
- demonstrate the seven year accumulation principle taking into account changes in the level of the nil rate band
- understand the tax implications of lifetime transfers and compute the relevant liabilities
- understand and compute the tax liability on a death estate
- understand and apply the transfer of any unused nil rate band between spouses
- understand and apply the residence nil rate band available when a residential property is inherited by direct descendants
- understand and apply the following exemptions: small gifts exemption; annual exemption; normal expenditure out of income; gifts in consideration of marriage; gifts between spouses
- basic inheritance tax planning
- identify who is responsible for the payment of inheritance tax and the due date for payment of inheritance tax

and answer questions relating to these areas.

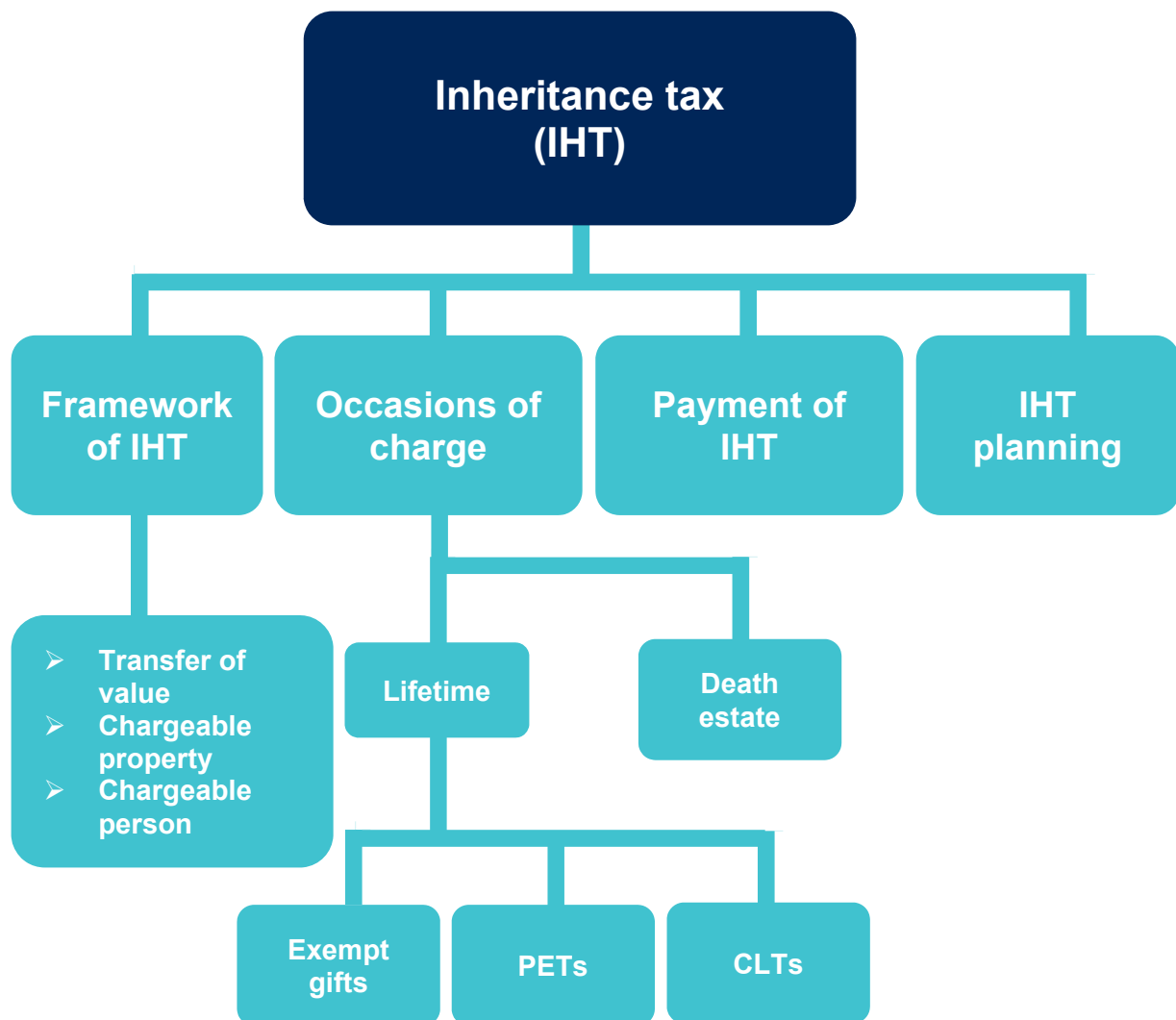


One of the PER performance objectives (PO15) is to prepare computations of taxable amounts and tax liabilities according to legal requirements. Another objective (PO17) is to advise on mitigating and deferring liabilities through legitimate tax planning measures. Working through this chapter should help you understand how to demonstrate those objectives.

The underpinning detail for this Chapter in your Kaplan Integrated Workbook can be found in Chapter 24 of the Study Text



## Overview



# 1 Scope of inheritance tax

## 1.1 Scope of inheritance tax

To be within the scope of inheritance tax (IHT) there must be:

<b>TRANSFER OF VALUE</b>	<b>= gift of any asset</b> resulting in a <b>reduction in the donor's estate</b>
<b>of</b>	
<b>CHARGEABLE PROPERTY</b>	<b>= all property</b> to which donor is beneficially entitled
<b>by a</b>	
<b>CHARGEABLE PERSON</b>	<b>An individual who is:</b> <b>UK domiciled</b> (chargeable on worldwide assets) <b>Not UK domiciled</b> (chargeable on UK assets only) In TX all individuals will be UK domiciled

Transfers of value **include** both:

- the wealth a person leaves when he or she dies (the death estate), and
- lifetime transfers (any gift which reduces the donor's estate)

and **exclude**:

- a bad business deal, with no gratuitous intent.

## Notes





## 1.2 Transfer value

Transfers are valued using the **diminution in value** concept for IHT purposes = the **loss to the donor** as a result of the gift.

- Loss to the donor usually = open market value (MV) at the time of the transfer.
- But in some cases the loss to the donor  $\neq$  open MV  
i.e. unquoted shares – a controlling shareholding has a higher value per share than a minority shareholding.

### Example 1



Mr T owns 75% of A-Team Ltd. He gives a 20% shareholding to his son, Murdock, during his lifetime.

The values agreed with HMRC are:

75% holding	£150,000
55% holding	£80,000
20% holding	£35,000

**Show the value of the shares transferred:**

- (a) for the purposes of inheritance tax, and
- (b) for the purposes of capital gains tax.

**Mr T**

**Value for the purposes of inheritance tax**

	£
Value of estate before: 75% holding	150,000
Value of estate after: 55% holding	(80,000)
	<hr/>
Diminution in value/transfer value	70,000
	<hr/>

**Value for the purposes of capital gains tax**

	£
Proceeds = MV	35,000
	<hr/>

# 2 Lifetime gifts

## 2.1 Types of lifetime transfer

There are three types of lifetime transfer.



**Exempt transfers** (see section 2.2 below) = no IHT at any point.



**Potentially exempt transfers (PETs)**

= a gift by an individual to another individual

- At the time the PET is made = no IHT is chargeable
- If the donor lives seven years  
= no IHT is chargeable (gift becomes exempt)
- If the donor dies within the next seven years  
= the PET becomes chargeable.



**Chargeable lifetime transfers (CLTs)** – for TX

= transfers into trusts.

Gifts in the exam will be referred to as gifts into a trust – in practice these are often gifts into discretionary trusts.

IHT is chargeable on a CLT both:

- at the time the gift is made (at lifetime rates), and
- at the time of death (at death rates), if the donor dies within seven years.

## Notes



## 2.2 Lifetime exemptions

The following exemptions apply to lifetime gifts only:

### Small gifts exemption

- Lifetime gifts = exempt if they are:
  - an outright gift to an individual ≤ £250
  - per recipient
  - per tax year.
- This exemption cannot exempt part of a larger gift.
- Gifts to any number of recipients can be covered by the exemption.

### Marriage/civil partnership exemption

- Relief is given for gifts made to a party of the marriage/civil partnership.
- Amount depends on the relationship of the donor to the recipient:
  - **£5,000** by a parent
  - **£2,500** by a grandparent or remoter ancestor
  - **£2,500** by a party to the marriage or the civil partnership
  - **£1,000** by anyone else.

Note that these limits are **not given** in the tax tables in the exam.

- Note that this exemption:
  - is 'in consideration of marriage' therefore the marriage must take place
  - can exempt part of a larger gift.

### Normal expenditure out of income

- A lifetime gift will be exempt if it:
  - is a regular, habitual payment (e.g. payment of children's school fees by grandparents)
  - is made out of the donor's income (not capital)
  - does not impact the donor's standard of living.

### Annual exemption (AE)

- The **first £3,000** gifted each tax year, which is not covered by other exemptions or reliefs, is exempt.
- Unused AE = carried forward **one tax year only**.
- Current year AE must be offset before unused AE brought forward.
- It is always applied chronologically even if the first gift is a PET that never becomes chargeable.

## Notes

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## 2.3 Exemptions for lifetime transfers and the death estate

Transfers made **between spouses or civil partners**, whether made during someone's lifetime or on death and regardless of the value, are **always exempt** from IHT.

### Example 2



Soraya made the following gifts:

15 April 2019	£2,200 to grandson
16 July 2019	£21,000 to her civil partner
20 November 2019	£2,900 to her niece on her 18 <sup>th</sup> birthday
9 April 2020	£7,200 to her brother on his marriage
10 July 2020	£245 to a neighbour

**Calculate the chargeable amount of each of the gifts after deduction of all exemptions, assuming Soraya had not made any previous gifts.**

#### Soraya

	2019/20 15.4.2019	2019/20 16.7.2019	2019/20 20.11.2019	2020/21 9.4.2020	2020/21 10.7.2020
	£	£	£	£	£
Transfer of value	2,200	21,000	2,900	7,200	245
Less: Exemptions					
Inter-spouse		(21,000)			
Small gifts					(245)
Marriage				(1,000)	
AEs					
– CY (2019/20)	(2,200)	–	(800)		–
– PY (2018/19)	–	–	(2,100)		–
– CY (2020/21)				(3,000)	
– PY (2019/20)				(0)	
Chargeable amount	0	0	0	3,200	0

## 3 Lifetime tax on CLTs

### 3.1 Calculating lifetime tax

CLTs are immediately chargeable to IHT. Each gift is charged separately, in **chronological order**, as follows:

- (1) Calculate the **chargeable amount** of the gift (PETs and CLTs).
- (2) Calculate the amount of **nil rate band** available (CLTs only).
- (3) Calculate the tax at the appropriate **lifetime rates** (CLTs only).
- (4) Calculate the **gross chargeable transfer** c/f (PETs and CLTs).
- (5) If required, state the **due date** for payment (see section 6) (CLTs only).

### 3.2 Chargeable amount

The chargeable amount is calculated as follows:

	£
Value of estate before transfer	X
Less: Value of estate after transfer	(X)
	<hr/>
Transfer of value	X
Less: Specific exemptions	
(e.g. spouse/civil partner, small gifts)	(X)
Marriage exemption	(X)
Annual exemptions	(X)
	<hr/>
Chargeable amount	X
	<hr/>

## Notes



## 3.3 The nil rate band (NRB)

The NRB = the amount that can be gifted without incurring any IHT liability.



The **NRB** in the **tax year of the gift** should be used.

The NRB for the tax year 2020/21 = £325,000.

If you need the NRB for a previous tax year, it will be given to you in the question.

The NRB must be reduced by the **gross chargeable transfers (GCTs)** made in the previous seven years. During the donor's lifetime GCTs only include CLTs, not PETs. See section 3.5 below.

## 3.4 The appropriate rate of tax

There are two rates of lifetime tax – it depends on who is paying the tax:

- if the trustees pay tax: 20%
- if the donor pays the tax (default assumption): 25%

Remember, tax is only payable on CLTs, not PETs, during the donor's lifetime.

## Notes





## Example 3

Donald created a discretionary trust on 1 July 2020 and transferred £400,000 to the trustees.

The trustees agreed to pay the IHT due.

**Assuming Donald has made no other lifetime transfers, calculate the IHT payable on the transfer.**

**Donald**

	2020/21
	CLT
	1 July 2020
	£
Transfer of value	400,000
Less: AEs	
– CY (2020/21)	(3,000)
– PY (2019/20)	(3,000)
Chargeable amount	394,000
NRB (2020/21)	(325,000)
Taxable amount	69,000
Lifetime tax @ 20%	13,800

## Notes





### 3.5 Calculating the gross chargeable transfer (GCT) carried forward

- If the **trustees pay** the tax = **gross gift**  
GCT = **chargeable amount only.**
- If the **donor pays** the tax = **net gift**  
GCT = **chargeable amount plus any lifetime tax paid by donor.**

## Example 4



On 17 August 2008, Barney created a discretionary trust and gave the trustees £320,000 in cash. Barney agreed to pay the IHT on this transfer.

On 1 June 2014, he gave £120,000 to his son.

On 18 September 2014, Barney gave a further £338,000 in cash to the trustees. The trustees agreed to pay any IHT due on this transfer.

**Assuming Barney has made no other lifetime transfers, calculate the IHT due on each transfer and the amount of the gross chargeable transfers carried forward.**

Relevant NRBs are as follows:

2008/09 – £312,000

2014/15 – £325,000

## Notes



## Chapter 23

### Barney

	<b>2008/09</b>		<b>2014/15</b>		<b>2014/15</b>	
	CLT		PET		CLT	
	17 August 2008		1 June 2014		18 September 2014	
	£	£	£	£	£	£
Transfer of value		320,000		120,000		338,000
Less: AEs						
– CY	2008/09	(3,000)	2014/15	(3,000)	2014/15	0
– PY	2007/08	(3,000)	2013/14	(3,000)	2013/14	0
Chargeable amount	Net	314,000		114,000	Gross	338,000
NRB (2008/09)	312,000					
NRB (2014/15)					325,000	
Less: GCT < 7 yrs before gift	(0)				(314,500)	
		(312,000)				(10,500)
Taxable amount		2,000		0		327,500
Lifetime tax	@ 25%	500		0	@ 20%	65,500
Gross chargeable amount c/f		314,500		114,000		338,000

## Notes





## Example 5

On 12 May 2006, Wilma created a discretionary trust and gave the trustees £300,000 in cash. Wilma agreed to pay the IHT on this transfer.

On 10 September 2009 Wilma made a cash gift of £24,000 to her daughter.

On 10 October 2010, Wilma gave a further £300,000 in cash to the trustees. The trustees agreed to pay any IHT due on this transfer.

**Assuming Wilma has made no other lifetime transfers, calculate the IHT due on each transfer and the amount of the gross chargeable transfers carried forward.**

Relevant NRBs are as follows:

2006/07 – £285,000

2009/10 – £325,000

2010/11 – £325,000

### Wilma

	2006/07 CLT 12 May 2006		2009/10 PET 10 September 2009		2010/11 CLT 10 October 2010	
	£	£	£	£	£	£
Transfer of value		300,000		24,000		300,000
Less: AEs						
– CY	2006/07	(3,000)	2009/10	(3,000)	2010/11	(3,000)
– PY	2005/06	(3,000)	2008/09	(3,000)	2009/10	0
Chargeable amount	Net	294,000		18,000	Gross	297,000
NRB (2006/07)	285,000					
NRB (2010/11)					325,000	
Less: GCT < 7 yrs before gift		0			(296,250)	
		(285,000)				(28,750)
Taxable amount		9,000		0		268,250
Lifetime tax	@ 25%	2,250		0	@ 20%	53,650
Gross chargeable amount c/f		296,250		18,000		297,000

# 4 Death tax on PETs and CLTs

## 4.1 Lifetime gifts chargeable on death

Death tax is due on any lifetime transfers made **within seven years of death**:

- PETs become chargeable for the first time
- Additional tax may be due on CLTs.

The recipient (donee or trustees of trust) is liable to pay the death tax due on a lifetime gift.

## 4.2 Calculating death tax

Death tax is calculated on each gift separately, in **chronological order**, as follows:

- (1) Identify all **gifts within seven years of death**.
- (2) Calculate the **gross chargeable amount** of each gift and any **lifetime tax paid** (section 3 above).
- (3) Calculate the amount of **NRB** available.
- (4) Calculate the **death tax** on the excess at **40%**.
- (5) Calculate and deduct any **taper relief** available.
- (6) For CLTs, deduct any **lifetime IHT paid**.
- (7) If required, state **who will pay** and the **due date** for payment (see section 6).

## 4.3 NRB on death

Use the NRB in the **tax year of death**.

**Deduct GCTs** made within seven **years of that gift** that are **chargeable** to IHT:

- all CLTs
- any PETs within seven years of death (which have become chargeable).

This means that PETs outside the seven years prior to death are ignored for the purposes of working out how much NRB is available.

#### 4.4 Calculating death tax



After the deduction of the NRB, the remainder is taxed at **40%**.



**Taper relief** is given for all gifts made between three and seven years before death.

The percentage of relief increases according to the number of years between the transfer and death as follows:

Years before death	Percentage reduction
More than 3 but less than 4 years	20
More than 4 but less than 5 years	40
More than 5 but less than 6 years	60
More than 6 but less than 7 years	80

**Lifetime IHT** already paid in respect of a CLT is **deducted** from the death tax on the same CLT.

The deduction cannot generate a repayment, at best it can reduce the death tax liability down to £Nil.

## Notes





## Example 6

Diana made the following lifetime gifts:

10 June 2013 – £65,000 to her sister

14 September 2016 – £200,000 to her son on the occasion of his marriage

29 August 2017 – £150,000 to her daughter

Diana died on 31 March 2021.

**Calculate the IHT arising as a result of Diana's death.**

Relevant NRBs are as follows:

2013/14 – £325,000

2016/17 – £325,000

2017/18 – £325,000

### Diana

#### IHT payable during lifetime

	2013/14 PET		2016/17 PET		2017/18 PET	
	10 June 2013		14 September 2016		29 August 2017	
	£	£	£	£	£	£
Transfer of value		65,000		200,000		150,000
Marriage exemption				(5,000)		
AEs						
– CY	2013/14	(3,000)	2016/17	(3,000)	2017/18	(3,000)
– PY	2012/13	(3,000)	2015/16	(3,000)	2016/17	0
Chargeable amount		59,000		189,000		147,000
IHT payable (all PETs)		0		0		0
Gross chargeable amount c/f		59,000		189,000		147,000

The earlier NRBs given in the question are not relevant since there is no lifetime tax to pay.

## IHT payable on death

Date of death: 31 March 2021

Seven years before: 31 March 2014

PET made in 2013 is more than seven years before date of death, therefore no IHT payable

	2016/17 PET 14 September 2016		2017/18 PET 29 August 2017	
	£	£	£	£
Gross chargeable amount b/f (above)		189,000		147,000
NRB at death (2020/21)	325,000		325,000	
Less GCTs < 7 years before gift	0		(189,000)	
NRB available		(325,000)		(136,000)
Taxable amount		0		11,000
IHT payable at 40%		0		4,400
Less: Taper relief			3-4 years – 20%	(880)
Less: Lifetime tax paid				(0)
IHT payable on death		0		3,520

## Notes





### Example 7

Levi made the following lifetime transfers:

Date	Amount	Transferee
1 May 2008	£328,000	Transfer to a trust (trustees pay the tax)
10 May 2008	£50,000	Angela (friend)
13 December 2013	£60,000	Daughter
25 July 2017	£365,000	Transfer to a trust (Levi paid IHT due)

Levi died on 30 November 2020.

**Calculate the IHT payable on lifetime gifts made by Levi during his lifetime and on death.**

Relevant NRBs are as follows:

2008/09 – £312,000

2013/14 – £325,000

2017/18 – £325,000

## Notes





## Levi

### Lifetime tax

	2008/09 CLT 1 May 2008		2008/09 PET 10 May 2008		2013/14 PET 13 Dec 2013		2017/18 CLT 25 July 2017	
	£	£	£	£	£	£	£	£
Transfer of value		328,000		50,000		60,000		365,000
Marriage exemption								
Less: AEs								
– CY	2008/09	(3,000)	2008/09	0	2013/14	(3,000)	2017/18	(3,000)
– PY	2007/08	(3,000)	2007/08	0	2012/13	(3,000)	2016/17	(3,000)
Chargeable amount	Gross	322,000		50,000		54,000	Net	359,000
NRB at date of gift	312,000						325,000	
Less:								
GCT < 7 yrs before gift	(0)						(0)	
		(312,000)						(325,000)
Taxable amount		10,000						34,000
IHT payable	@ 20%	2,000		0		0	@ 25%	8,500
Gross chargeable amount		322,000		50,000		54,000		367,500

## Notes



## Chapter 23

### IHT payable on death

Date of death: 30 November 2020

Seven years before: 30 November 2013

CLT made in 2008 is more than seven years before date of death, therefore no death tax payable.

PET made in 2008 is more than seven years before date of death, therefore no IHT payable.

	2013/14 PET 13 December 2013		2017/18 CLT 25 July 2017	
	£	£	£	£
Gross chargeable amount b/f (above)		54,000		367,500
NRB at death (2020/21)	325,000		325,000	
Less: GCTs < 7 years before gift	(322,000)		(54,000)	
NRB available		(3,000)		(271,000)
Taxable amount		51,000		96,500
IHT payable at 40%		20,400		38,600
Less: Taper relief	6-7 years – 80%	(16,320)	3-4 years – 20%	(7,720)
Less: Lifetime tax paid				(8,500)
IHT payable on death		4,080		22,380

## Notes



## 5 The death estate

### 5.1 Pro forma death estate computation

The death estate comprises **all assets** held on death at their **open** MV at that date (known as the probate value).

Any funds held in a pension fund should not be included in the death estate.

	£	£
Freehold property	X	
Less: Mortgage (except endowment mortgage)	(X)	
	—	
		X
Business owned by sole trader/partnership		X
Stocks and shares (including ISAs)		X
Government securities		X
Insurance policy proceeds (if deceased has policy on own life, include proceeds rather than MV)		X
Leasehold property		X
Motor cars		X
Personal chattels		X
Debts due to the deceased		X
Cash at bank and on deposit (including ISAs)		X
		—
		X
Less:		
Debts due by the deceased (if legally enforceable and incurred for valuable consideration, e.g. not gambling debts)	(X)	
Outstanding taxes (e.g. IT, CGT due)	(X)	
Funeral expenses (must be reasonable)	(X)	
	—	
		(X)
Less: Exempt legacies to spouse/civil partner		(X)
		—
Gross chargeable estate		X
		—

### 5.2 Procedure to calculate IHT on the death estate

- (1) Calculate **lifetime IHT** and **death IHT** on all **gifts within seven years of death**.
- (2) Calculate the **gross chargeable estate** value.
- (3) Calculate the amount of residence nil rate band (**RNRB**) available, if applicable (see section 5.3 below).
- (4) Calculate the amount of **NRB** available after deducting the value of GCTs (all PETS and CLTs) in the last seven years.
- (5) Calculate the **death tax** on the excess at **40%**.
- (6) If required, state **who will pay** and the **due date** for payment (see section 6).

### Example 8



Hamish died on 1 May 2020. His death estate comprised the following:

	£
House	350,000
Personal chattels	95,000
Shares held in an ISA	16,000
Car	22,000
Life insurance policy on own life	200,000 (proceeds)
	180,000 (MV)

Hamish's funeral expenses amounted to £2,500.

He left his house to his wife and all remaining assets to his daughter.

Hamish had made a lifetime gift of £100,000 cash to his daughter in September 2018 on the occasion of her wedding.

**Calculate the IHT payable as a result of Hamish's death.**

## Hamish

### Death estate – date of death 1 May 2020

	£
House	350,000
Personal chattels	95,000
Shares held in an ISA	16,000
Car	22,000
Life insurance policy – own life (proceeds)	200,000
Less: Funeral expenses	(2,500)
	<hr/>
	680,500
Less: Exempt legacy – house	(350,000)
	<hr/>
Gross chargeable estate	330,500
	<hr/>
NRB at death	325,000
Less: GCTs < 7 years before death (W)	(89,000)
	<hr/>
	(236,000)
	<hr/>
Taxable amount	94,500
	<hr/>
IHT on chargeable estate at 40%	37,800
	<hr/>
<b>Working</b>	
Transfer of value	100,000
Less: Marriage exemption	(5,000)
Less: AE (2018/19)	(3,000)
AE (2017/18)	(3,000)
	<hr/>
Chargeable amount	89,000
	<hr/>

There is no lifetime tax payable on the lifetime gift as it is a PET and there is no death tax payable as it is covered by the NRB.

### 5.3 Additional residence NRB (as applicable in TX)

- There is an additional NRB if individuals leave a home they have lived in to their direct descendants. This is known as the residence nil rate band (RNRB).



The maximum amount in 2020/21 is £175,000.

- The RNRB applies when:
  - calculating the tax on the **death estate** (not on lifetime gifts)
  - the date of death is **on or after 6 April 2017**
  - the chargeable death estate includes a **residential property** (that the deceased has lived in at some time), and
  - the property is inherited by the deceased's **direct descendants** (children or grandchildren).
- Available RNRB = Lower of:
  - **£175,000**
  - the **value of the property** (net of any repayment mortgage).
- The RNRB is applied before the normal NRB in the estate computation.
- Any unused RNRB can be transferred to the surviving spouse or civil partner (see below).

## Notes





## Example 9

Salma died on 1 June 2020. Her death estate, which was all left to her daughter, comprised the following:

	£
Main residence	400,000
Other assets	520,000

**Calculate the IHT payable as a result of Salma's death assuming she had made a gift to her grandson of £392,000 on 15 May 2019.**

**Salma**

**Date of death 1 June 2020**

**IHT payable on death – Death estate**

	£
House	400,000
Other assets	520,000
	<hr/>
Gross chargeable estate	920,000
Less: RNRB	
(lower of £175,000 and £400,000)	(175,000)
NRB at death	325,000
Less: GCTs < 7 years before death (W)	(386,000)
	<hr/>
	(0)
	<hr/>
Taxable amount	745,000
	<hr/>
<b>IHT on taxable estate at 40%</b>	<b>298,000</b>
	<hr/>

## Notes



### IHT payable on death – Lifetime gift of £392,000

#### Working

Transfer of value	392,000
Less: AE (2019/20)	(3,000)
AE (2018/19)	(3,000)
	<hr/>
Chargeable amount	386,000
	<hr/>

Death tax due on the PET made one year prior to death:

$$(\pounds 386,000 - \pounds 325,000) \times 40\% = \pounds 24,400$$

Although the normal NRB has been fully utilised against the earlier PET, the RNRB is still available for offset against the death estate.

## Notes





## 6 Payment of IHT

### 6.1 Lifetime tax



Lifetime gift made in:	
First half of tax year (6 April to 30 September)	Second half of tax year (1 October to 5 April)
<b>payable by 30 April of the next year</b>	<b>payable 6 months after the end of the month of the gift</b>

### 6.2 Death tax



- Death IHT on lifetime gift  
= **due 6 months after the end of the month of death.**

- Death tax on **CLTs** = **payable by the trustees.**
- Death tax on **PETs** = **payable by the recipient of the gift.**



- Death tax on the death estate = due on the earlier of:
  - **6 months after the end of the month of death**
  - **delivery of an account** of the estate assets to HMRC.
- Death tax is payable by the **executors**, but suffered by the residual legatee (the person who inherits the residue of the estate).

## Notes



# 7 Married couples/civil partners

## 7.1 Transfer of unused NRB

- Any **unused proportion** of the NRB on the death of a spouse/civil partner can be transferred for **use on the surviving spouse/civil partner's death**.
- The increased NRB can be used on the calculations of death tax for both:
  - lifetime transfers, and
  - the death estate of the surviving spouse

but not for lifetime IHT.



- The additional NRB is claimed:
  - by the executors of the surviving spouse/civil partner
  - within 2 years of the second death.

## Notes





## Example 10

Nita's husband Hamzah died on 14 July 2008.

He had made no lifetime transfers but had a chargeable estate of £330,720 (which did not include a residential property). He left half his estate to Nita and half to their only son.

Nita died on 1 September 2020.

**Calculate the NRB available on Nita's death.**

The NRB in 2008/09 was £312,000.

**Nita**

Hamzah's NRB at death was £312,000.

His chargeable estate, after the exempt bequest to Nita, was £165,360.

Unused NRB = £146,640 (£312,000 – £165,360)

Unused % =  $(£146,640 \div £312,000) \times 100 = 47\%$

On Nita's death, available NRB =  $(147\% \times 325,000) = £477,750$ .

## Notes



### 7.2 Transfer of unused RNRB

Any **unused proportion** of the RNRB on the death of a spouse/civil partner can also be transferred for use against the surviving spouse/civil partner's estate.

The transfer is available even when the spouse/civil partner died prior to the introduction of the RNRB (i.e. prior to 6 April 2017). In this case, the unused proportion of the RNRB will always be 100%.

## Notes

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## 8 IHT planning

### 8.1 Advantages of lifetime giving

- Reduces value of the death estate.
- Utilises annual and other lifetime exemptions and NRBs (because of the seven-year accumulation period the NRB effectively refreshes itself every seven years).
- For gifts to other individuals, there is no IHT if the donor survives for > seven years and even if he or she survives for < seven years, taper relief may be available to reduce IHT liability if survives for > three years.
- If asset is an appreciating one, the value is fixed for IHT at time gift is made.

### 8.2 Disadvantages of lifetime giving

- Lose use of asset going forward.
- Could give rise to capital gains tax liability (no CGT on death).

### 8.3 Generation skipping

- Grandparents leave estate, or make gifts, to grandchildren rather than children.
- Avoids additional IHT exposure when passed from children to grandchildren.

## Notes



### Questions



You should now be able to answer TYU questions 1 to 16 from the Study Text Chapter 24 as well as the questions 'Gerry', 'Tareq', 'Nur' and 'Michaela' from Chapter 27.

For further reading, visit Chapter 24 of the Study Text and review the TX article on 'inheritance tax' (which is in two parts) at [www.accaglobal.com](http://www.accaglobal.com).

# Chapter 24

## Value added tax: Outline



### Outcome

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Upon completion of this Chapter you will be able to:

- recognise the circumstances in which a person must register or deregister for VAT (compulsory) and when a person may register or deregister for VAT (voluntary)
- recognise the circumstances in which pre-registration input VAT can be recovered
- explain the conditions that must be met for two or more companies to be treated as a group for VAT purposes, and the consequences of being so treated
- calculate the amount of VAT payable/recoverable
- recognise the tax point when goods or services are supplied
- explain and apply the principles regarding the valuation of supplies
- recognise the principal zero rated and exempt supplies
- recognise the circumstances in which input VAT is non-deductible
- recognise the relief that is available for impairment losses on trade debts
- understand the treatment of the sale of a business as a going concern

and answer questions relating to these areas.



PER

One of the PER performance objectives (PO15) is to prepare computations of taxable amounts and tax liabilities according to legal requirements. Another objective (PO17) is to advise on mitigating and deferring liabilities through legitimate tax planning measures. Working through this chapter should help you understand how to demonstrate those objectives.

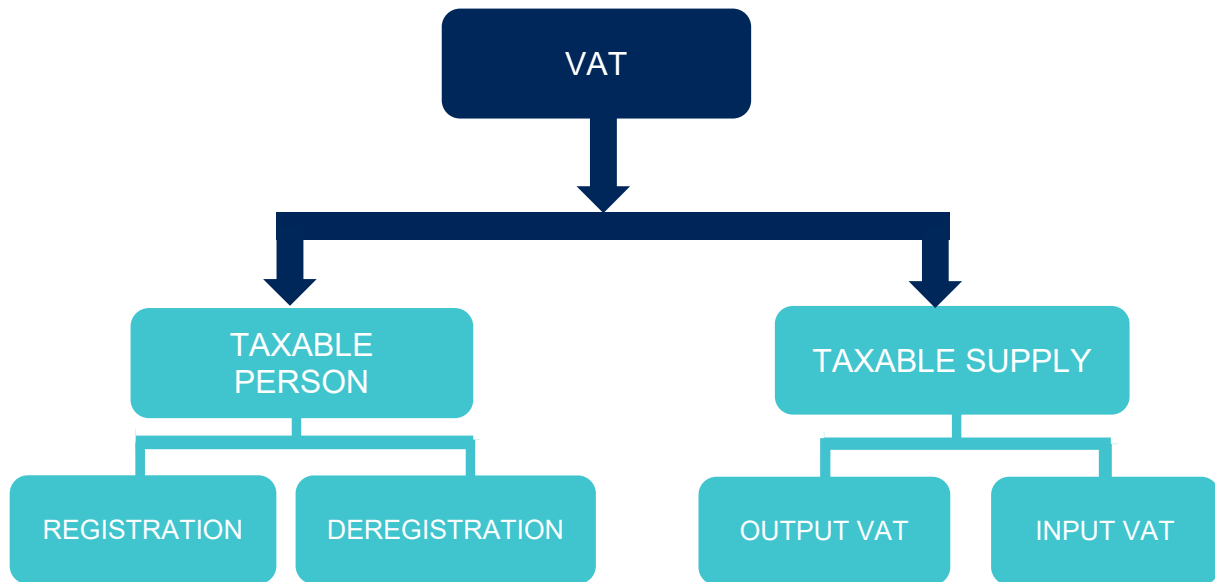
The underpinning detail for this Chapter in your Integrated Workbook can be found in Chapter 25 of your Study Text.





## Overview

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## 1 VAT basics

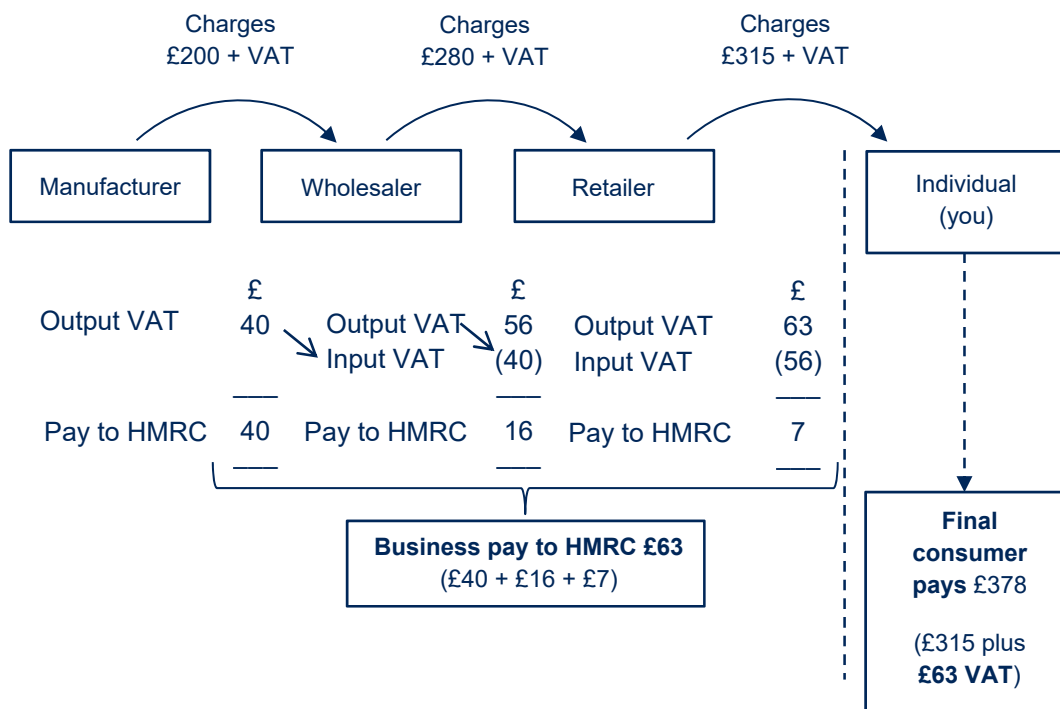
### 1.1 Scope of VAT

VAT is charged on the sale of **taxable supplies** by a **taxable person** in the course of a business.



A **taxable person** is a sole trader, partnership, limited company, club or association making taxable supplies, who is or should be registered for VAT.

### 1.2 How VAT works



## Notes



## 1.3 Taxable supplies

Supplies may be classified as outside the scope of VAT, exempt from VAT, or taxable. Their classification will always be stated in the exam but it is useful to be aware of some of the key items that fall within each of the relevant headings.

	Outside Scope	Exempt	Taxable		
			Zero-rate	Reduced-rate	Standard-rate
Examples	Dividends Salaries	Insurance Land Postal services Financial services Education	Non-luxury food Children's clothes Books Medicines Transport	Domestic gas & electricity  (not important for the TX exam)	Everything else
Can I register for VAT?	No	No	Yes	Yes	Yes
Can I charge output VAT?	No	No	Adds 0% to sales price	Adds 5% to sales price	Adds 20% to sales price
Can I reclaim input VAT?	No	No	Yes	Yes	Yes

## Notes



## Chapter 24

### 1.4 VAT return



VAT that is charged on taxable supplies, collected by the business and paid over to HMRC is known as **output VAT**.



Any VAT paid by a VAT taxable person on their purchases can be reclaimed from HMRC and is known as **input VAT**.

Every month/quarter the input and output VAT is netted off and paid to/recovered from HMRC.

VAT on sales: Output VAT	X
VAT on purchases: Input VAT	(X)
	<hr/>
Paid to/(received from) HMRC	X/(X)
	<hr/>

## Notes



## 2 VAT registration and deregistration

### 2.1 Registering for VAT

VAT registration can be completed online or by completing form VAT1.

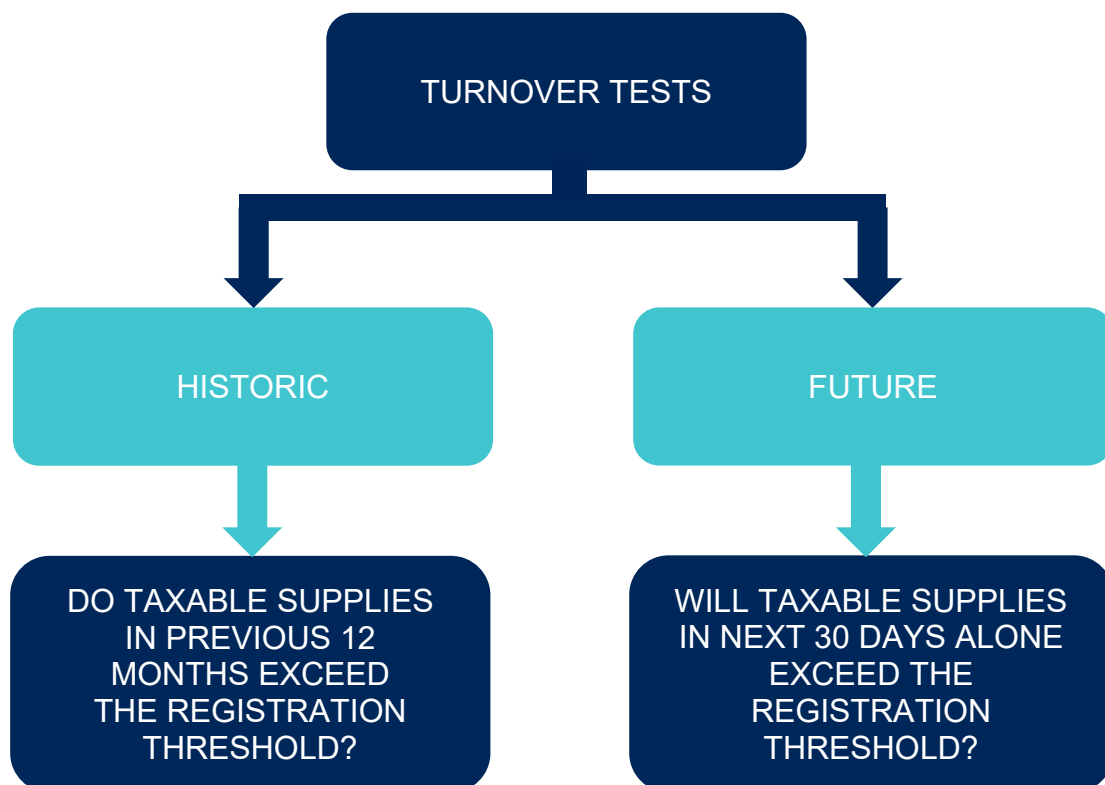
VAT registration is compulsory in some cases (see below), but voluntary registration is also possible.

Sole traders carrying on several businesses have a single registration.

Each limited company has a separate registration (subject to group registrations – see below).

### 2.2 Compulsory registration

There are two separate tests for compulsory registration:



## Notes



## Chapter 24

### 2.3 Turnover tests

The historic and future tests both refer to the annual registration threshold.



The **annual registration threshold** is £85,000.

The tests operate as follows:

	Historic test	Future test
<b>Frequency</b>	Performed at the end of each month	Considered constantly
<b>What is the test?</b>	On the last day of every calendar month, the trader looks back 12 months (or since starting to trade if less) to see if total taxable supplies exceeded the registration threshold	The trader looks forward to see whether it is expected that, in the next 30 days alone, taxable supplies will exceed the registration threshold
<b>Notification</b>	Within 30 days of the end of the month in which the registration threshold is exceeded	By the end of the 30 day period
<b>Effective</b>	From the first day of the second month following the month in which the registration threshold is exceeded	Immediately i.e. from the start of the 30 day period
<b>Other points</b>	Traders need not register if taxable supplies for the next 12 months are expected to be less than the deregistration threshold (currently £83,000), nor if they only make zero-rated supplies	

For the purpose of the registration tests, taxable supplies mean all sales excluding:

- VAT
- Exempt supplies
- Supplies outside the scope of VAT (e.g. wages)
- Sales of capital assets.

**Note:** There are penalties for late registration. In addition, traders can be asked to pay over the VAT they should have collected during the time that they should have been registered for VAT.

## Notes



## Example 1



Andy owns a shop selling babies' clothing (zero-rated) and prams (standard-rated).

In his first year of trading to 30 September 2019, his sales of babies' clothing were £2,800 per month and of prams £2,500 per month.

In his second year of trading these figures increased to £4,400 and £3,650 respectively.

**State the following dates:**

- (a) The date from which Andy is liable to register for VAT.
- (b) The date by which Andy needs to notify HMRC that he is liable to register for VAT.
- (c) The date from which Andy will have to start charging VAT.

## Notes



### Andy

Both babies' clothing and prams are taxable supplies so Andy must register when his sales for the previous 12 months exceed the registration threshold of £85,000.

In his first year, sales are £5,300 per month so his turnover for the year ended 30 September 2019 is £63,600.

Thereafter his sales are £8,050 per month so each month he sells £2,750 more than one year ago.

Month end	Cumulative turnover for the last 12 months
31 October 2019	£66,350
30 November 2019	£69,100
31 December 2019	£71,850
31 January 2020	£74,600
29 February 2020	£77,350
31 March 2020	£80,100
30 April 2020	£82,850
31 May 2020	£85,600

- (a) Andy is therefore liable to register on 31 May 2020 (although he will have exceeded the limit during the month the historic test is only performed at the month end).
- (b) Andy must notify HMRC by 30 June 2020.
- (c) Andy will be registered from 1 July 2020, or such earlier date as may jointly be agreed. VAT will be charged on sales made by Andy from this date.





## Example 2

For several years Pearson Ltd has been making sales of children's toys (standard-rated) of around a constant £6,000 per month. On 15 July 2020, it receives an order for £80,000 worth of goods to be delivered in the next 30 days – this is in addition to its normal ongoing sales.

**State the following dates:**

- (a) The date from which Pearson Ltd is liable to register for VAT.
- (b) The date by which Pearson Ltd needs to notify HMRC that it is liable to register for VAT.
- (c) The date from which Pearson Ltd will have to start charging VAT.

### **Pearson Ltd**

- (a) Pearson Ltd is liable to register because on 15 July 2020 there are grounds to believe that taxable supplies in the next 30 days alone will exceed the registration threshold of £85,000 ( $£80,000 + £6,000 = £86,000$ ).
- (b) The company must notify HMRC of its liability to register within 30 days of 15 July (inclusive) i.e. Pearson Ltd must notify HMRC by 13 August 2020.
- (c) Pearson Ltd will be registered from 15 July 2020 and VAT must be charged on sales made by Pearson Ltd from this date (i.e. including on the new contract).

## Notes





### Example 3

The following traders are all clients of your firm.

Trader	Supplies	Details
Darius	Bookseller (zero-rated)	Started in business 1 January 2021. Estimated monthly sales of £100,000.
Emily	Plumbing services (standard-rated)	Established the business 1 April 2020. Estimated monthly sales of £12,400.
Burials R Us Ltd	Funeral services (exempt)	Commenced trading 1 November 2020. Estimated monthly sales of £15,000.

**State the following dates:**

- (a) The date from which each trader is liable to register for VAT.
- (b) The date by which each trader needs to notify HMRC of the liability to register for VAT.
- (c) The date from which each trader will have to start charging VAT.

#### **Darius**

- (a) Darius is liable to register on the first day of trading as sales for the next 30 days will exceed the threshold. However, Darius could apply for exemption from registration as he is making wholly zero-rated supplies, but in this case, he would not be able to reclaim any input tax.
- (b) Darius must notify HMRC by the end of the 30 days, i.e. by 30 January 2021.
- (c) Darius will be registered with effect from 1 January 2021 and therefore must charge VAT (at 0%) from the start of trading.

### **Emily**

- (a) Emily's taxable turnover will exceed the threshold after 7 months, so Emily is liable to register on 31 October 2020.
- (b) Emily will need to notify HMRC by 30 November 2020.
- (c) Emily will be registered with effect from 1 December 2020 and must charge VAT from that date.

### **Burials R Us Ltd**

The company is making wholly exempt supplies so cannot register for VAT.

## Notes

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### 2.4 Consequences of registration

Registration entails many additional responsibilities. These include:

- charging output tax on taxable supplies
- quoting the taxable person's VAT registration number on all sales invoices
- filing a VAT return for the allocated 'tax period' (normally every three months)
- maintaining appropriate VAT records, for example to be able to support the recovery of input tax on business purchases and expenses.



### 2.5 Voluntary registration

A person may register voluntarily for VAT provided he is making, or is intending to make, taxable supplies.



#### Advantages

- Can recover input VAT on purchases
- Avoids penalties for late registration
- Can disguise the small size of the business



#### Disadvantages

- Burden of compliance with VAT administration rules
- Must charge output VAT, which makes goods/services comparatively more expensive than an unregistered business for customers who cannot recover the VAT (i.e. final consumers)

Voluntary registration is beneficial if a business has input VAT to recover and makes:

- zero-rated supplies
- supplies to VAT registered customers who can recover the VAT charged.

## Notes





## 2.6 Accepting new business

When looking at the viability of accepting new business, the VAT implications should always be considered, especially if the increased revenue may push the business over the registration threshold.

## 2.7 Pre-registration input VAT recovery

VAT incurred before registration can be recovered as follows:

Goods	Services
➤ Must be acquired for business purposes and should not be sold or consumed prior to registration, i.e. should still be in inventory	➤ Services must be supplied for business purposes
➤ Acquired $\leq$ 4 years before registration	➤ Supplied $\leq$ 6 months before registration

## Notes



### 2.8 Groups of companies

Two or more companies can form a VAT group provided that

- one company controls (> 50%) the other(s), or
- the companies are under common control (of a company, individual or partnership).

In this situation:

- The VAT group appoints a representative member, which is responsible for accounting for all input and output VAT.
- The representative member submits a single VAT return covering all group members within the normal time limit.
- All VAT group members are jointly and severally liable for the VAT payable by the group as a whole.
- Intra-group supplies are outside the scope of VAT, therefore no VAT is charged.

Advantages	Disadvantages
➤ No VAT needs to be accounted for on intra group supplies	➤ All members remain jointly and severally liable
➤ Only one VAT return needs to be submitted – administrative cost savings	➤ Collection and collation of information to go into the single VAT return may be more problematic and time consuming because coming from so many different sources

## Notes



### 2.9 Deregistration for VAT

Deregistration may be compulsory or voluntary.

#### Compulsory deregistration

- A person must deregister when he/she ceases to make taxable supplies.
- HMRC should be notified within 30 days.
- Deregistration is effective from the date of cessation.



#### Voluntary deregistration

- A person may voluntarily deregister for VAT, even if the business continues, if there is evidence that the taxable supplies in the next 12 months will not exceed £83,000.
- The 12-month period is measured starting at any time.
- Deregistration is effective from the date of request, or an agreed later date.

#### Effect of deregistration

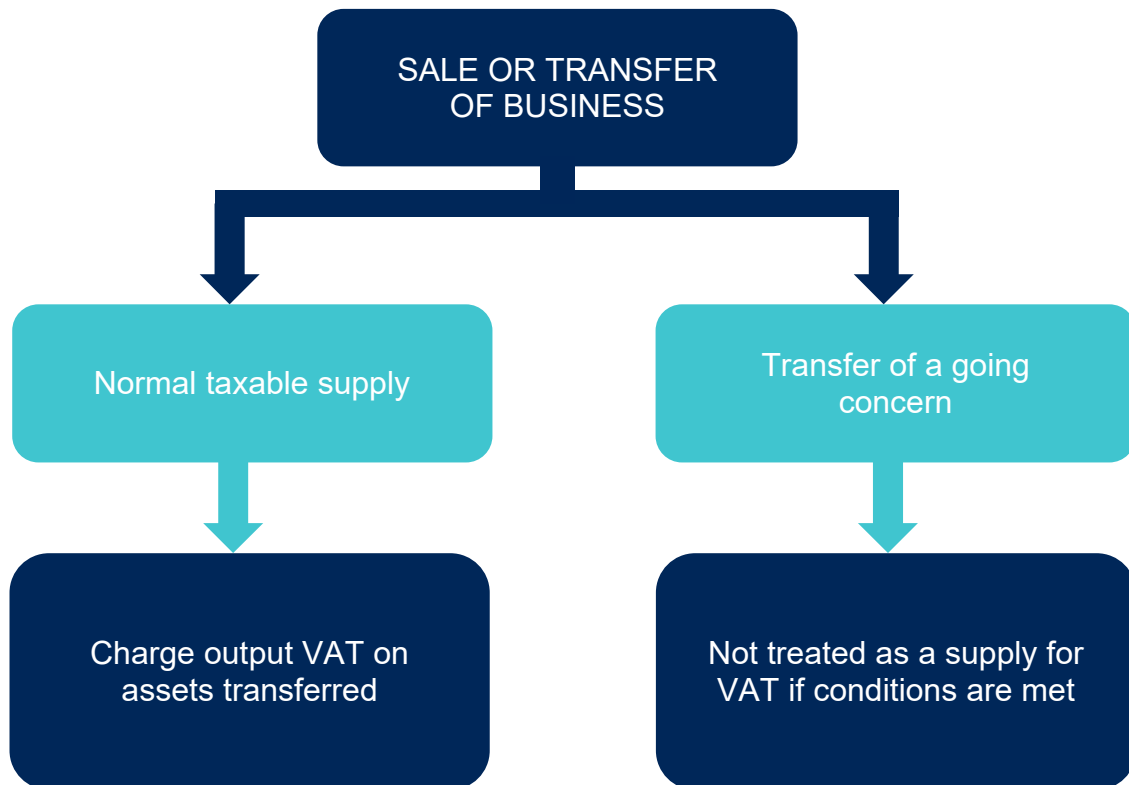
- On deregistration, output tax must be accounted for on the value of all non-current assets and inventory held at the date of deregistration on which a deduction for input tax has been claimed.
- However, this final tax liability is waived if it is  $\leq$  £1,000.

## Notes



### 2.10 VAT on the sale of a business

The sale may be treated one of two ways:



- The transfer will be treated as the transfer of a going concern (TOGC) if **all** the following conditions are met:
  - The business is transferred as a going concern
  - No change in trade
  - No significant break in trade
  - Transferee is, or becomes, VAT registered immediately after the transfer.
- If the transfer is treated as a TOGC:
  - it will not be a taxable supply
  - no output VAT will be charged on the assets transferred
  - no input VAT is recoverable by the purchaser.



### Transfer of registration

- Normally on the transfer of a VAT registered business compulsory deregistration would apply.
- It is possible, by joint election, for the transferee to take over the VAT registration of the transferor.

However, this means the transferee is taking over all of the past liabilities of the transferor, which may give rise to unacceptable risks from their perspective.

## Notes

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### 3 Output VAT

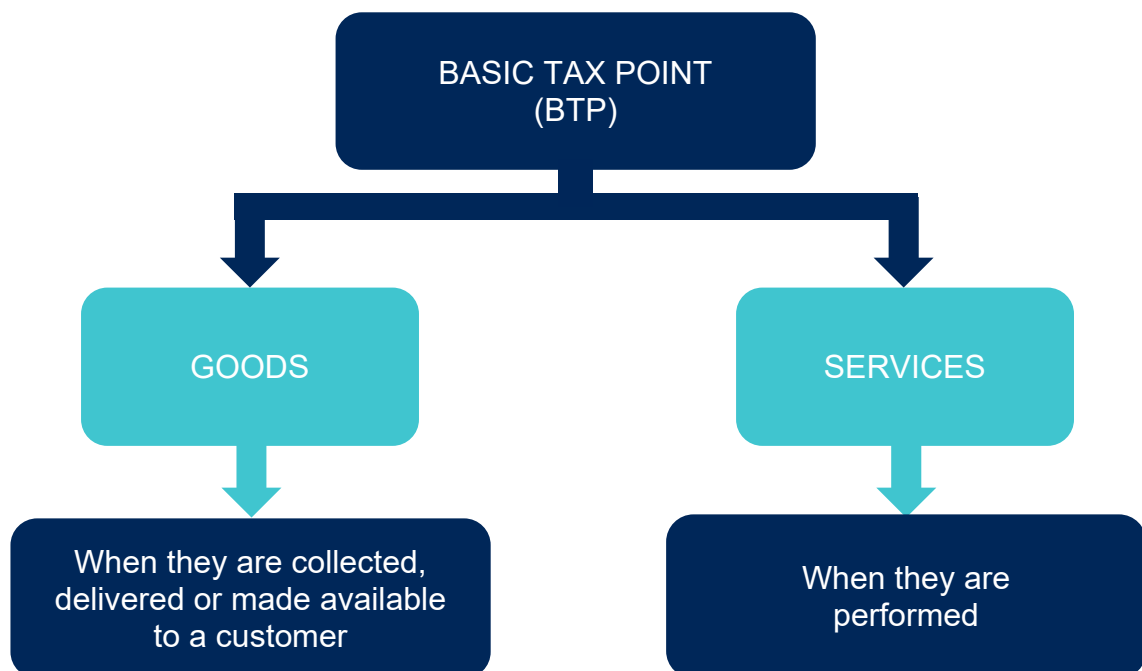
#### 3.1 Timing of the supply (the tax point)

VAT is normally accounted for on a quarterly basis so it is important to know the time of a supply, to identify the quarter in which it needs to be included.

Also, if rates of VAT were to change, it is important to know when the supply occurs, so that the correct rate can be charged.

The date the supply occurs for VAT purposes is known as the **tax point**.

The starting point is the **basic tax point (BTP)**.

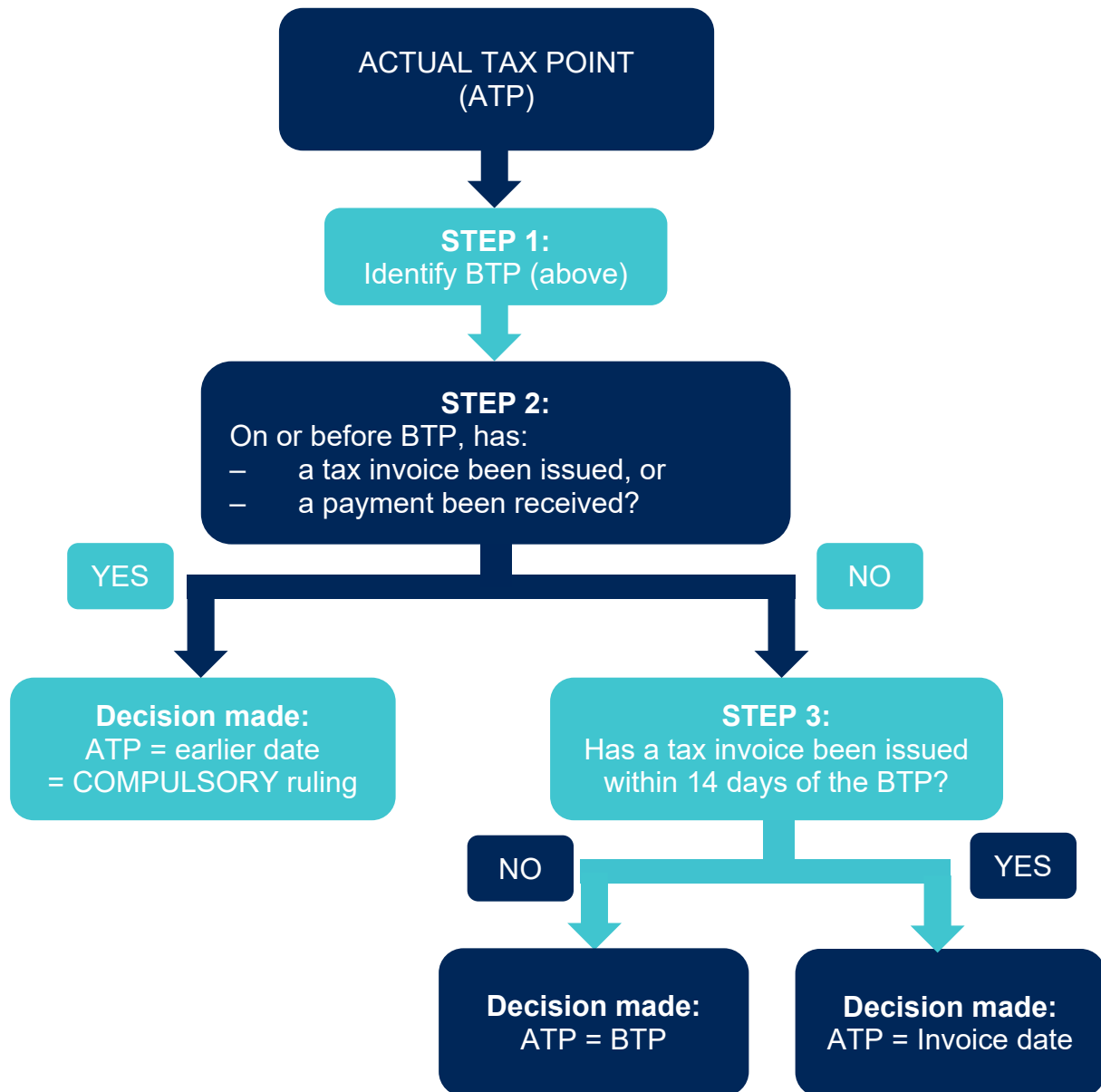


Certain supplies require special rules:

- **Continuous supplies:** time of supply = **earlier of:**
  - tax invoice being issued
  - payment being received.
- **Goods on sale or return:** time of supply = **earlier of:**
  - Adoption of goods by customer
  - Twelve months after the date of despatch.

**Actual tax point (ATP)**

An ATP may override the BTP, as follows:



Notes





## Example 4

**State the tax point for each of the following:**

Goods removed 2 September, invoice issued 28 September, payment received 4 October	
Goods removed 18 April, invoice issued 24 April, payment received 16 April	
Goods removed 6 December, invoice issued 4 December, payment received 18 December	
Goods removed 15 March, invoice issued 22 March, payment received 1 April	

### Tax point

Goods removed 2 September, invoice issued 28 September, payment received 4 October	2 September (basic tax point)
Goods removed 18 April, invoice issued 24 April, payment received 16 April	16 April (actual tax point, payment before basic tax point)
Goods removed 6 December, invoice issued 4 December, payment received 18 December	4 December (actual tax point, invoice before basic tax point)
Goods removed 15 March, invoice issued 22 March, payment received 1 April	22 March (actual tax point, invoice within 14 days after basic tax point)



## Example 5

On 1 November, Green Ltd ordered a new machine, and on 5 November, paid a deposit of £7,500. The machine was despatched to Green Ltd less than two months later, on 2 January. On 20 January, an invoice was issued to Green Ltd for the balance due of £32,500. This was paid on 1 May.

**State the tax point for:**

- (a) the £7,500 deposit
- (b) the balance of £32,500.

**Green Ltd**

- (a) £7,500 deposit

The basic tax point is the date of despatch, 2 January. As the deposit was paid before the date of despatch, this date is the actual tax point – i.e. 5 November.

- (b) £32,500 balance

As an invoice was issued more than 14 days after the basic tax point, the date of despatch (basic tax point) is the tax point – i.e. 2 January.

## Notes



## Chapter 24

### 3.2 Charge to VAT – standard-rated supplies

- The rate used to calculate VAT on a VAT-exclusive price = 20%
- The fraction used to calculate VAT on a VAT-inclusive price = 20/120 or 1/6.

### 3.3 What output VAT is charged on

Standard-rated sales @ 20%	X
Zero-rated sales @ 0%	0
Discounted sales	X
Goods taken for own use	X
Gifts of goods	X
Private fuel for employees	X
	—
Total output VAT	X
	—

### 3.4 Discounts

- VAT should always be calculated on the price a customer actually pays. Therefore, if a trade discount is given, VAT must be calculated on the discounted price.
- Specific rules apply to prompt payment/settlement discounts.
- A supplier has two choices for calculating the VAT:
  - (1) Supplier charges the full amount of VAT on the undiscounted sales price. If the customer pays within the time-frame and takes a prompt payment discount, supplier then issues a credit note.
  - (2) Supplier shows details of both discounted and non-discounted amounts on the invoice and includes a statement that the customer can only recover input VAT on the amount actually paid. If the discount is taken, the supplier must then adjust their records to account for the correct output tax.

## Notes





## Example 6

Kally sells standard-rated goods for £4,000 excluding VAT.

A 5% discount is offered if the customer pays within 30 days.

**Assuming the customer does pay within 30 days, how much VAT should be charged on the sale?**

**Kally**

	£
VAT-exclusive price	4,000
Less: Discount: $5\% \times £4,000$	(200)
	<hr/>
Value of supply	3,800
	<hr/>
VAT charged: $£3,800 \times 20\%$	760
	<hr/>

Note that if the customer paid after 30 days, the full VAT of £800 ( $£4,000 \times 20\%$ ) would have been payable.

## Notes



### 3.5 Goods for own use

- If the goods were originally purchased for business purposes and the trader withdraws them for their own use, output VAT must be accounted for on the **replacement** cost of the goods.
- If the goods were originally purchased for private purposes, no input VAT should be reclaimed at the time of purchase and there is no output VAT charge.

### 3.6 Gifts

- Gifts of inventory or non-current assets are treated as taxable supplies at **replacement** value, except gifts of:
  - goods to the same person  $\leq$  £50 in any 12 month period
  - trade samples (regardless of the number).
- Gifts of services are not taxable supplies.

## Notes

---







## Example 7

**State the amount of VAT due in each of the following cases:**

- (1) Gift of inventory costing £300 with a current replacement cost of £420 – all figures exclude VAT.
- (2) Removal of standard-rated goods by the owner. Goods originally bought in a previous quarter for business purposes for £195, with a replacement cost of £205. All figures are VAT-inclusive.
- (3) Gifts of 4 pens to different customers, each costing £20 each, including VAT. Current replacement cost of £25, including VAT.

**VAT due**

- (1)  $20\% \times £420 = £84$
- (2)  $1/6 \times £205 = £34$
- (3) Less than £50 each, so no output VAT

## Notes



### 3.7 Motor expenses

- A business can recover **all** input VAT on the running costs of cars such as fuel and repairs, even when there is some private use.
- When a business pays for fuel costs for an employee/owner and there is some private use, an output VAT charge will be payable:
  - if the driver reimburses the business for the full cost of all private fuel, output VAT is payable on the amount reimbursed.
  - if the driver doesn't reimburse the business for the cost of any private fuel, output VAT is charged based on a scale rate.
- The fuel scale charge is based on the CO<sub>2</sub> rating of the car.
- Scale charges will be given in the question if needed.

### Example 8



Lamp Ltd provides a company car and fuel for its managing director for business and private use. The car has CO<sub>2</sub> emissions of 179g/km.

**What is the output tax in respect of the running costs for this car for the quarter ended 30 June 2020?**

Assume that the VAT-inclusive quarterly scale rate for a car with CO<sub>2</sub> emissions between 175g/km and 179g/km is £369.

**Lamp Ltd**

£369 is the VAT-inclusive output and the output VAT charge is £61 (£369 × 1/6).

## Notes



## 4 Input VAT

### 4.1 What input VAT is reclaimed on

Input VAT can be reclaimed on purchases of goods and services for business purposes.

This includes the purchases of capital items.

Standard-rated expenditure @ 20%	X
Zero-rated expenditure @ 0%	0
Recovery of VAT previously paid on impaired debts	X
	—
Total input VAT	X

### 4.2 Irrecoverable input VAT

Input VAT on the following goods and services cannot be recovered:

- purchase of cars (unless 100% used for business purposes e.g. driving school)
- leased cars with some private use – only 50% input VAT is recoverable
- non-business use (if partial private use – appropriate apportionment is needed)
- business entertaining (see below)
- purchases for which no VAT receipt is held.

### 4.3 Business entertaining

Input VAT on business entertaining is irrecoverable, with two exceptions:

- staff entertaining
- entertaining overseas customers.

## Notes





## Example 9

You are given the following information about the costs incurred by Sunshine Ltd in the relevant VAT quarter.

**Complete the table to show the amount of input tax that can be reclaimed on each item.**

All items are standard-rated for VAT purposes.

<i>Item</i>	VAT-inclusive cost £	Input tax recoverable £
Car to be used by the managing director, 60% for business and 40% privately	16,600	
Delivery van	17,500	
Staff party – staff were each allowed to bring a guest. Half the cost is estimated to be for these guests	640	
Entertaining UK customers and suppliers	526	
Car to be used as a pool car (i.e. available for all employees and kept at the business premises)	11,480	

### Sunshine Ltd

- 1 None – the car is not used 100% for business
- 2 £2,917 ( $£17,500 \times 1/6$ )
- 3 £53 ( $£640 \div 2 \times 1/6$ ) – VAT is recoverable on half the cost
- 4 None – blocked VAT
- 5 £1,913 ( $£11,480 \times 1/6$ ) – car is used 100% for business

## Notes



#### 4.4 Impairment losses

Output tax is accounted for according to the tax point rules – generally this means the date of despatch or the invoice date.

If the debt becomes irrecoverable, the seller has paid the VAT to HMRC and never recovers this from the customer.

The output VAT on impairment losses can be reclaimed as input VAT if:

- at least **six months** have elapsed since payment was due, and
- the debt has been written off in the seller's books



- a claim is made by the seller within four years and six months of the payment falling due.

### Example 10



On 1 March 2021, Red Ltd wrote off two debts as follows (all figures are VAT-inclusive):

£41,046 due for payment on 1 June 2020

£19,700 due for payment on 1 December 2020

**State the amount of relief for impaired debts available to the company in the return for the quarter ended 31 March 2021.**

#### Red Ltd

On the first debt, the VAT included of £6,841 ( $1/6 \times £41,046$ ) can be recovered by treating it as additional input VAT in the quarter ended 31 March 2021.

The second debt is less than six months old, so no relief is available yet.

## Notes





## Example 11

Hoggit Ltd is a company selling both standard-rated and zero-rated supplies. For the quarter to 30 September 2020, the following information is given. All figures exclude VAT unless otherwise stated.

	Note	£	£
Sales (standard-rated)			75,975
Sales (zero-rated)			65,625
			<hr/>
			141,600
Purchases	1	35,040	
Wages		16,960	
Customer entertaining	2	2,760	
Staff entertaining		1,860	
Impaired debt written off	3	630	
Other expenses	1, 4	15,790	
		<hr/>	
			(73,040)
			<hr/>
Profit			68,560
			<hr/>

### Notes

- (1) All purchases and other expenses are standard-rated.
- (2) Customer entertaining relates to UK customers.
- (3) The impaired debt related to an amount which was due in January 2020.
- (4) Other expenses include an amount of £1,795 in respect of fuel for the director's BMW. The director does not reimburse any of the cost of the fuel for private mileage and, based on its level of CO<sub>2</sub> emissions, the appropriate (VAT-inclusive) scale charge for his car for the quarter is £325.
- (5) Gifts of inventory were made to a customer in the period – the items gifted cost £1,200 and had a current replacement cost of £1,680 (VAT-inclusive amounts).

**Calculate the VAT payable for the quarter ended 30 September 2020.**

**Hoggit Ltd**

	£	£
<b>Output Tax</b>		
Standard-rated supplies ( $£75,975 \times 20\%$ )		15,195
Zero-rated supplies ( $£65,625 \times 0\%$ )		0
VAT on scale charge ( $£325 \times 1/6$ )		54
VAT on gifts of inventory ( $£1,680 \times 1/6$ )		280
		<u>15,529</u>
<b>Input Tax</b>		
Purchases	35,040	
Staff entertaining	1,860	
Impaired debt	630	
Other expenses	15,790	
	<u>53,320</u>	
	$53,320 \times 20\%$	(10,664)
VAT payable		<u>4,865</u>

**Notes:**

- Output VAT must be accounted for on the provision of private fuel (based on scale charge) and the gift of inventory (based on replacement cost).
- Wages are outside the scope of VAT.
- Input VAT is recoverable on staff entertaining but not client entertaining (unless the client is overseas).
- Impairment loss relief is available as it is more than six months from the due date of payment and the debt has been written off.

## Notes



### Questions



You should now be able to answer TYU questions 1 to 16 from the Study Text Chapter 25 as well as the question 'Wilf' from Chapter 27.

For further reading, visit Chapter 25 of the Study Text and review the TX article on 'VAT part 1' at [www.accaglobal.com](http://www.accaglobal.com).



# Chapter 25

## VAT: Administration and overseas aspects



### Outcome

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Upon completion of this Chapter you will be able to:

- understand how VAT is accounted for and administered
- list the information that must be given on a VAT invoice
- understand when the default surcharge, a penalty for an incorrect VAT return, and default interest will be applied
- understand the treatment of imports, exports and trade within the European Union
- understand the operation of, and when it will be advantageous to use the VAT special schemes:
  - (i) Cash accounting scheme
  - (ii) Annual accounting scheme
  - (iii) Flat rate scheme

and answer questions relating to these areas.



PER

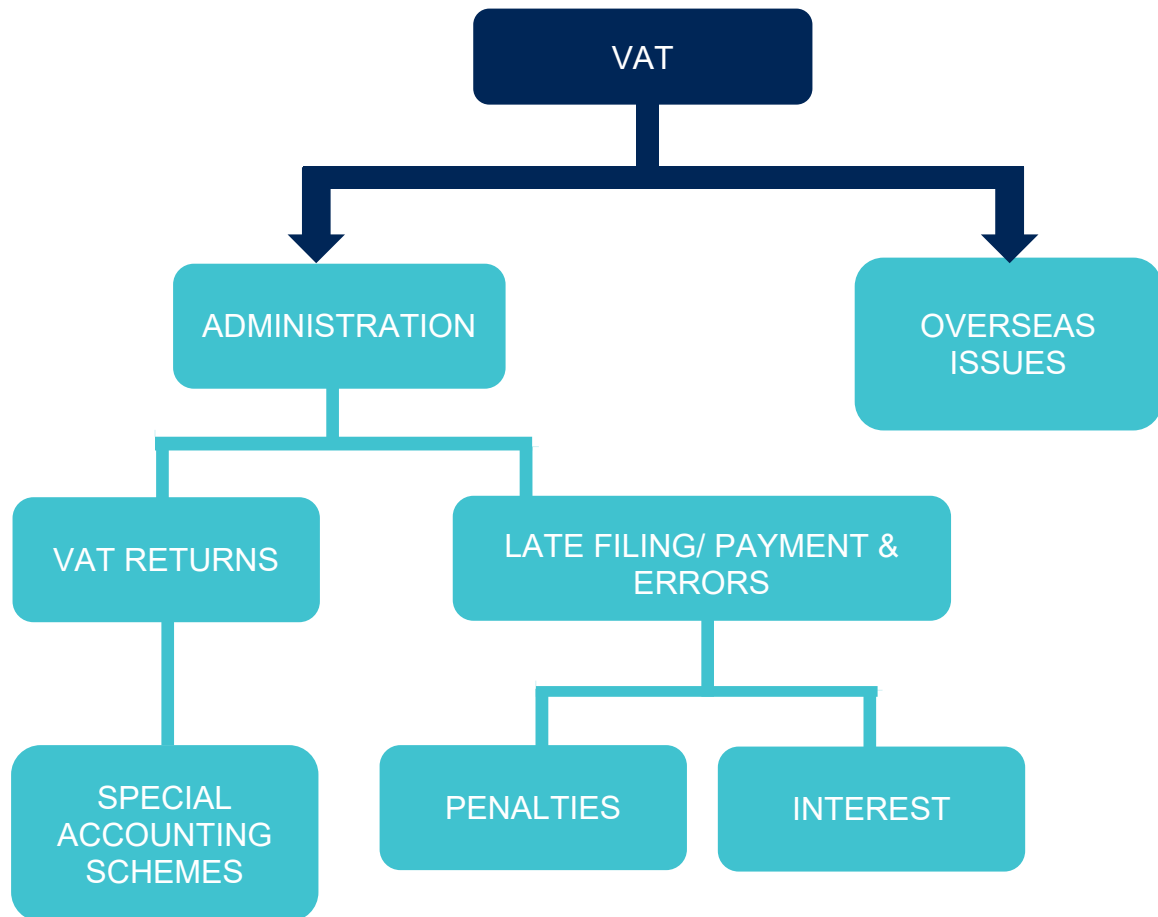
One of the PER performance objectives (PO16) is to make sure that individuals and entities comply with their tax obligations – on time, and in the spirit and letter of the law. Another objective (PO15) is to prepare computations of taxable amounts and tax liabilities according to legal requirements. Working through this chapter should help you understand how to demonstrate those objectives.

The underpinning detail for this Chapter in your Integrated Workbook can be found in Chapter 26 of your Study Text.



### Overview

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# 1 VAT return and payment procedures

## 1.1 VAT accounting

### VAT return and payment of VAT

- A trader's VAT return period is normally three months long.
- Traders who regularly receive repayments can opt to have monthly return periods to receive their repayments earlier.
- All VAT registered businesses must pay and submit returns electronically.
- The VAT return shows total output VAT and total input VAT for the period.



- The deadline for the online filing of the return and payment of the tax is **one month and seven days after the end of the quarter**.

- Businesses with taxable turnover above the VAT threshold of £85,000 are required to keep records digitally under 'making tax digital' (MTD).
- These businesses use MTD software to automatically compile a digital tax return, which they must review before submitting it to HMRC.
- There are temporary Covid-19 tax deferral options available regarding VAT payments due between 30 March and 30 June 2020. In the exam you should assume that the taxpayer has not deferred any payments.

### VAT refunds

- VAT refunds are normally processed within 10 days.



- If it is discovered that VAT was overpaid in the past, the trader has a period of 4 years from the due date of the relevant return for claiming the refund.

### 1.2 Substantial traders



**Substantial traders** are those with a VAT liability exceeding £2.3 million per annum, who are subject to special rules:



- Monthly payments on account are due at the end of months 2 and 3 in every quarter of 1/24th of the annual liability for the previous year.
- Any additional amounts are due on the normal payment date.

## Notes

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# 2 VAT records and invoices

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## 2.1 VAT records

Records must be kept of all goods and services received and supplied in the course of a business.

Businesses with taxable turnover above the VAT threshold of £85,000 are required to keep their VAT records digitally. The records must be sufficient to allow the VAT return to be completed and to allow HMRC to check the return.

Records must be kept up to date and must be preserved for six years.

Typical records include:

- Copies of all VAT invoices issued
- Evidence supporting the claim for recovery of input VAT (e.g. invoices)
- Records of all outputs and inputs
- VAT accounts (i.e. summaries of total output and input tax for each period).

## Notes

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## VAT: Administration and overseas aspects

### 2.2 VAT invoices

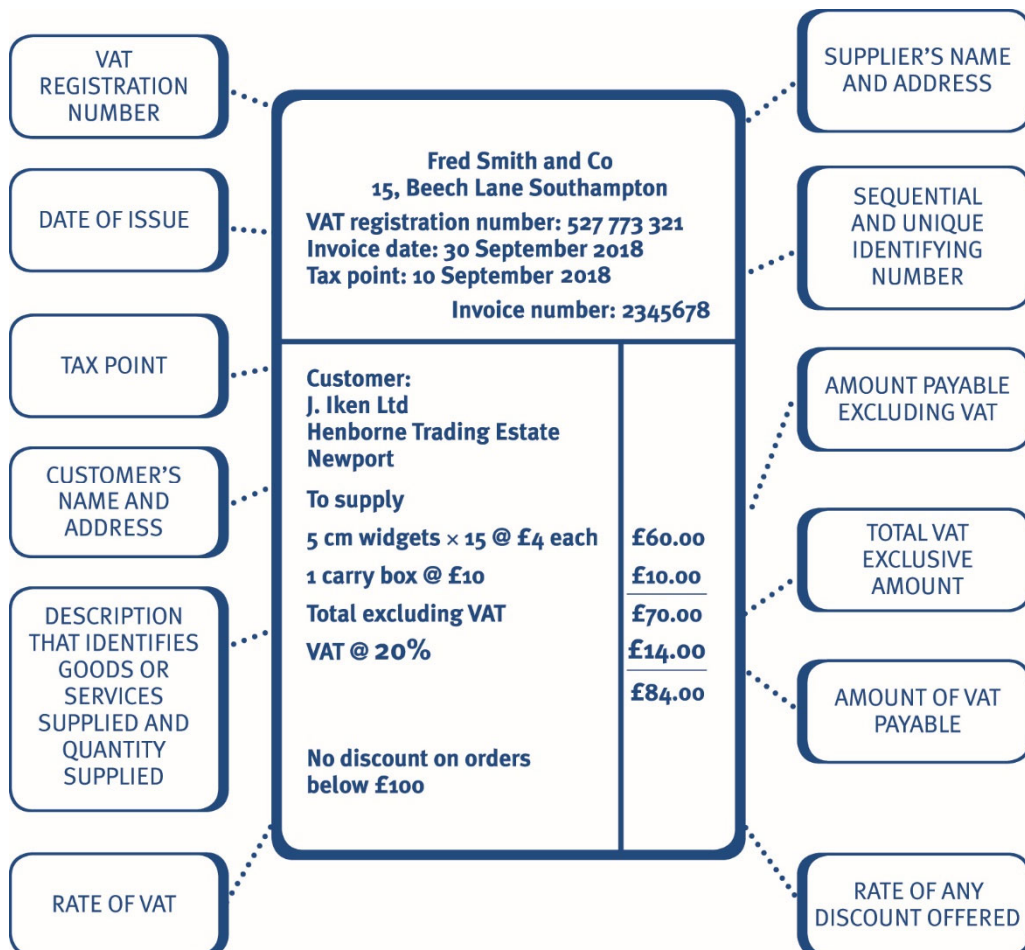
A VAT invoice provides evidence for the reclaim of input VAT when customers do their own VAT return.



It must be issued when a **standard-rated supply** is made to a **VAT registered customer**, within **30 days** of the date of supply.

It can be sent electronically if the customer agrees.

A VAT invoice must contain the following:



## Notes



### 2.3 Simplified (less detailed) invoices

- A less detailed invoice can be issued for supplies  $\leq$  £250 (VAT-inclusive).
- Less detailed invoices only need to show:
  - supplier's name, address and VAT registration number
  - date of supply
  - description sufficient to identify goods and services
  - amount payable (including VAT) for each rate of VAT
  - VAT rate applicable.

## Notes

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## Example 1

Look at the following list of items.

Select by entering the appropriate number whether the items:

- 1 Should only be shown on a normal detailed VAT invoice, or
- 2 Should be shown on both a normal detailed VAT invoice and on a less detailed invoice, or
- 3 Should not be shown on either form of invoice.

	Item	Number (1, 2, or 3)
A	Identifying number	
B	Tax point date	
C	Delivery date	
D	Total amount of VAT payable	
E	Customer's registration number	

### VAT invoices

A	1
B	2
C	3
D	1
E	3

## Notes



# 3 Default surcharge

### 3.1 Late payment or late filing: default surcharge



A **default** occurs when a VAT return is filed late or a VAT payment is made late. For a late payment, a default surcharge (penalty) may arise.

- On the first default:
  - HMRC will serve a surcharge liability notice specifying a 12-month surcharge period starting from the end of the return period.
  - There is no default surcharge.
- For each further default during the surcharge period:
  - The surcharge period is extended to end 12 months after the end of the latest period of default.
  - If VAT has been paid late, there is a surcharge based on the outstanding amount. This charge depends on the number of defaults in the surcharge period, as follows.

#### Default in the surcharge period

#### Surcharge as a percentage of the unpaid VAT due

First	2%
Second	5%
Third	10% (or £30 if greater)
Fourth and subsequent	15% (or £30 if greater)

Surcharges at the 2% and 5% rates are not charged for amounts of less than £400.

A trader's surcharge period will only end if the trader pays the tax and files the returns on time for four consecutive periods.

## Notes





## Example 2

Livingstone Ltd has paid the VAT due from its recent quarterly returns as follows:

VAT quarter ended	VAT due £	Date VAT paid
30 June	14,500	16 August
30 September	26,200	19 November

All previous payments were made on time.

**What surcharges will be payable for late payment of VAT?**

**Livingstone Ltd**

**VAT return period for the quarter ended 30 June**

The return was due on 7 August so it was filed late.

This was the company's first default.

A surcharge period begins; this will end on the following 30 June.

There is no default surcharge as this was the first default.

**VAT return period for the quarter ended 30 September**

The return was due on 7 November so it was filed late.

This was the company's first default in the surcharge period.

The surcharge period is extended and will now end on the following 30 September.

As this is the first default in the surcharge period a penalty of  $£26,200 \times 2\% = £524$  will be charged.

## Notes



# 4 Errors on VAT returns

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## 4.1 Self-assessment

- Traders calculate their own VAT liability.
- HMRC have the power to make control visits to check returns are correct.
- These powers allow them to enter premises, inspect documents, take samples and inspect computer records.

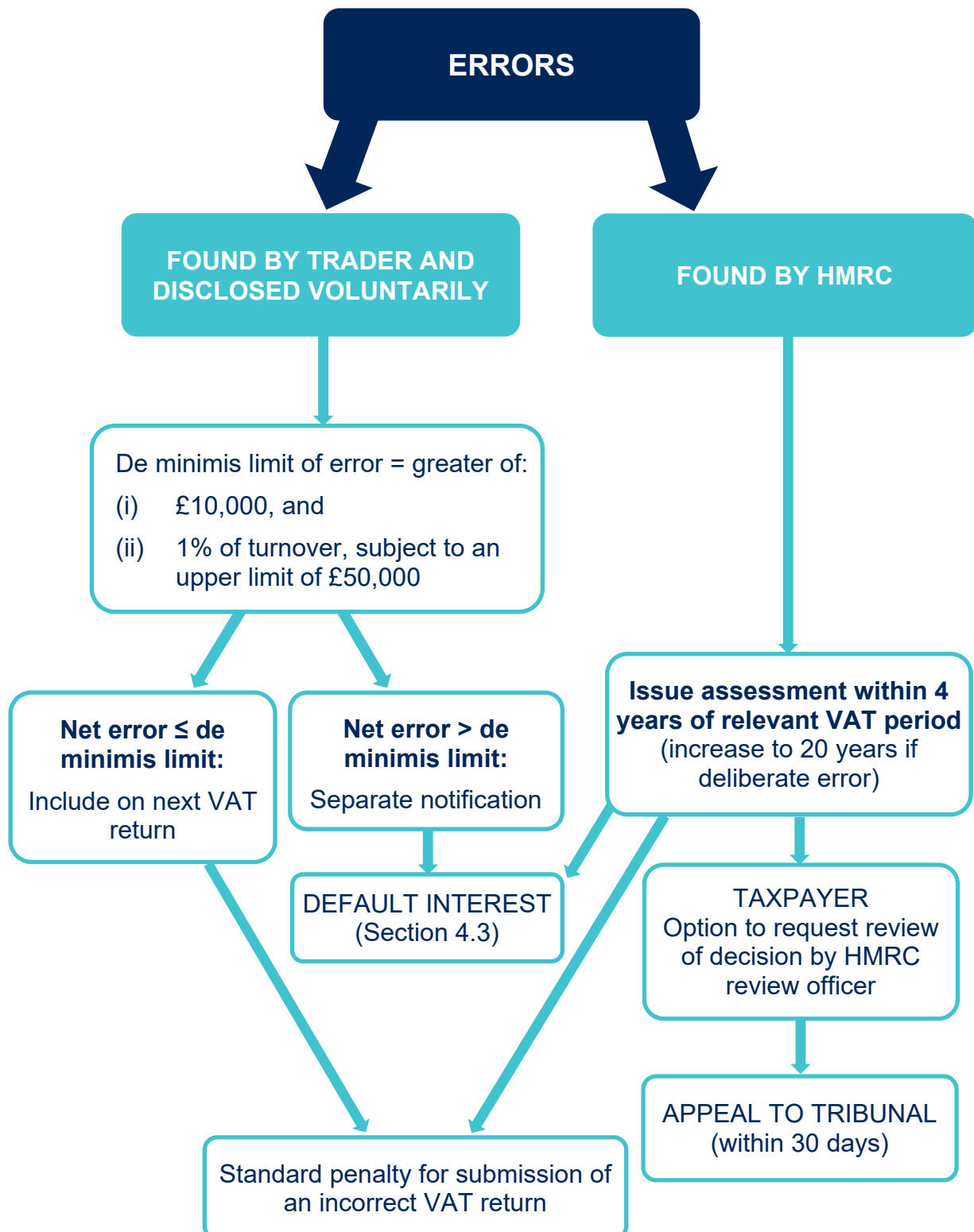
## 4.2 Errors

Errors on VAT returns may lead to standard penalties (see Chapter 12). However, no default interest (see section 4.3) will be charged if the error is below the de minimis and voluntarily disclosed by the taxpayer.

## Notes

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## Example 3

Your firm, Primary LLP, has four new clients who have been struggling with their VAT administration and have now engaged the firm to prepare their VAT returns. Whilst preparing the clients' returns for this quarter, you have noticed the following errors in the returns from the previous quarter:

Client	Net error	Turnover	Include in next return?	Separate disclosure?
	£	£		
1	3,567	150,000		
2	22,987	3,000,000		
3	42,690	3,500,000		
4	51,260	5,700,000		

For each of the businesses indicate whether they can correct their net (non-deliberate) errors on the next VAT return or whether separate disclosure is required.

## Notes



## Primary LLP

Client	Net error	Turnover	Include in next return?	Separate disclosure?
	£	£		
1	3,567	150,000	✓	
2	22,986	3,000,000	✓	
3	42,690	3,500,000		✓
4	51,260	5,700,000		✓

### Notes:

- (1) 1% of turnover is £1,500, which is less than £10,000, therefore the de minimis limit is £10,000. The net error is less than £10,000 therefore the error can be included in the next return.
- (2) 1% of turnover is £30,000, which is more than £10,000, therefore the de minimis limit is £30,000. The net error is less than £30,000 therefore the error can be included in the next return.
- (3) 1% of turnover is £35,000, which is more than £10,000, therefore the de minimis limit is £35,000. The net error is more than £35,000 therefore the error must be disclosed separately, and default interest will be charged.
- (4) 1% of turnover is £57,000, but this is subject to an upper limit of £50,000. Since the net error made is for more than £50,000, it must be disclosed separately and default interest will be charged.

## Notes



### 4.3 Default interest

A taxable person may be charged default interest where:

- HMRC raise an assessment, or
- the taxpayer voluntarily discloses an error that exceeds the de minimis.

Interest runs from the date the tax should have been paid to the actual date of payment.

Any interest charged by HMRC is limited to a maximum of three years prior to the date of the assessment or voluntary disclosure.

## Notes

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### Example 4

Harry discovers an error in his VAT return for the quarter ended 31 December 2019, which has led to an underpayment of VAT of £54,100. Harry pays the outstanding sum on 7 March 2021.

**Assuming the rate of interest is 2.75% calculate the interest on late paid tax payable by Harry.**

#### Harry

The under declared VAT is greater than £50,000 therefore it cannot be de minimis and will need to be separately disclosed by Harry. As such, default interest will be charged.

The error relates to the quarter ended 31 December 2019 and the VAT for this quarter would have been due on 7 February 2020. Since the amount of £54,100 is not paid until 7 March 2021, 13 months of interest will apply.

Thus, the interest charge will be  $£54,100 \times 2.75\% \times 13/12 = £1,612$ .

In addition, penalties will apply – the precise percentage will depend on Harry's behaviour in terms of the original error.

## Notes



# 5 Schemes for small businesses

## 5.1 Annual accounting scheme

### Operation of the scheme

- Only one VAT return is submitted each year but VAT payments must still be made regularly.



- The annual return must be filed within **two months** of the end of the return period.
- The trader normally makes nine monthly payments on account – at the end of months 4 through to 12 during the year. Each payment is based on 10% of last year's VAT liability (or an estimate for a new business).
- A balancing payment (or repayment) is made when the return is filed.



### Advantages:

- One return helps relieve the burden of administration.
- Fixed monthly payments as the year progresses assist with budgeting and possibly cash flow if VAT payable is increasing year on year.
- Extra month to submit return and make balancing payment.

### Conditions (same as cash accounting scheme)

- Traders can join the annual accounting scheme if the VAT-exclusive taxable turnover (including zero-rated sales but excluding sales of capital assets) in the next year is expected to be  $\leq \text{£}1,350,000$ .
- The trader's VAT returns must be up-to-date and they must have no convictions for VAT offences or penalties for dishonest conduct.
- A trader can remain in the scheme until taxable supplies from the previous 12 months  $> \text{£}1,600,000$ .

### Example 5



Patch accounts for VAT using the annual accounting scheme.

His VAT liability for the year ended 30 April 2020 was £36,000.

When Patch completes his tax return shortly after the year ended 30 April 2021 he calculates the VAT due for the year to be £38,000.

**State what payments Patch is required to make in respect of the year ended 30 April 2021 and when they are due.**

#### **Patch**

Nine monthly payments on account totalling 90% of the VAT due for the year ended 30 April 2020 are required.

Each payment is therefore  $(£36,000/10) = \textbf{£3,600}$  – starting 31 August 2020.

A final payment of £5,600  $(£38,000 - (9 \times £3,600))$  is due along with the VAT return 2 months after the year end i.e. **30 June 2021**.

### Notes



### 5.2 Cash accounting scheme

#### Operation of the scheme

- VAT is accounted for based on cash receipts and payments, rather than based on invoices issued and received.
- The tax point becomes the time of receipt or payment.



Advantages	Disadvantages
<ul style="list-style-type: none"><li>➤ Businesses selling on credit do not have to pay output VAT to HMRC until they receive payment from customers</li><li>➤ This gives automatic relief for impaired debts</li></ul>	<ul style="list-style-type: none"><li>➤ Input tax cannot be claimed until the invoice is paid. This delays recovery of input VAT if the business is buying on credit</li><li>➤ Not suitable for cash sales or zero-rated businesses that would simply suffer a delay in input tax recovery</li></ul>

#### Conditions (same as annual accounting scheme)

- Traders can join the cash accounting scheme if the VAT-exclusive taxable turnover (including zero-rated sales but excluding sales of capital assets) in the next year is expected to be  $\leq \text{£}1,350,000$ .
- The trader's VAT returns must be up-to-date and they must have no convictions for VAT offences or penalties for dishonest conduct.
- A trader can remain in the scheme until taxable supplies from the previous 12 months  $> \text{£}1,600,000$ .

## Notes





## Example 6

Complete the table below stating which of these businesses would benefit from the cash accounting scheme.

Description	Benefit from cash accounting? Yes/No
X Ltd is a company manufacturing mobile phone accessories, which it sells to retail stores. Credit of up to 2 months is allowed for payment and X Ltd had to write off irrecoverable (bad) debts of £40,000 last year.	
Busy Bakery Co makes bread, which it sells to small local shops. This is a zero-rated activity.	
Jason owns a high street shop and sells directly to the public. All sales are standard-rated for cash.	

### Cash accounting scheme

Description	Benefit from cash accounting? Yes/No
X Ltd is a company manufacturing mobile phone accessories, which it sells to retail stores. Credit of up to 2 months is allowed for payment and X Ltd had to write off irrecoverable (bad) debts of £40,000 last year.	Yes
Busy Bakery Co makes bread, which it sells to small local shops. This is a zero-rated activity.	No
Jason owns a high street shop and sells directly to the public. All sales are standard-rated for cash.	No

### 5.3 Flat rate scheme

#### Operation of the scheme

- Net VAT due = flat rate percentage applied to gross (VAT-inclusive) total turnover figure (inclusive of zero-rated and exempt supplies).
- No input VAT is recovered.
- The percentage varies according to the type of trade that the business is involved in. The relevant percentage will be given in the question.
- VAT invoices issued as normal (standard-rated, zero-rated, etc.)
- No input VAT records need be kept.
- The flat rate scheme can be used in conjunction with the annual accounting scheme but not the cash accounting scheme. However, traders can request to apply the flat rate percentage to cash actually paid/received rather than VAT-inclusive turnover.



#### Advantages:

- Less admin burden as no input VAT records required.
- Possibly less VAT due than under normal VAT rules.

#### Conditions for the scheme

- Traders can join the flat rate scheme if the annual taxable turnover (excluding VAT) in the next year is expected to be  $\leq$  £150,000.
- A trader can remain in the scheme until total tax inclusive turnover (including exempt income)  $>$  £230,000.

## Notes





## Example 7

Ross runs a cutlery making business. In the year ended 31 December 2020 Ross thinks the value of his taxable sales will be £144,000 (VAT-inclusive). Ross also has some zero-rated sales the value of which is expected to be £10,000. His total purchases, including VAT, are £36,000 all of which are used for the taxable sales.

**Calculate the VAT due for the year using:**

- (a) the normal rules, and
- (b) the flat rate scheme using a flat rate of 10.5%.

**Ross**

### (a) Normal method

		£
Output VAT:		
Standard-rated sales	$(£144,000 \times 1/6)$	24,000
Zero-rated sales	$(£10,000 \times 0\%)$	0
Input VAT	$(£36,000 \times 1/6)$	(6,000)
		<hr/>
VAT payable		18,000
		<hr/>

### (b) Flat rate method

$$(£144,000 + £10,000) = £154,000 \times 10.5\% = £16,170$$

Under the flat rate scheme there is a VAT saving of £1,830 (£18,000 – £16,170).

Additionally, administration is simplified: Ross will not have to keep records of input or output VAT.

## Notes

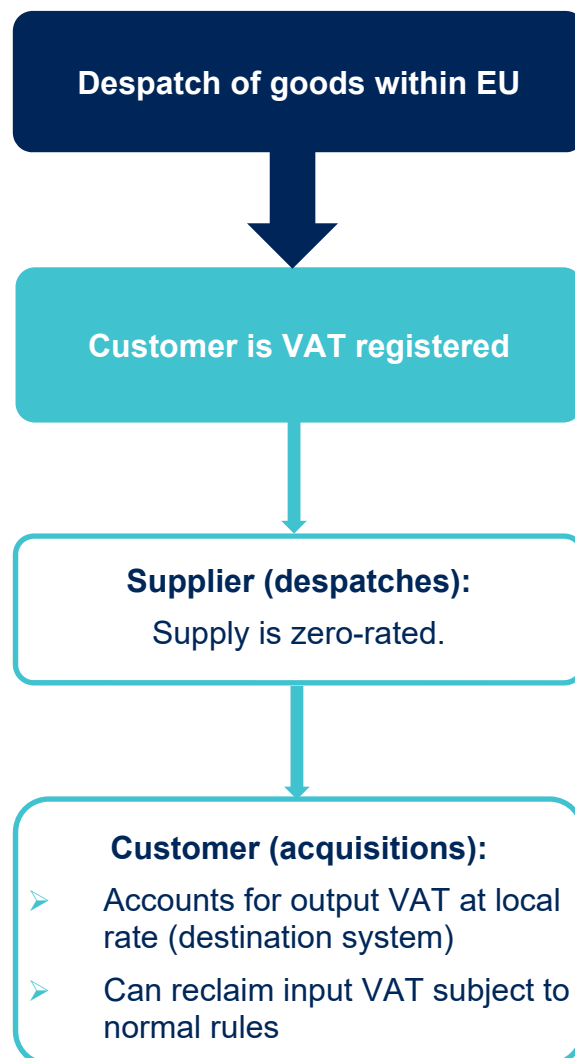


# 6 Overseas aspects of VAT

## 6.1 Supply of goods within the European Union (EU)

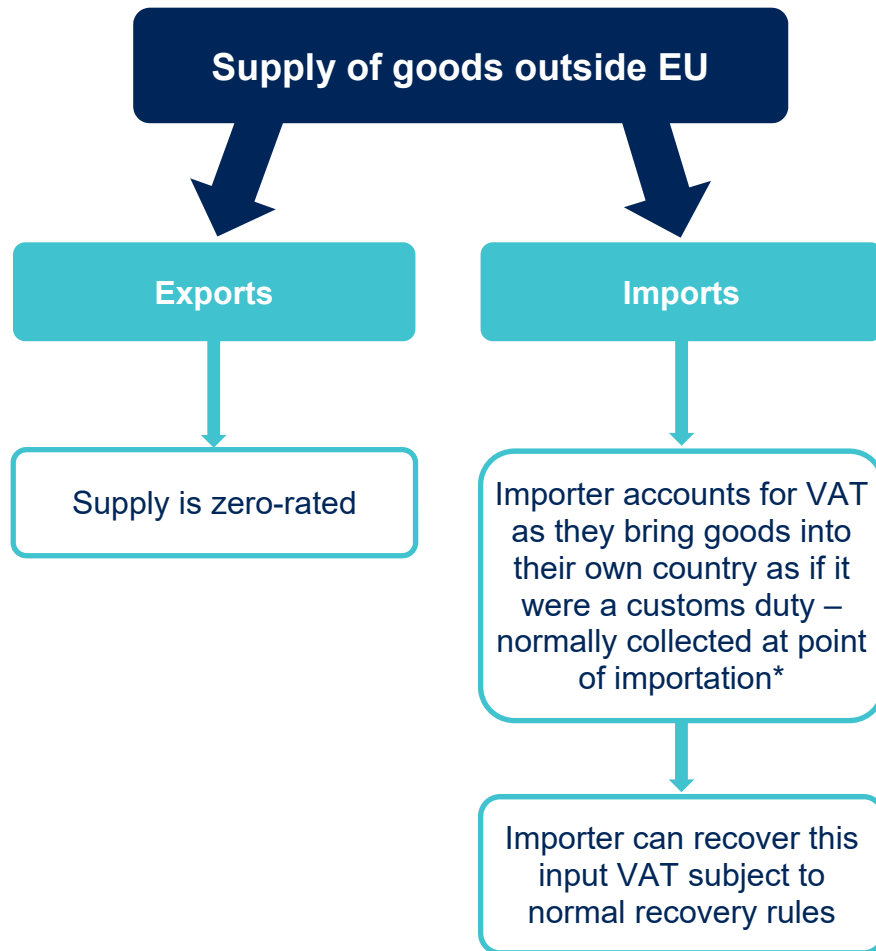
VAT applies throughout EU however; the rate of VAT may vary.

The UK officially left the EU prior to FY20, but the EU VAT rules will not change during Brexit transition. This is due to end on 31 December 2020, however in the exam it is assumed the EU rules will continue to apply.



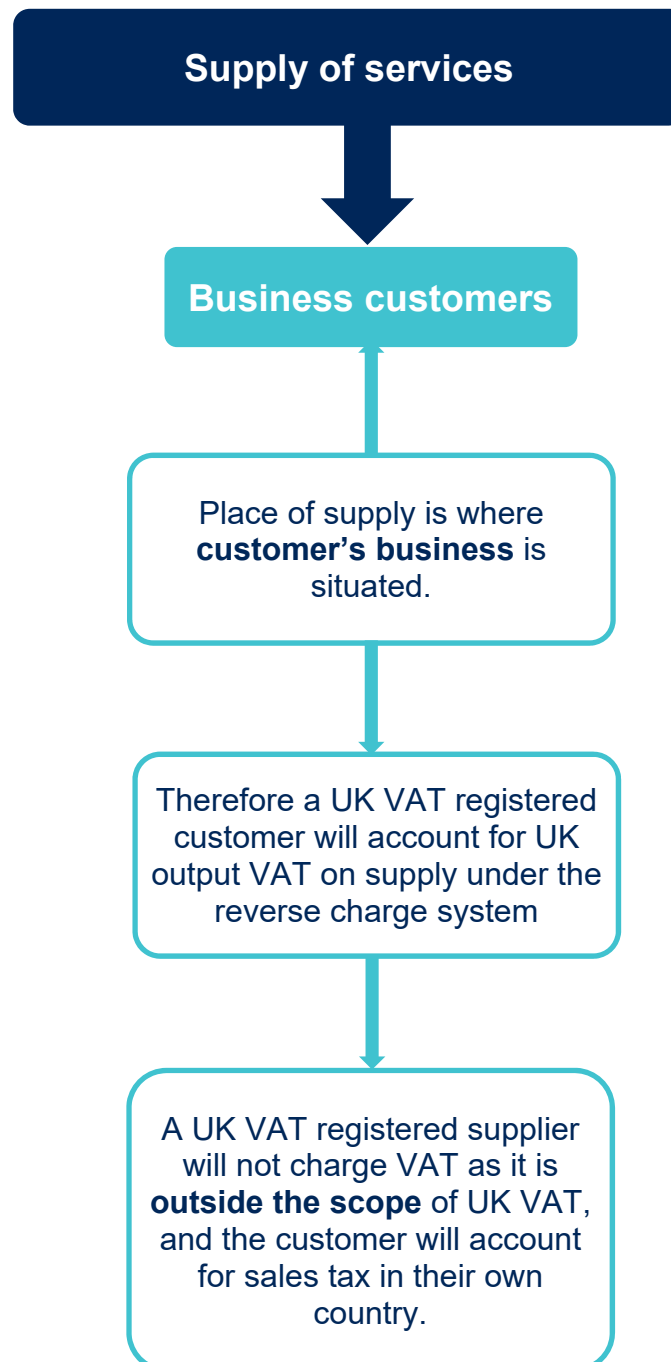


### 6.2 Supply of goods outside the EU



\*Approved traders can pay off all of their VAT on imports through the duty deferment system. The trader must provide HMRC with a bank guarantee to set up an account. This allows all VAT on imports to be paid on the 15th of the month following the month of importation. This assists the trader's cash flow and is more convenient.

### 6.3 Supply of services



## Example 8



Amber Ltd, a UK manufacturing company, has the following information for the quarter to 30 September 2020:

### Sales

	£
Sales in UK (standard-rated)	150,000
Sales in France (VAT registered customers)	25,000
	<hr/>
	175,000
	<hr/>

### Purchases

	£
Raw materials and expenses	35,000
Materials from France	5,000
Accountancy services in Spain	4,000
	<hr/>
	44,000
	<hr/>

All purchases are standard-rated. All figures exclude VAT.

**Calculate VAT due for the quarter.**

## Notes



### Amber Ltd

#### VAT due for quarter ended 30 September 2020:

##### Output tax

	£	£
Standard-rated supplies ( $\text{£}150,000 \times 20\%$ )		30,000
Zero-rated supplies ( $\text{£}25,000 \times 0\%$ )		0
Materials from France ( $\text{£}5,000 \times 20\%$ )		1,000
Accountancy services in Spain ( $\text{£}4,000 \times 20\%$ )		800
		<hr/>
		31,800

##### Input tax

Raw materials and expenses	35,000	
Materials from France	5,000	
Accountancy services in Spain	4,000	
	<hr/>	
	44,000	$\times 20\%$
	<hr/>	(8,800)
		<hr/>
VAT due for quarter		23,000
		<hr/>

The supply of goods to French VAT registered customers is zero-rated.

The receipt of goods from France and accountancy services in Spain are subject to the reverse charge rules and therefore there is output and input VAT on these supplies for Amber Ltd.

## Questions



You should now be able to answer TYU questions 1 to 15 from the Study Text Chapter 26 as well as the question 'Mary' from Chapter 27.

Knowledge Check Test: Inheritance tax and VAT on MyKaplan.

For further reading, visit Chapter 26 of the Study Text and review the TX article on 'VAT part 2' at [www.accaglobal.com](http://www.accaglobal.com).

## Notes

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