FitchLearning

10-20 Questions

2. Introduction to UK Taxation

Fiscal year (tax year)

- Individuals and trusts subject to UK income tax:
  - Calculate taxable income from and capital gains for a fiscal year
  - Companies pay corporation tax, not income tax or capital gains tax
- Fiscal year:
  - 6 April – 5 April

Financial year

- Companies subject to UK corporation tax
- Financial year:
  - 1 April – 31 March

Further information

Tax Avoidance vs. Tax Evasion

It is important to understand the difference between tax avoidance and tax evasion:

- Tax avoidance – legally minimising tax liabilities
- Tax evasion (or tax fraud) – illegally hiding/not declaring the true nature of income and capital gains

Tax evasion incurs penalties and ultimately a prison sentence.

2. Introduction to UK Taxation

Residence

- Automatic overseas resident:
  - First overseas test
    - Present in the UK for fewer than 16 days in the current fiscal year
  - Second overseas test
    - Present in the UK for fewer than 46 days in the current fiscal year
    - Not present in the UK during the last three fiscal year
  - Third overseas test
    - Work full time overseas
    - Spend fewer than 91 days in the UK
    - No more than 30 working days in the UK

2. Introduction to UK Taxation

Residence

- Automatic UK resident:
  - First UK resident test
    - Present in the UK for at least 183 days in a fiscal year
  - Second UK resident test
    - Their only home (or main home) is in the UK
      - Available for use for 91 days or more and
      - Used for at least 30 days
  - Third UK resident test
    - They work full time in the UK

2. Introduction to UK Taxation

Residence

- Sufficient ties test:
  - A family tie
  - An accommodation tie
  - A work tie
  - A 90-day tie

2. Introduction to UK Taxation

Residence

- UK resident:
  - Taxable on their worldwide income as it arises:
    - Does not have to be remitted to the UK to be taxable
- Overseas resident
  - Taxable on their UK income as it arises

Further information

In general, non-UK residents are not entitled to personal allowances (neither the income tax allowance nor the annual exempt amount for capital gains). However, citizens of the European Economic Area and Commonwealth countries, and residents in the Isle of Man and the Channel Islands, are entitled to these allowances.

2. Introduction to UK Taxation

Domicile

- Relevant only for the taxation of foreign income and gains for income tax and capital gains purposes
- Important for determining liability to inheritance tax
- Domicile of origin:
  - Acquired from father or mother
- Domicile of choice:
  - Applies from age 16
  - Leave country of domicile and settle in another country

2. Introduction to UK Taxation

UK Resident but non-domicile

- Can elect for overseas income and gains to be taxed by HMRC on a remittance basis
  - May incur a remittance basis charge for long-term residents
    - 7 out of 9 years = £30,000
    - 12 out of 14 = £50,000
    - 17 out of 20 = deemed domicile

2. Introduction to UK Taxation

Self-assessment

- Most individuals pay tax via the PAYE system (pay as you earn)
- Some individuals are required to complete a self-assessment tax return:
  - Self-employed
  - Individuals with capital gains in the year
  - Higher rate taxpayers with other income, such as rental income or savings or dividend income
- Self-assessment tax return deadline for 2014/15
  - 31 January 2016 if submitted online
  - 31 October 2015 for a paper return submission
  - Payment of tax is due by 31 January 2016
- Late submission results in a £100 fine

Further information

Payment on Account

For those taxpayers who are self-employed or who pay less than 80% of last year's income tax at source.

The taxpayer will pay two equal payments on account of their tax on 31 January in the tax year and 31 July following the end of the tax year.

These are payments to cover tax over the current year and are designed to improve HMRC's cash flow.

There is a final 'sweep up', known as a balancing payment on the following 31 January based on the submitted tax return.

3. Income Tax

Taxable income

- Non-savings income:
  - Income from employment, pensions and some social security benefits
  - Profits from a trade, profession or vocation, including profits from a partnership
  - Profits from a property business: e.g. rental income from a buy-to-let flat
- Savings income:
  - Interest from bank, building societies, bond interest (including gilts) and debentures
  - Income portion of a purchased life annuity (covered later in the course)
  - Income may have been received gross or net of income tax

3. Income Tax

Taxable income

- UK dividend income:
  - Deemed to be received net of 10% tax credit
    - Tax credit is deductible against the individual's tax liability
    - Dividends are effectively tax-free for basic rate taxpayers
  - A company pays £900 in dividends:
    - The shareholder will receive £900
    - An individual will declare 100 / 90 x £900 = £1,000 on their tax return

3. Income Tax

Allowances and deductions

- Personal allowance

	2014/15	2013/14
Personal allowance	**£10,000**	£9,440

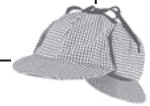
- Age allowance:
  - UK residents above 65 receive a higher personal allowance

Additional tax implications for high earners

- Reduction in personal allowance for those earning over £100,000:
  - Personal allowance will be reduced by £1 for every £2 earned above a threshold of £100,000
  - Personal allowance could be reduced to nil

Hints

Interest income from bank accounts and building society accounts are assumed to have been received net of 20% tax.
Dividend income on UK shares is deemed to have been received net of a 10% tax credit.



3. Income Tax

Overview

- Rates of tax on taxable income (after allowances):

		Non-savings income %	Savings income %	Dividends %
Basic rate	Taxable income up-to-and-including **£31,865** (£32,010 in 2013/14)	20	20	10
Higher rate	Taxable income between **£31,866-£150,000**	40	40	32.5
Additional rate	Taxable income over **£150,000**	45	45	37.5

- Starting rate for savings
  - 10% for the first £2,880 of interest income

Further information

Use of Allowances

If one spouse is a higher rate taxpayer and the other spouse is having a career break, it makes sense to transfer ownership of investments, that generate taxable income into the name of the non-working spouse.

However, when income generated from capital, gifted by a parent to a child under 18, exceeds £100 pa all of the income will be taxed as if it is still the parent's own income.

3. Income Tax

Example

Martin is 45 years old and has a salary of £60,000. What is the income tax liability on this income?

		Tax
Salary		
Personal allowance		
Taxable income		
Basic rate of tax		
Higher rate of tax		
Total income tax		

3. Income Tax

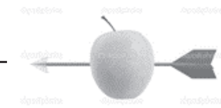
Example

Martin is 45 years old and has a salary of £60,000. What is the income tax liability on this income?

		Tax
Salary	£60,000	
Personal allowance	(10,000)	
Taxable income	£50,000	
Basic rate of tax	£31,865 @ 20%	£6,373
Higher rate of tax	£18,135 @ 40%	£7,254
Total income tax		**£13,627**

Keeping on target

What would the tax implications be on Martin if he received interest income from his bank account of £800 and dividend income from UK shares of £500?



3. Income Tax

Taxation of trusts

- Trustee is responsible for settling the tax
- Generally
  - First £1,000 income taxed at standard rate band
    - 20% for savings and property income
    - 10% for dividends
  - Any income above £1,000 taxed at the trust rate
    - 40% for savings and property income
    - 37.5% for dividends
- Bare trust
  - Taxed at the beneficiaries marginal rate

Hints

The £1,000 income threshold is per settlor not per trust. A settlor with two trusts will have an standard rate band of £500 in each trust.

Answer to the question on the previous slide:
Martin is a HRT so owes further tax on his savings and dividend income.
Savings income
Gross income = £800 x 100/80 = £1,000
Total tax on savings = £1,000 x 0.40 = £400
Further tax on savings = £400 - £200 = £200
Dividend income
Gross income = £500 x 100/90 = £555.56
Tax credit = £555.56 - £500 = £55.56
Total tax on dividend = £555.56 x 0.325 = £180.56
Further tax on dividend = £180.56 - £55.56 = £125

4. National Insurance Contributions (NICs)

Who pays National Insurance?

- Employees: pay class 1A (primary) NICs
- Employers: pay class 1B (secondary) NICs, must keep NI records
- The self-employed – class 2
  - Small earning exemption limit
- The self-employed – class 4 (variable on profits)

Voluntary NI contributions

- Class 3 contributions are voluntary contributions to top-up benefits
  - 30 years contribution needed to gain full basic pension

5. Capital Gains Tax

Capital gains tax

- Tax:
  - Chargeable disposals
  - Chargeable assets
  - Chargeable persons
- Applies to gains made in a fiscal year

5. Capital Gains Tax

Chargeable persons

- Individual's liability to CGT
  - UK resident
    - Taxable on their worldwide gains on the arising basis
  - Overseas resident
    - No liability to capital gains on assets in the UK or elsewhere

Chargeable disposals

- Chargeable disposal:
  - Sale of whole or part of an asset
  - Gift of whole or part of an asset

5. Capital Gains Tax

Chargeable assets

Exempt assets include:	
	Primary residence
	Betting and lottery wins
	Currency bought for holidays
	National savings certificates and premium bonds
	Private motor cars
	Life assurance policies
	Gilts and qualifying bonds
	Gifts to charities
Liable assets include:	
	Company shares and non-qualifying bonds
	Second property or subsequent properties
	Units in CIS
	Currency bought for gain

Further information

Convertible bonds

The main category of non-qualifying bonds are those which convert into equity.

5. Capital Gains Tax

Calculation of a basic capital gain or loss	**£**
Proceeds	50,000
Less costs of disposal	(1,000)
Net proceeds	49,000
Less allowable costs	(10,000)
Gain or loss	39,000

- Proceeds:
  - Consideration received
  - Market value (if the asset is gifted)
- Allowable costs:
  - Fees and commissions for disposal
  - Advertising costs
  - Cost of purchase and costs associated with purchase
  - Enhancement expenditure, such as extending the property

5. Capital Gains Tax

Use of CGT losses

- Current year losses:
  - Offset against gains in the same tax year
- Losses from previous tax years:
  - Reduce gains not covered by the annual exemption
- Unused losses can be carried forward indefinitely

Annual exemption allowance

- Amount of net chargeable gains that are not subject to tax:
  - 2014/15 = £11,000 (use it or lose it)
    - (£10,900 in 2013/14)

Further information

Strategies to mitigate Capital Gains Tax

- Spreading ownership of assets between family members to make use of the maximum number of annual exemptions
- Phasing encashments over several tax years if at all possible in order to access more than one annual exemption
- Deliberately realising paper losses in order to reduce gains
- Deliberately realising gains within the annual exemption so that there is no actual taxable gain, then repurchasing a similar (but not identical) investment (purchasing back the same shares would be subject to the share matching rules and therefore taxable)

5. Capital Gains Tax

Calculation of a taxable gain or loss

	£
Gain on asset	39,000
Losses on other assets this year (for example)	(4,000)
Gain for the year	35,000
Less annual exemption	(11,000)
Loss relief (for example)	(5,000)
Taxable gain	19,000

Capital gains tax rates

- Taxable gains are taxed at 18% for basic rate taxpayers
- Higher and additional rate taxpayers pay 28%

Keeping on target

Mr. Boyle's overall gains in 2014/15 are £60,000 and he has other taxable income of £40,000. What is his capital gains tax liability?

A: £16,800
B: £13,720
C: £11,200
D: £8,120

Keeping on target

Marion has a taxable income of £30,000. She also makes a taxable gain of £8,000. What CGT is due?

6. Inheritance Tax (IHT)

Inheritance tax liability

A tax charge on the transfer of a person's estate on or before death.

- UK domiciled individuals
  - Worldwide assets
- Non-UK domiciled individuals
  - UK assets only

Answer to the first question on the previous slide:
B: £13,720

Overall gains	£60,000
Annual exemption	(£11,000)
Taxable amount	£49,000
Tax @ 28%	£13,720

Answer to the second question on the previous slide:
CGT uses the income tax bands to assess the CGT to charge. Marion only has £1,865 of her basic rate band remaining, any gain above that will be taxed at the higher rate.
CGT at the basic rate = £1,865 @ 18% = £335.70
CGT at the higher rate = £6,135 @ 28% = £1,717.80
Total CGT = £2,053.50

6. Inheritance Tax (IHT)

Potentially exempt transfer (PET)	Chargeable lifetime transfer (CLT)	Exempt transfer
Not taxed immediately **but** becomes chargeable if the person dies within **seven years** of date of gift	Taxed immediately **and** becomes chargeable again if the person dies within seven years of date of gift	No IHT

6. Inheritance Tax (IHT)

Exemptions

- Annual exemption
  - £3,000 per fiscal year per individual
- Gifts in consideration of marriage
  - £5,000 by a parent
  - £2,500 by a more remote ancestor (e.g. grandparent) or a party to the marriage (i.e. bride/groom)
  - Gift must be in consideration of marriage
    - I.e. conditional on the marriage actually taking place
- Transfers to spouses or civil partners
- Transfers to political parties or charities

6. Inheritance Tax (IHT)

Inheritance rates

- 40% tax rate
  - Charged on chargeable estate after exemptions, exempt transfers
  - Chargeable estate reduced by nil rate band

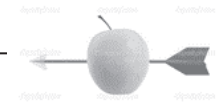
Fiscal year	Nil band £
2014/15	**325,000**
2013/14	325,000

- Nil rate band now frozen until 2015/16

Keeping on target

Barry dies in August 2012, with an estate worth £800,000. The majority of the estate is in his house worth £650,000. He is survived by May, his wife, and Sophia his daughter, to whom he left £100,000. In December 2015, May dies, leaving an estate of £625,000.

The inheritance tax nil rate band for 2012/13 and 2015/16 is £325,000. What would be the inheritance tax liability upon Barry's death?



6. Inheritance Tax (IHT)

Nil band utilisation

- Unused nil band is transferred to a surviving spouse or civil partner
  - The first spouse/partner does not have to worry about using up their nil rate band
    - Benefit from any increase in allowance
  - E.g. a husband dies leaving all his assets to his wife
    - 100% of the nil band is unused
      - Wife’s estate will be able to use two nil bands at death

Gifts to charity

- If 10% or more of the estate is left to charity, a reduced IHT rate of 36% (a reduction of 10% on the standard rate) will be applied

Answer to the question on the previous slide:0
As Barry died leaving a surviving spouse, any transfers between them are exempt from inheritance tax. The only amount that could be subject to inheritance tax is the £100,000 left to Sophia, but this is covered by the nil rate band exemption. Therefore, there is no inheritance tax liability upon Barry’s death.

6. Inheritance Tax (IHT)

Reservation of benefit

- Anti-avoidance legislation
  - It is not possible to transfer legal title of an asset to another person and retain a beneficial interest to avoid IHT
  - If a beneficial interest is retained, HMRC will treat the asset as:
    - A PET when legal title passed; or
    - An asset still owned by the deceased, valued as at time of death

7. Taxation of Investments

Taxation of direct investment

	Income	Capital	Withholding	Stamp duty
Cash	Yes	No	20%	No
NS&I	Variable	No	Variable	No
Gilts	Yes	No	No	No
Corp. debt (qualifying)	Yes	No	20%	No
Corp. debt (convertible)	Yes	Yes	20%	Yes
Equity	Yes	Yes	10%	Yes
Property (primary res)	N/A*	No	N/A	Yes
Property (investment)	Yes	Yes	No	Yes
Chattles	No	Yes†	N/A	No

* Rent-a-room scheme allows £4,250 p.a. tax free

† Chattels below £6,000 in value are tax free

7. Taxation of Investments

Taxation of indirect investment

- Tax at the fund level

	Income	Capital gain	Stamp duty
Equity CIS	Yes at 20%	No	Yes
Debt CIS	Yes at 20%	No	Yes (on equity)
ITC	CT rate applicable	No	Yes
REIT	No	No	Yes (SDLT)
VCT	CT rate applicable	No	Yes

- Tax at the investor level

	Income	Withholding tax	Capital gain	Stamp duty
Equity CIS	Yes (Div)	Yes 10%	Yes	No
Debt CIS	Yes (Sav)	Yes 20%	Yes	No
ITC	Yes (Div)	Yes 10%	Yes	Yes
REIT	Yes (Sav)	Yes 20%	Yes	Yes
VCT	No	N/A	No	Yes

Hints

Distributions from a CIS will be taxed whether this is paid out to investors or used to accumulate units.

8. Stamp Duty

Stamp duty reserve tax (SDRT)

- Paid by the buyer in paperless transactions
- Taxable transfers
  - UK equities
  - UK convertible loan stock
  - An option to buy shares
- Exempt transfers
  - Gilts
  - Corporate bonds (unless convertible)
  - Bearer securities
  - Overseas securities
  - AIM and ISDX shares for April 2014

SDRT rate

- Stamp duty reserve tax (SDRT): 0.5% rounded to the nearest penny

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Hints

The buyer of units in a unit trust or shares in an OEIC will not pay SDRT. However, when units are surrendered, the manager is charged SDRT and pays directly to HMRC. This value is typically built into the management fee.

8. Stamp Duty

Stamp duty land tax

- Stamp duty land tax (SDLT) is generally payable by the buyer on the purchase or transfer of property or land in the UK
- SDLT tax return submitted on the following basis:
  - Effective date of transaction
  - Purchase price of property

Purchase price/lease premium or transfer value	SDLT rate
Up to £125,000	Zero
£125,001 to £250,000	1%
£250,001 to £500,000	3%
£500,001 - £1,000,000	4%
£1,000,001 - £2,000,000	5%
Over £2,000,000	7%

Further information

SDLT: Other issues

SDLT on non-residential property

- Nil-rate band up to £150,000
  - As long as annual rent is below £1,000
- Over £500,000 is the top bracket at 4%

SDLT on leases is based on net present value of the lease. It is charged at 1% on properties

- Above £125,000 for residential properties
- Above £150,000 for non-residential properties

Hints

For purchases of property by non-natural persons (companies for example) SDLT is 15% for properties over £2m.

9. Corporation Tax

Rates of corporation tax

Set in the financial year

Corporation tax rate	Level of profits	2014/15 rates	2013/14 rates
Small profits rate	Below £300,000	**20%**	20%
Main rate	Above £1.5m	**21%**	23%

Corporation tax payment

- Normally nine months after accounting year end
- Large companies pay quarterly

Trading losses

- A company's trading losses can be offset against
  - Income and gains from the same accounting period
  - Income and gains from the previous year
  - Trading profits from the same trade in future years

10. Value Added Tax (VAT)

Value added tax

- Tax charged on the provision of goods and services in the UK

Categories of supply

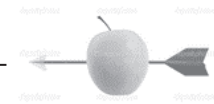
Taxable supplies	Rate of VAT charged
Standard-rated	20%
Zero-rated	0%
Reduced	5%
Supplies outside the scope of VAT	N/A

- Only businesses making taxable supplies can reclaim VAT
  - Businesses making exempt supplies or supplies outside the scope of VAT cannot reclaim VAT it has paid
    - For example, charities

Keeping on target

Which of the following is not a current rate of VAT?

A: 20%
B: 10%
C: 5%
D: 0%



10. Value Added Tax (VAT)

VAT for stockbrokers

Type of service	Type of supply
Portfolio management fees	Standard rated
Advisory services	Standard rate but only if unbundled (i.e. invoiced separately)
Commissions, CIS annual and initial charges	Exempt
Nominee services	Exempt

Answer to the question on the previous slide:
B: 10%

11. Tax Wrappers

New individual saving account (NISA)

New ISA allowance £15,000 per tax year

Stocks and shares ISA

Minimum age 18 years

UK resident

Moving abroad – what happens?

Investments:

- Shares
- Bonds and gilts
- Unit trusts/ITs/OEICs/REITs

Cash ISA

Minimum age 16 years

UK resident

ISA transfers

Note: £4,000 in a Junior ISA

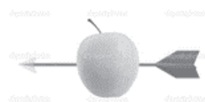
Further information

Investments within a New ISA are exempt from income tax and CGT. The 10% tax credit paid on dividends from UK shares is not recoverable.

Keeping on target

Which of the following might create a Capital Gains Tax liability on disposal?

A: A principal private residence
B: A gilt
C: Shares in a stocks and shares ISA
D: A convertible bond



11. Tax Wrappers

Offshore funds

- Offshore jurisdictions
  - Very different tax rules and procedures
- Reporting funds
  - Granted by HMRC provided the fund:
    - Reports its income to HMRC and investors
    - Complies with the reporting fund rules
  - Dividends received from offshore funds are taxable to UK residents
  - Any capital gain taxed as capital gain
- Non-reporting funds
  - Income and gains taxed as income (not at CGT rates)
  - Cannot use annual CGT exemption
  - Losses cannot be offset against gains

Answer to the question on the previous slide:
D: A convertible bond

11. Tax Wrappers

Qualifying and single premium (non-qualifying policies)

- Investments in life funds can be qualifying or non-qualifying
  - Qualifying policies – no more tax to pay (fund has paid 20% – cannot reclaim)
  - Non-qualifying policies – extra 20% income tax for HRT payer
- The qualifying rules
  - At least annual premiums
  - Term at least ten years

5% rule

- Life company bonds are not qualifying investments
- Tax deferred until death or encashment (chargeable event)
  - 5% of the capital may be withdrawn and any tax deferred until a chargeable event

Further information

An **endowment policy** is an example of a qualifying policy. A Life assurance bond is an example of a single premium policy.

Further information

When encashment occurs, the gains on the policy are divided by the life of the policy. This is referred to as top slicing.

Example

Purchase value of the bond = £100,000

Surrender value of the bond = £110,000

Withdrawals from the bond = £30,000

Life of the bond = 10 years

Profit on the bond = 110,000 + 30,000 - 100,000 = 40,000

Profit to assess income tax liability = 40,000 / 10 years = 4,000

This £4,000 is added to income in the year of encashment

We assess the further tax (for HRT and ART) and multiply by 10 years.

11. Tax Wrappers

Venture capital trusts (VCTs)

- Tax incentives on investments in start ups and small companies
- 30% income tax relief (subscription to new shares only)
  - Must hold for five years
  - Maximum investment on which relief applies: £200,000
- Exemption from income tax on dividends
- No CGT (disposal relief)

Enterprise Investment Schemes (EISs)

- Overview of EISs
  - Aimed at helping smaller, higher-risk trading companies raise finance
  - Only available to individuals who invest in EIS companies
- Income tax relief (year investment made)
  - 30% of the cost of the shares, invest up to £1,000,000 (max relief – £300k) if held for three years
- Capital gains tax relief
  - No CGT provided EIS held for three years

Further information

Seed enterprise investment schemes

SEIS run alongside EIS. They are targeted specifically at start-up companies. They offer:

- 50% income tax relief on up to £100,000 of investment per year
- Up to 50% of gains that are reinvested in a SEIS are exempt from CGT

11. Tax Wrappers

Pensions

- An individual who is under the age of 75 is entitled to tax relief on contributions to a registered pension scheme in a tax year. The maximum contributions that can be made are the higher of:
  - The individual's earnings chargeable to income tax subject to an annual cap of £40,000 (2014/15 tax year)
  - The basic amount of £3,600
  - Maximum lifetime allowance is £1.25 million

- Tax relief is at the taxpayer's marginal tax rate, so a higher rate taxpayer can obtain 40% tax relief on their pension contribution

- A tax-free lump sum of up to 25% can be taken from an accumulated pension fund

12. Tax Planning

Other considerations

- Share the wealth:
  - Use personal allowances of all family members
  - Transfer ownership to take advantage of tax status
  - Use potentially exempt transfers
- Tax-free allowances:
  - £15,000 ISA allowance
  - £4,000 Child Trust Fund/Junior ISA allowance
  - £11,000 CGT allowance
- Investments that reduce tax exposure:
  - Pension, EIS and VCT tax reductions
  - Some tax-free NS&I products
  - Eligible bonds are CGT free
  - Many funds exempt from CGT within the fund
- Administration issues:
  - Make a tax efficient will
  - Record all capital losses
  - Full tax review at the end of each year

Course Evaluations

Following your course you will receive an email containing an evaluation form. Please take the time to complete this and return it by email – your feedback is really important to us.

Many thanks

Jerome Payne

Regulation Exams Manager

The Method to Pass

- Preparing to pass: study methods
  - Read each chapter of the text, make notes/mind maps
  - Test your understanding of each chapter with practice questions
  - Re-read the text – you will learn more every time you re-read it
  - Complete all practice questions and mock exams; ideally twice (>80%)
  - Complete additional questions; ideally twice (>80%)
- In the exam: techniques
  - Remember the hard work has already been done
  - Read the questions carefully
  - Rule out wrong answers
  - Come back to more difficult questions later on
  - If you have read the question correctly, your first thought is generally the right answer
  - Be wary of changing answers
  - You can do it – believe in yourself
  - Enjoy your celebrations when you pass