Business tax factsheet

Administration

- Taxation administered by HM Revenue and Customs ('HMRC').
- Rules covering tax are contained in statute (=law). Law passed every year, Finance Act.
- Decisions reached by the Courts interpreting the law are known as case law.
- HMRC also issue guidance **–** Extra Statutory Concessions and Statements of Practice.

Taxes

- Corporation Tax – paid by companies on both income and capital gains.
- Income Tax – paid by individuals on their income (for example, self-employed income).
- Capital Gains Tax – paid by individuals on their capital gains (for example, a one-off profit from the sale of a business asset).

Tax avoidance and tax evasion

- Tax evasion – any action taken to evade tax by illegal means. Risk of criminal prosecution.
- Examples of tax evasion – failing to declare income and claiming false expenses.
- Tax avoidance – taxpayer uses legitimate means to minimise his/her tax liability. For example, investing in a tax-free ISA (Individual Savings Account).

An outline of Corporation Tax

- Companies pay Corporation Tax on their profits for each accounting period.
- There are two Corporation Tax rates – small companies' rate for lower profits and main rate for higher profits. These rates are set each financial year.
- Marginal relief is available for profits in between the small companies' rate and main rate profits.
- Profits = income + gains – charges.
- Accounting periods are usually twelve months long but can be shorter.
- If a company's accounts are longer than twelve months, the first twelve months will be one accounting period and the remainder a second accounting period.
- All UK property income is pooled as a single source of income and taxed on an accruals basis.
- Gift Aid Donations are charges on income.
- Having associated companies can affect the tax rate charged on a company's profits.

Adjustment of profits

Pro forma for adjustment of profits

	£	£
Net profit as per accounts		X
Add Expenses charged in the accounts that are not allowable as trading expenses	X	
		X
		X
Less Income included in the accounts which is not assessable as trading income	X	
		(X)
Adjusted profit/(loss)		X

Disallowed expenses

- Expenses that fail the remoteness test so not "wholly and exclusively" for trading purposes.
- Fines on the business or fraud by directors.
- Donations to national charities – might be allowed as a charge on income if Gift Aid donations. Political donations are never allowable.
- Capital expenditure. For example, the purchase of equipment included in the Income Statement.
- Depreciation. Capital Allowances granted instead.
- Costs of bringing newly acquired second-hand assets to useable condition.
- Legal and professional expenses relating to capital items or breaking the law.
- Under FRS 26 all allowances for debtors (such as bad debts) are allowable for tax purposes.
- Customer entertaining. Staff entertaining can be allowable.
- Customer gifts. Unless gift incorporates business advertising, cost is less than £50 per annum per customer and gift is not food, drink, tobacco or cash vouchers.

Non-assessable income

- Income taxed in any other way, such as interest or property income.
- Profits on sale of fixed assets.

Capital allowances

Layout of capital allowances on plant and machinery computation

	First Year Allowance (FYA 100%)	Annual Investment Allowance(AIA)	General pool	Special rate pool (10%)	Short Life Asset	Total allowances
		£	£	£	£	£
WDV b/f			X	X	X	
Additions	X	X	X	X		
Disposals			(X)	(X)	(X)	
	X	X	X	X	X	
Balancing allowance/balancing charge (BA/BC)					X/(X)	X/(X)
					Nil	
AIA/FYA (balance transferred to general pool)	(X)	(X)				X
Writing down allowance @ 20/10%			(X)	(X)		X
WDV c/f	Nil	Nil	X	X		
	===	===	===	===		
Total Allowances						X

AIA – 100% allowance for first £25,000 (FY2011 £100,000) of expenditure (not cars) in twelve month period (pro rata). Expenditure > £25000 pa qualifies for first year allowance (FYA) or writing down allowance (WDA).

Full WDA for the period is given regardless of date of purchase of item. WDA is scaled for periods other than 12 months.

FYA – 100% allowance given on purchase of environmentally friendly cars (CO2 < 111g/km) and energy saving/water efficient plant. FYA is not scaled for short accounting periods.

If the written down value (WDV) on the general pool (= WDV b/f + additions-disposals) is £1,000 or less then pool is written off as small pools annual writing down allowance.

Motor Cars – CO2 emissions between 111 and 160g/km, in general pool and 18% (FY2011 20%) WDA. If CO2 emissions greater than 160g/km, in special rate pool with 8% (FY2011 10%) WDA.

Short life assets (SLA) – de-pool asset if life expected to be less than four years. Not available for cars.

The calculation of total profits

The pro forma Corporation Tax computation

ABC Ltd

Corporation Tax computation for the year/period ended

	£
Trading income	X
Interest income – accrual basis	X
Property income – accrual basis	X
Chargeable gains	X
	X
Less charges on income – Gift Aid donations	(X)
Total Profits (TP)	X

Key points

- Trading income is adjusted from net profit per company accounts less capital allowances.
- All income in computation to be gross.
- Some income may need to be grossed up. Companies receive interest gross.
- Virtually all interest receivable is taxed as Interest Income.
- Dividends payable by a company are not an allowable expense.
- UK dividends receivable by a company are not taxable.
- Net-off current year capital losses against current year capital gains. If there is a net capital loss carry it forward.

The calculation of Corporation Tax payable

- Calculate 'Profits' = Total Profits (TP) + Franked Investment Income (FII).
- FII = UK dividends received x $^{100}/_{90.}$
- Compare 'profits' with lower and upper limits.
- Profits less than lower limit, rate is small companies' rate.
- Profits greater than upper limit, rate is full rate.
- Profits between lower and upper limits:
    - Corporation Tax = (TP x full rate) – marginal relief.
- Marginal relief formula:-

    (U - A) x (N / A) x marginal relief fraction for financial year
    U = Upper limit
    A = 'Profits'
    N = TP

- Percentages and limits are provided in the examination.

Corporation Tax – further aspects

Short chargeable accounting periods (CAPs)

- Upper and lower limits are annual limits. Pro rata these limits accordingly for the length of CAP.

Long periods of account

- Will consist of two CAPs = first twelve months and remainder of period.
- Split profits as follows.
    - Adjusted trading profit and property income – time apportion.
    - Capital allowances – separate computations for each CAP.
    - Interest income – accruals basis.
    - Chargeable gains – according to date of disposal.
    - Charges on income – according to date paid

Corporation Tax - losses

- Can elect to set trading losses against current accounting period total profits.
- If the above election is made, can also carry back trading loss to set against total profits within the previous 12 months.
- Trading losses are automatically carried forward to set against the first available profits of the same trade if not utilised by the above claims.
- If there is a choice of loss relief, firstly consider the rate of tax then the timing of the relief.
- Capital losses can only be set against capital gains in the same or future accounting periods.
- Rental losses can be set against total profits of the current accounting period or carried forward to set against future total profits.
- Set out the use of the losses in a loss memorandum.

Corporation Tax – the return

- Familiarise yourself with the tax return. The Short Tax Return is for smaller companies with straightforward tax affairs, and the completion of this form is a common requirement in the assessment.

- The figures to enter into the tax return boxes will either be your own answers or will be provided in the information given in the question.
- The description labels given to the boxes on the supplementary pages will assist you in inserting figures into the appropriate box.

Corporation Tax – payment and administration

Payment dates

- Small and marginal companies – 9 months + 1 day after end of the accounting period (CAP).
- Large companies - must estimate year's tax liability and pay 25% of the year's liability:
    - 6 months and 14 days after start of CAP.
    - 9 months and 14 days after start of CAP.
    - 14 days after end of CAP.
    - 3 months and 14 days after end of CAP.

- Estimate must be revised for each quarter. Penalties may be charged if company deliberately fails to pay sufficient instalments.
- No instalments due for first year company is large unless profits > £10 million.

Interest on late payments

- Interest charged daily on late payment. Overpayment of tax receives interest from HMRC. Interest is taxable/tax allowable as interest income.

Filing the return

- Filed on the later of 12 months after end of CAP or 3 months after the notice to deliver a tax return has been issued.
- Late filing penalties are: <3 months late £100 / >3 months late £200 / >6 months late 10% of tax due per return / >12 months late 20% of tax due per return.
- Company must notify HMRC it is within scope of Corporation Tax within 3 months of starting to trade.
- Company can amend return within 12 months of the filing date.

Enquiries and other penalties

- HMRC must notify company of enquiry within 12 months of submission of return.
- Basis of enquiry – random or HMRC believe income/expenses misstated.
- Penalty for failure to produce enquiry documents = £50 + £30 per day.
- Penalty for failure to keep proper records is up to £3,000.
- Penalties for incorrect return are - simple mistake 0% / fail to take reasonable care 30% / deliberate error 70-100%.

Unincorporated businesses – trading income

Trading income calculated for each period of account:

	£
Adjusted accounting profit	X
Less: Capital Allowances	(X)
Trading income for the period of account	X

Expenses charged in the accounts which are not allowable as trading expenses

- Same rules apply as for companies.
- In addition consider any transactions with the owner of the business. For example:
  - add back salary paid to owner. Salaries paid to family members do not need to be added back provided they are not excessive
  - private expenditure included in accounts is disallowed
  - class 2 NI contributions.

Trading income not credited in the accounts

- Goods taken for own use, the profit element of the sale must be added to business profits.

Private use assets

- Private use assets have separate column in Capital Allowance computation. Disallow private use % of WDA/AIA/FYA.

Capital allowances – business cessation

- In the cessation period of account, no WDA/AIA/FYA.
- Include additions and disposals as normal. Any asset taken over by owner, treat as a disposal at market value. Balancing adjustment made (balancing charge or balancing allowance).

Tax return

- Familiarise yourself with the self-employed supplementary pages.
- The figures to enter into the tax return boxes will either be your own answers or will be provided in the information given in the question.
- The description labels given to the boxes on the supplementary pages will assist you in inserting figures into the appropriate box.

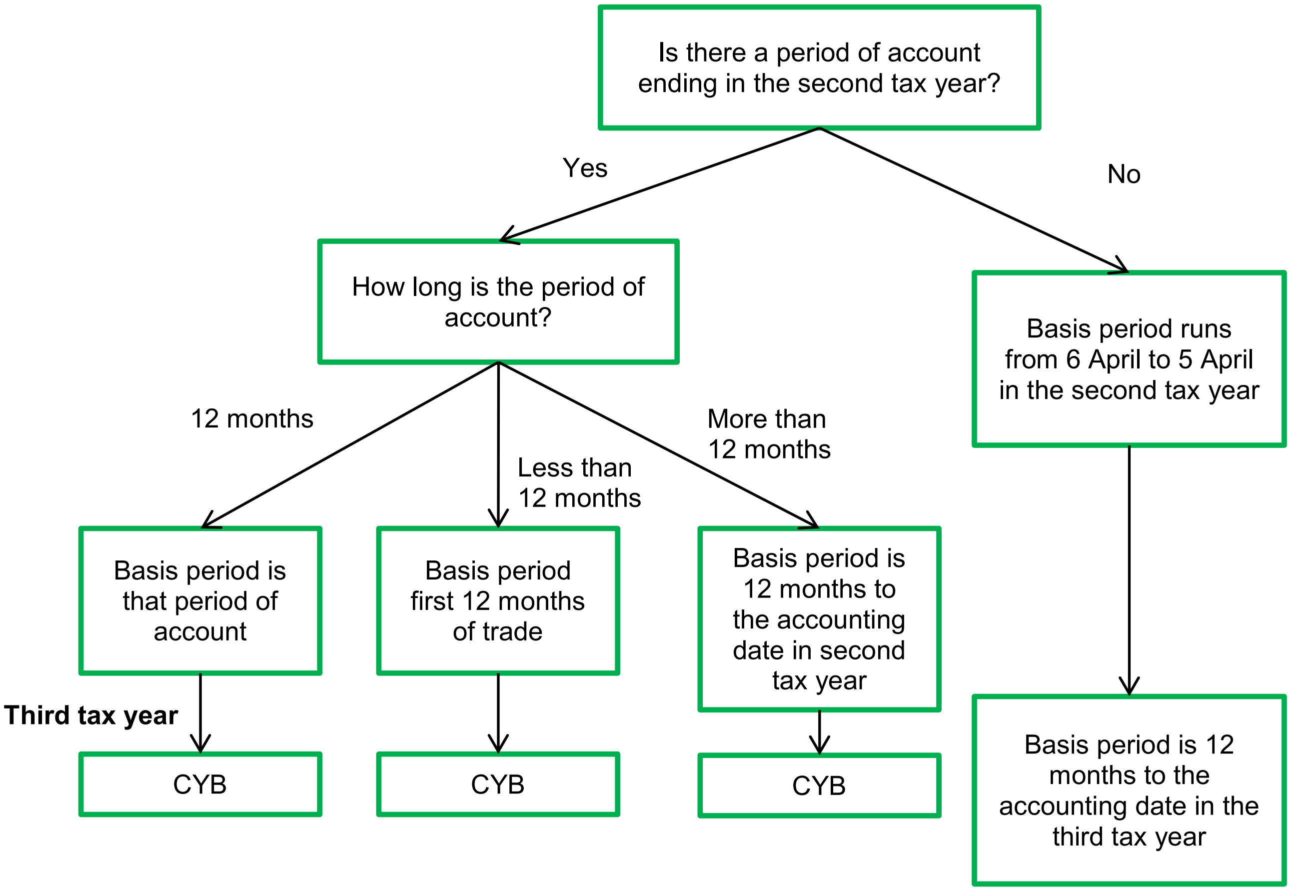
Trading income – basis periods

Tax year – 2012/13 tax year runs from 6 April 2012 to 5 April 2013

Basis period rules

First Year – runs from start date of trading to the next 5 April.

Second Year and Third Year – use this flowchart:



Later years – basis period is the period of account ending in the tax year = Current Year basis (CYB).

Final year – basis period is the period from the end of the basis period for the previous tax year to cessation date.

Overlap profits - opening year rules may lead to profits being taxed twice. Relief is given on cessation of the business.

National Insurance Contributions

- Self-employed individuals pay Class 2 and Class 4 contributions.

Class 2 contributions

- Class 2 contributions are £2.65 per week, payable from the week self-employment commences to the week self-employment ceases.
- No contributions payable if profits less than £5,595 per annum.
- Payable from the age of 16 to retirement.

Class 4 contributions

- Class 4 contributions are at 9% on profits between the lower and upper limits. Then 2% on profits above the upper limit.
- Payable for the tax year in which the individual becomes 16 to the tax year in which they reach retirement.
- Percentages and limits are provided in the examination.

Trading losses for unincorporated businesses

- A loss is computed in the same way as a profit, making the same adjustments to the net profit as per the accounts and deducting capital allowances.

Set off of trading loss against total income

- Set off loss against total income of the preceding tax year and/or the tax year of loss. For example, loss in 2012/13 set off against total income in 2011/12 and/or 2012/13.
- Cannot restrict loss to preserve use of personal allowance so personal allowance may be wasted.
- For 2012/13 loss claim needed by 31 January 2015.

Carry forward of trading losses

- If any loss remains unrelieved after current year and carry back claim has been made, or no such claims are made, then carry forward the loss against the first available profits of the same trade.

Choice of loss relief – consider the following.

- Utilise loss in the tax year in which income is taxed at a higher rate.
- Possible wastage of personal allowance.
- Level of future profits – will these utilise a loss carried forward?
- Cash flow important? Get a tax refund as soon as possible by loss carry back.

Partnerships

- Each partner is taxed like a sole trader on their share of the partnership profits.
- First step is to share accounting profits between partners.
    - Divide the profit for each set of accounts between the partners based upon the profit sharing arrangement.
    - You may need to split the period if there is a change such as a partner joining or leaving.
- Opening year and cessation rules apply to partners individually when they join or leave the partnership.
- Allocate the profit for each partner to the correct tax year using usual basis period rules
- Basis periods for continuing partners are unaffected by joiners or leavers.

Tax return

- Each partner enters their share of profits for a tax year in the partnership pages of their own tax return.
- Familiarise yourself with the partnership supplementary pages.

- The figures to enter into the tax return boxes will either be your own answers or will be provided in the information given in the question.
- The description labels given to the boxes on the supplementary pages will assist you in inserting figures into the appropriate box

Income Tax – payment and administration

The return must be filed by:

- 31 October following the end of the tax year if filing a paper return
- 31 January following the end of the tax year if filing online.

Penalties for late filing

- Initial penalty for failing to file by 31 January - £100.
- If over 3 months late, additional £10 per day to a maximum of £900.
- Over 6 months late, further £300 penalty or 5% of the tax owing whichever is higher.
- If 12 months late, additional £300 penalty or 5% of the tax owing whichever is higher. Further penalties of up to 100% of the tax due can be raised in serious cases.

Disclosure and errors

- Taxpayer must notify HMRC if tax return is needed by 5 October following end of the tax year.
- Taxpayer can amend tax return within 12 months of filing date or make an overpayment relief claim within four years of the end of the tax year.

Payments on account (POA)

- Due 31 January (in tax year) and 31 July (after tax year end). Each instalment is 50% of the previous year's tax and Class 4 NIC liability.
- Balancing payment made 31 January after tax year end.
- No POA due if last year's tax and Class 4 NIC liability was less than £1,000 or if more than 80% of last year's liability was deducted at source.
- Can reduce POA if this year's liability expected to be less than last year's. Penalties will be charged if a deliberate incorrect claim is made.

Interest on tax paid late/overpaid tax

- Same rules apply as for companies except individuals not taxed on interest received from HMRC.
- Penalties are also imposed on individuals, 5% applied when balancing payments more than 30 days late plus a further 5% when six months late and a further 5% if still unpaid 12 months after the payment due date.

Enquiries and other penalties

- Same rules apply as for companies.

Introduction to chargeable gains

- Individual pays Capital Gains Tax (CGT) on net chargeable gains in a tax year.
- For companies, chargeable gains are included as income in calculating Total Profits.
- Individuals receive an annual exemption from CGT, 2012/13 £10,600.
- For individuals, CGT is charged at 18% for basic rate tax payers and at 28% for higher rate tax payers.
- Gains/losses arise when a chargeable person makes a chargeable disposal of a chargeable asset.
- Chargeable person = individual or company.
- Chargeable disposal = sale, gift or loss/destruction of the whole or part of an asset. Exempt disposals — on death and gifts to approved charities.
- Chargeable asset = all assets unless exempt. Exempt assets = motor cars and some chattels.

Calculation of gains and losses for individuals

Calculation of individual gains/losses

	£	£
Consideration received		X
Less Incidental costs of sale		(X)
Net sale proceeds		NSP
Less Allowable expenditure		
• Acquisition cost	X	
• Incidental costs of acquisition	X	
• Enhancement expenditure	X	
		(Cost)
Gain/(Loss)		X/(X)

- Consideration received is usually sales proceeds, but market value will be used instead of actual consideration where the transaction is a gift or between connected persons.
- An individual is connected with **their spouse, lineal relatives (and their spouses) and spouse's lineal relatives (and their spouses).**
- Husband and wife/civil partner transfers - **nil gain nil loss**. Tax planning opportunity.

Part disposals - the cost allocated to the disposal = Cost x (A/(A+B))

A = consideration received on part disposal B = market value of the remainder of the asset

Chattels - tangible moveable object. Two types:

- Wasting – expected life of 50 years or less (such as a racehorse or a boat). CGT exempt.
- Non-wasting – expected life greater than 50 years (such as antiques or jewellery). CGT=£6,000 rule (see below).

Buy / Sell	£6,000 or less	More than £6,000
Less than £6,000	Exempt	Allowable loss but proceeds are deemed = £6,000
More than £6,000	Normal calculation of the gain, then compare with 5/3 (gross proceeds - £6,000) • Take the lower gain	Chargeable in full

Shares and securities – disposals by individuals

One screen summary

Capital Gains Tax on shares and securities

Disposal of shares and securities are subject to CGT except for listed government securities (gilt-edged securities or 'gilts'), qualifying corporate bonds (for example, company loan notes/debentures) and shares held in an Individual Savings Account (ISA).

The identification rules

Used to determine which shares have been sold and so what acquisition cost can be deducted from the sale proceeds. (for example, match the disposal and acquisition).

Disposals are matched:

- firstly, with acquisitions on the same day as the day of disposal
- secondly, with acquisitions made in the 30 days following the date of disposal (FIFO basis)
- thirdly, with shares from the share pool.

The share pool

- The share pool contains all shares of the same type acquired prior to the disposal date.
- Each acquisition is not kept separately, but is 'pooled' together with other acquisitions and a running total kept of the number of shares and the cost of those shares.
- When a disposal from the pool is made, the appropriate number of shares are taken from the pool along with the average cost of those shares.
- The gain on disposal is then calculated.

Bonus issues and rights issues

- Bonus issue – no adjustment to cost needed.
- Rights issue – adjustment to cost needed.

Calculation of Capital Gains Tax

Net chargeable gains = total gains in the tax year after netting off any current year or brought forward losses and the annual exemption.

Annual Exemption (AE)

- For individuals only.
- AE cannot be carried forward or carried back.
- Current year losses must be netted off against current year gains before AE. This means AE can be wasted.
- Brought forward capital losses are set off against current year gains after AE. So AE is not wasted.

Payment of Capital Gains Tax – individuals

- Capital Gains Tax (CGT) liability paid 31 January following the end of the tax year. No POA needed for CGT.

Chargeable gains – reliefs available to individuals

Entrepreneurs' relief – reduces the gains on 'qualifying business disposals'.

- The relief is given before the deduction of losses and annual exemption but after gift relief and rollover relief.
- Reduces rate of CGT on gain from 18% or 28% to 10%.
- From 6 April 2011, the lifetime maximum of relevant gains was increased to £10m.
- For 2012/13 claim must be made by 31 January 2015.
- Qualifying business disposals (assets must be owned for at least 12 months prior to sale).
    - The whole or part of a business carried on by the individual (alone or in partnership).
    - Assets of the individual's or partnership's trading business that has now ceased.
    - Shares in the individual's 'personal trading company'. Individual must have owned the shares and been an employee of the company for 12 months prior to sale.

Replacement of business assets (Rollover) relief – when a qualifying business asset is sold at a gain, taxpayer can defer gain by reinvesting proceeds in a qualifying replacement asset.

- Deferred gain is deducted from the cost of the replacement asset so gain crystallises when the replacement asset is sold.
- Qualifying assets (original and replacement) – must be used in a trade by the vendor and be land and buildings, fixed plant and machinery or goodwill.
- Qualifying time period – replacement asset must be purchased between one year before and three years after the sale of the original asset.
- Partial reinvestment – only some of the sales proceeds reinvested then the gain taxable is the lower of the full gain and the proceeds not reinvested.

Gift relief (holdover relief) – donee takes over asset at donor's base cost. In other words, the gain is given away along with the asset.

- Qualifying assets – trade assets of donor or shares in any unquoted trading company or personal trading company (individual owns at least 5% of company).

Calculation of gains and losses for companies

Pro forma computation

		£	£
Consideration received			X
Less	Incidental costs of sale		(X)
Net sale proceeds			NSP
Less	Allowable expenditure		
	• Acquisition cost	X	
	• Incidental costs of acquisition	X	
	• Enhancement expenditure	X	
			(Cost)
Unindexed gain			X
Less	Indexation allowance		(IA)
Chargeable gain			Gain
			=====

- You will be given the indexation factors to apply.
- Indexation allowance is not available where there is an unindexed loss; nor can it turn an unindexed gain into an indexed loss.
- Note that companies do not get an annual exemption.
- Losses relieved in order – current year first followed by losses brought forward.

Shares and securities – disposals by companies

The identification rules — a disposal of shares is matched:

- Firstly, with same day transactions.
- Secondly, with transactions in the previous 9 days (FIFO). No indexation allowance is available.
- Thirdly, with shares from the 1985 Pool (shares bought from 1 April 1982 onwards).

1985 Pool – pro forma working

	No.	**Cost £**		**Indexed cost £**
Purchase	X	X		X
Index to next operative event				X
				X
Operative event (purchase)	X		X	X
	X	X		X
Index to next operative event				X
				X
Operative event (sale)	(X)	(X) **A**		(X) **B**
Pool carried forward	X	X		X

Operative event = purchase, sale, rights issue. Bonus issue is not an operative event.

Computation

	£
Proceeds	X
Less cost (A from pool)	(X)
	X
Less IA (from pool, in other words indexed cost B - cost A)	(X)
Indexed gain	X

Chargeable gains – reliefs available to companies

Only relief available to companies is rollover relief.

- Rollover relief is a deferral relief.
- Main rollover relief rules – see reliefs available to individuals.
- Key differences applying for companies:
    - Indexation is given on disposal of the original asset.
    - Goodwill is not a qualifying asset for companies.
    - Gain deferred is the indexed gain.
    - On disposal of the replacement asset, indexation is calculated on the 'base cost' not actual cost

The badges of trade

6 badges of trade

S	Subject matter
O	Ownership
F	Frequency of transactions
I	Improvement expenditure
R	Reason for sale
M	Motive for profit

Duties and responsibilities of a tax adviser

- Maintain client confidentiality at all times.
- AAT members must adopt an ethical approach and maintain an objective outlook.
- Give timely and constructive advice to clients.
- Honest and professional conduct with HMRC
- Penalties:
    - Assistance in making an incorrect return – adviser liable to £3,000 penalty.
    - Involvement in fraudulent evasion of income tax is a criminal offence.