

INTRODUCTION TO UK TAXATION

There are five major types of taxes in UK

1. Income Tax (IT)
2. Corporation Tax (CT)
3. Capital gain Tax (CGT)
4. Value added Tax (VAT)
5. Inheritance Tax (IHT)

Income Tax (IT), Corporation Tax (CT), Capital Gain Tax (CGT) and Inheritance Tax (IHT) are all direct taxes while Value Added Tax (VAT) is an indirect tax.



Direct tax is one which is directly paid to HMRC by the tax payer.

Indirect tax is one which is not directly paid to HMRC by the tax payer rather it is paid through other entities.

Split year basis

When split year basis apply, a person leaving the UK will become non-resident from the date of departure and a person coming to UK will become resident from the date of arrival.

Leaving the UK		Arriving in the UK	
Individual must be <ul style="list-style-type: none"> - UK resident in current year - UK resident in previous year - Not UK resident in following year 		Individual must be <ul style="list-style-type: none"> - UK resident in current year - Not UK resident in previous year 	
Individual leaves the UK and:	Overseas part starts:	Individual arrives in UK and:	UK part starts
Ceases to have any UK home	Date have no UK home	Acquires a UK home	Date acquires UK home
Begins working full time abroad	Date starts work abroad	Begins working full time in UK	Date starts work in UK
Accompanies partner working full time abroad	Earlier of: <ul style="list-style-type: none"> - Joins partner - Partner starts full time work abroad 	Returns following a period when individual worked full time overseas	Date individual stops working overseas

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Taxable/tax adjusted trading profit

Trading profit is adjusted as follows

	£
Accounting / Net profit	x
Add: Non deductible expenses (deducted)	x
Taxable income (not added)	x
Less Deductible expenses (not deducted)	(x)
Non taxable incomes (added)	<u>(x)</u>
Tax adjusted trading profit	<u>x</u>

Revenue expenses incurred wholly and exclusively for the purpose of trade are deductible expenses.

Capital allowances

In tax year 2016-17 capital allowances are only available on expenditure on plant and machinery.

There are three types of capital allowances that are available on plant and machinery.

- Annual investment allowances (AIAs).
- First year allowances (FYAs).
- Written down allowances (WDAs).

Annual investment allowances (AIAs) (100%)

- AIAs are available on all plant and machinery except for motor cars.
- AIAs are restricted to £200,000 per annum.

First year allowances (FYAs) (100%)

- FYAs are available only on low emission cars (cars with CO2 emission of less than or equal to 75 g/km)

Written down allowances (WDAs) (18%)

- Written down allowances are available on
 1. b/f balances
 2. Plant and machinery acquired during the period in excess of annual limit of £200,000
 3. All the motor cars except for low emission car acquired during the period
- WDAs are available @ 8% on special rate pool and @ 18% on all other assets.

In the year of cessation no AIAs, FYAs or WDAs are available rather balancing allowance or charge is calculated.

Scheme summaries

	SAYE	SCOP	EMI
Participation	All employees	Selected employees	Selected employees
Maximum value	£5 to £500 per month	£30,000 per employee	£250,000 per employee Total £3m Maximum
Exercise period	3 or 5 years	3 to 10 years	Up to 10 years
Issue price	Not <80% of MV	MV	MV to avoid IT
Others		Excluded from scheme if owns >30% shares of company	Gross assets ≤ £30M Employees < 250 For ER purposes ownership period starts from grant date and no need to own ≥ 5% OSC

SIP	
Participation	All employees
Awarded free shares	Max £3,600 per year
Purchase partnership shares	Max = lower of £1800 and 10% of salary
Awarded matching shares	Max 2 per partnership shares
Dividends	Tax free if invested in further shares
Holding period	5 years for full benefit
Base cost of shares	MV when removed from plan

Lump sum payments

Wholly exempt	Partially exempt	Wholly taxable
<ul style="list-style-type: none"> ○ Statutory redundancy payments ○ Payment for injury, disability or death ○ Lump sum payment from an approved pension plan 	<ul style="list-style-type: none"> ○ Ex-gratia payments <ul style="list-style-type: none"> - First £30,000 exempt - This limit is reduced by statutory redundancy payments received 	Any other payment received which is <ul style="list-style-type: none"> - expected from employer - or contractual - or for restrictive covenants

Partnership tax rules

- Partnership does not pay tax. Each partner in partnership pays tax on his/her share of profits.
- Trading profits of partnerships are adjusted in the same way as for individuals.
- Capital allowance on assets owned by partnership are deducted from partnership profits whereas on assets owned by individual partners are deducted from profit share of individual partners.
- When a partner joins the partnership it is treated as starting the trade.
- When a partner leaves the partnership it is treated as ceasing the trade.
- Accounting date for each partner is the same as for partnership.
- Distributable profit is shared among partners which is calculated as:

		£	£
Adjusted trading profit			x
Salaries payable to partners	A	x	
	B	x	
			(x)
Interest on capital payable to partners	A	x	
	B	x	
		--	(x)
Interest on drawing	A	x	
	B	x	
		--	x

Distributable profits			x

Limited liability partnership

- Liability of each partner is limited to the amount of capital invested.
- Profits are taxed in the same way as for normal partnership.
- Loss relief against general income or against early years against non partnership income is restricted to the amount of capital invested and is subject to overall cap of £25,000.

- If a company has accounting period of more than 12 months, it is divided into two accounting periods. First of 12 months and second of remaining months and then tax is calculated for each accounting period.

Trading profits

Trading profits are calculated in the same way as for IT but taxable on the basis of accounting period instead of basis period.

Capital allowances

Capital allowances are calculated in the same way as for IT but on the basis of accounting period instead of period of account. Private use of assets is also not taken into account in CT.

Business property income

Business property income is also calculated in the same way as for IT with one difference. Interest payable on loan taken to purchase rental property is deducted from investment income instead of rental income (as in IT).

Dividend income

Dividends are not taxable under CT rules.

Qualifying charitable donations

It is other name of gift aid donations and paid gross by companies. It is deducted from total profits when calculating taxable total profits.

Loan relationship

Trading loan relationship: interest received and paid is treated in trading profits.
 Non-trading loan relationship: interest received and paid is treated in investment income.

Trading losses

Trading losses can be relieved as follows:

1. Loss relief against total profits.
 - C/y loss is relieved from c/y total profits and then can be carried back against previous 12M total profits.
 - In case of cessation trading loss of last 12M period is carried back for 36 months from the start of last 12M period on LIFO basis.
2. Brought forward loss relief.
 - Unrelieved loss in current and previous year is carried forward against first available trading profits from the same trade.

Value added tax (VAT)

VAT is an indirect tax which is levied on taxable turnover.

- Taxable supply includes both goods (current and non-current assets) and services.
- Output VAT is tax on sales proceeds. It is received from customers and paid to HMRC.
- Input VAT is tax purchases and expenses which paid to suppliers and then recovered from HMRC if the person is registered for VAT and tax is recoverable.
- Standard rate of VAT is 20% for TY 2016-17.

VAT period

VAT is accounted for and paid on quarterly basis. VAT return and payment is due one months and seven days after the end of VAT quarter.

Tax point

It is the date on which taxable supply is treated as incurred.

- For goods date of delivery is the basic tax point. However if payment/invoice is made before basic tax point or within 14 days from the basic tax point, it will become actual tax point.
- For services date of rendering services is basic tax point. However if payment/invoice is made before basic tax point or within 14 days from the basic tax point, it will become actual tax point.

VAT on bad debts

VAT on bad debts can only be recovered if debt is written off after 6 months from its due date for payment.

VAT and discount (modified)

VAT is charged on actual amount received if discount is offered for prompt payments. Previously VAT was charged on net of discount amount whether or not discount was accepted.

VAT on motor car expenses

	Business Use	Non business Use	Business + Non business Use
Purchase price	Recoverable	Non recoverable	Non recoverable
Running cost	Recoverable	Non recoverable	Recoverable

Fuel for business use

If fuel is provided to employees for business use only, VAT incurred on it is recoverable.

Fuel for private use

If fuel is provided to employees for private use, VAT incurred on it is recoverable but the business must account for output VAT using a set of scale charges. The scale charges will be given in exam paper.

Gift of goods

A business gift is exempt if

- Gifts made to the same person during the tax year do not exceed £50.
- Gift is a sample. If more than one identical samples are given to a person, only one of them is exempt.

Drawings of goods

Goods withdrawn by the owner of the business are treated as sold at their market value and output VAT applies.

VAT registration**Compulsory registration****Historical test**

- If cumulative taxable turnover of last 12 months period exceeds registration threshold (£83,000), VAT registration is compulsory.
- HMRC needs to be informed within 30 days from the end of month in which limit is exceeded.
- Registration applied from first day of the second month following the month in which limit is exceeded.

Future test

- If taxable turnover of 30 days period is expected to exceed registration threshold, VAT registration becomes compulsory.
- HMRC needs to be informed by the end of 30 days period in which limit is expected to be exceeded.
- Registration will apply from the start of that 30 days period.

Disaggregation

- Disaggregation is where business is artificially split into small units to save VAT
- HMRC may take into account all units as one to assess the compulsory registration threshold

Voluntary registration

A person making taxable supplies can get registered for VAT; it is allowed but not required. Registration can apply from any agreed date.

Seven year accumulation period

- Each transfer (lifetime or death) has its own nil rate band.
- Nil rate band is reduced by the amount of chargeable transfers made in last 7 years from the date of transfer (not from the date we are calculating the tax) for which band is being used.
- It means if we are calculating lifetime tax, PET made in last 7 years will not reduce the nil rate band. But if we are calculating death tax, PET made during last 7 year period will reduce the nil rate band.

Advantages of lifetime transfers

- A PET is completely exempt after seven years.
- A CLT will not incur any additional IHT liability after seven years.
- Even if the donor does not survive for seven years, taper relief will reduce the amount of IHT payable after three years.
- The value of PETs and CLTs is fixed at the time they are made, so it can be beneficial to make gifts of assets that are expected to increase in value such as property or shares.

Valuation of shares and securities

Unquoted shares

Shares valuation division of HMRC provides this valuation.

Quoted shares

Quoted shares are valued at lower of

1. Quarter up rule = $LQP + (LQP + HQP)/2$
2. $(HBV + LBV)/2$

LQP = lower quoted price
 HQP = higher quoted price
 LBV = lowest bargain value
 HBV = highest bargain value

Cum dividend share prices are included in chargeable estate.

Cum dividend price = Ex dividend price + next dividend payment

Unit trusts

Unit trusts are valued at lowest bid price.

Overseas aspects of IHT

- Overseas transfers are chargeable to IHT if individual is domiciled in UK
- DTR is available on overseas transfers

Deed of variation

Terms of an individual's will can be changed after its death to make it tax efficient if all the beneficiaries agree on it.

Gift with reservation

- Gift with reservation is a lifetime transfer where title is transferred but transferor remains beneficiary of the assets transferred.
- Reservation can continue till death or may be lifted before death.

Tax treatment

- If transferor remains beneficiary of the asset till death, it is included in his death estate.
- If reservation is lifted before death HMRC will treat the transfer
 - Either at transfer date
 - Or at the date reservation is lifted

Whichever date gives higher IHT value

Payment of IHT

Due date for payment of IHT is

Lifetime tax	=	latter of	30 April following the end of the TY in which the gift is made.
			Six months from the end of the month in which the gift is made.
Death tax	=		Six months from the end of the month in which death occurred.

IHT consequences

During lifetime

- Transfer to RPT = CLT by settler
- All lifetime gift into trust = RPTs
- Not possible to set up IDPI trust in lifetime

On death

- No special tax consequences
- Assets taxed in settler's estate as normal
- After tax assets put into the trust

IPDI trust

- No charges

RPT

- Principle charge arises
- Every 10 years
- Maximum 6%

IPDI (ends on death of life tenant)

- During life tenant's lifetime
- PET by life tenant
- At death of life tenant
- Settled property in life tenant's death estate

RPT (ends at any time)

- Exit charge when capital distributed
- Maximum 6%

