

Business Tax

Revision

Task 1 Computation of adjusted profits for sole traders, partnerships and limited companies

12 marks

- Start with profit.
- Add back any expenditure that is not allowable for tax purposes.
 - Depreciation
 - Increase in general bad debt provision
 - Charitable payments
 - Gifts to customers – unless under £50 and with advert
 - Anything relating to capital (incl legal)
- Deduct any income that is not trading income.
 - Rent
 - Dividends

The examiner says

“Where learners have failed in this task, it seems to be due to lack of robust knowledge on areas such as lease payments, private usage and what is treated as capital and what is not. For example, learners could be told that a sole trader incurs motor expenses on their car of £5,000 and the business usage is 75%. A common mistake would be to adjust for £3,750, instead of adjusting for the private element, being £1,250.”

Task 2 Computation of capital allowances for sole traders, partnerships and limited companies

14 marks. Human marked

Is the accounting period 12 months? If not then pro rata your allowances.

Deduct when calculating adjusted trading profits.

1. Annual Investment Allowance (AIA)
 - AIA = £500,000 since 1/4/2014 (1/1/2013 – 31/3/2014 = £250,000)
 - If the CAP straddles 31/03/2014 then the AIA is pro rata.
 - Not cars.
2. 100% First year Allowance. For new low emission cars ($\leq 95\text{g/Km}$ CO₂, new zero emission goods vehicles, and certain energy efficient and water efficient plant.
3. 8% Writing Down Allowance (10% pre 31/3/2012) on the special rate pool.
4. 18% Writing Down Allowance (20% pre 31/3/12) on pool balances except special rate pool and single asset pools where asset has been disposed of.
5. Balancing Allowance/ Charge when an asset is disposed of.

The examiner says

“By far the largest task in this assessment, capital allowances is a key area that must be studied with great care by learners. Every question will include a capital allowances computation, but many also include other questions, such as theory on short-life assets or the implications of private usage. Learners can always expect purchase of assets, which may include those that receive annual investment allowance (AIA), cars of all emissions and those assets that receive first year allowance (FYA). For the AIA computation, learners must know how to handle accounting year ends that straddle different amounts but the very complex area of restricting AIA due to date of purchase will not be assessed.

About 50% of learners exceeded the minimum standard for competence in this task, which is very encouraging, with overall competence being at 70%. This still means that 30% of learners are struggling with this topic and due to the number of marks allocated this can have a detrimental effect on the whole marks awarded for this assessment.

The biggest area of confusion for learners is the handling of cars. The sample assessments for both BTAX FA13 and BTX FA13 give examples of the type of information learners can expect on cars. Looking at the BTAX FA13 task, the question involves a limited company. Information is given on two cars, both with information on private usage. The reason for including this information is for learners to demonstrate that they understand that it is to be ignored. Indeed, there will be a mark allocated for ignoring private usage. The other issue with cars is accurately handling the engine emissions and ensuring that the correct written down allowance percentage is applied. “

Task 3 Split of partnership profits for new, continuing and leaving partners. Or basis periods for sole traders and partnerships

12 marks

Partners

- Calculating taxable trading profit. NB partners salaries and interest on capital must be added back as they are a form of drawings.
- Deduct any salary and interest on capital before apportioning profit.
- If profit share changes then time apportion.
- Joining and leaving partners, opening and closing year rules.

Basis periods

Continuing Business – Current Year Basis Of Assessment (12 month accounting period that ends in that tax year)

| | Tax year | Basis Period |
|---|------------------------------|---|
| 1 | The year the business starts | Start date - 5 th April |
| 2 | Second tax year | 12 months to accounting date in 2 nd tax year Or the first 12 months of a business (if accounting period not long enough) |
| 3 | Third tax year | 12 month accounting period that ENDS in tax year. (normal) |
| | | |
| | Final year | End of the accounting period for previous year to the date the business ceases. The profits are reduced by any overlap profits. |

Overlap profits are the profits which are assessed twice.

The examiner says

“This task is quite complex, partly because of the variety of questions that can be asked. It covers basis periods for sole traders, including opening, continuing and cessation of trade, and it covers the same basis periods for partnerships.

As there are 12 marks allocated to this task, most questions will have a range of smaller tasks to complete that may well include a mixture of topics. It is vital that learners can accurately work out the tax years that apply to the question(s) as this then drives the rest of the answers, particularly if dates need to be given.

The results for this task are very similar to that for Task 2, so 30% of learners are struggling with this topic. As perhaps expected, it tends to be opening years that causes the most problems, closely followed by assessable profits for individual partners.

Learners are advised to use pen and paper to carefully work out dates within tax year for opening basis periods to ensure that dates selected are logical. Evidence from live exams shows learners appearing to randomly select dates that bear no relation to the information given in the question. Using time effectively in the assessment, learners should be spending nearly 15 minutes on this question, but it is clear that this is not happening.”

Karen Mustard

Task 4 Taxable total profits and corporation tax payable

12 marks

Sources of income - assessment

| Income | When assessed |
|--|-------------------------------------|
| Adjusted profits | Accrue evenly in accounting period. |
| Interest received – bank, debentures, gilts | Accrue evenly in accounting period. |
| Dividends (AP) | Accrue evenly in accounting period. |
| Property income | Accrue evenly in accounting period. |
| Chargeable gain | Date of disposal |
| Gift aid payments | Date of payment |

Marginal relief

This reduces the Corporation Tax, it smoothes the transition from one tax rate to the next.

Marginal Relief = Fraction x (U-A) x (N/A)

| | 1/4/2012-31/3/2013 | 1/4/2013-31/3/2014 |
|--------------------------|---------------------------|---------------------------|
| Marginal Relief Fraction | 3/100 | 1/400 |

- Calculating Corporation Tax

Calculate augmented profits figure – gives tax rate and whether marginal relief is available.

Taxable Total Profits x rate

Less Marginal relief

=Corporation Tax Liability

- **Associated companies**

divide bands by number of companies

The examiner says

“This task solely covers limited companies and tests learners understanding of how to work out corporation tax payable. It can include computation of taxable total profits, companies of all sizes, any length of financial accounting period, straddling of 31 March and the impact of associated companies. This is not an exhaustive list, but is the majority of the aspects examined within this task.

Learners are performing well in Task 4, with similar results to Task 2 and 3 – about 30% not achieving the necessary standard. Payment dates seem to cause particular issues, especially for large companies and instalment dates. Any questions on this topic will not be overly complex, but learners do not seem to be able to work out the dates accurately even for the most straightforward of questions.

Marginal relief is a common-asked question in this task, and most learners are comfortable with this computation. The most common occurring error within marginal relief is how to work out the limits given more than one company and a time period of less than 12 months. ”

Karen Mustard

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Task 5 National insurance contributions

4 marks

NICS

National Insurance Contributions (NICs)

Self-employed individuals (sole traders and partners) pay NIC relating to their profits.

- Class 2 NICs: flat rate of £2.75 per week (unless there is a small earnings exception – profit < £5885).
- Class 4 NICs on profits over £7956 pa.
 - 9% $7956 < \text{profit} < 41865$
 - 2% $\text{profit} > 41865$
- No NICs payable if under 16 or a pensioner.
- Class 2 due 31st Jan and July (like payments on account), or monthly dd.
- Class 4 paid with Income Tax for the year.

Task 6 Losses for sole traders, partnerships and limited companies

6 marks

Can be sole trader or partnership.

1. Sole trader/partner

- i. Carry forward to reduce profits from the same trade.
- ii. Reduce total taxable income for that tax year (all sources).

Remaining loss can then be set any against capital gains of that year.

- iii. Loss can be carried back against the total taxable income for the preceding tax year. Remaining loss can then be set any against capital gains of that year.

The tax payer can do ii or iii.

2. Limited company

- i. Carry forward to reduce trading income from the same trade.
- ii. Reduce total taxable profit (TTP) for that CAP, before gift aid.
- iii. If (ii) chosen then can carry back the remaining loss to offset against TTP of the previous 12 months or carry forward.

The examiner says

“Learners appear to be quite confused over how losses can be relieved, and show confusion over the different rules that apply to sole traders and limited companies. Learners can expect either or both in one task, so there is a need to fully understand the rules. Whilst learners will not be expected to know complexities such as losses in the early years of trading, or terminal loss relief, they do need to understand the connection between losses carried back, carried forward and relief in the year of loss.

Learners are therefore advised to thoroughly study the theory first, and then practice numerical questions to test this theory. And make sure the differences between sole traders and limited companies are fully understood too.”

Karen Mustard

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Task 7 Theory underpinning topic, payments on account and penalties

10 marks. Human marked written question

Dates of payment

1. Limited Companies – Corporation tax

- Payable 9 months and 1 day after the end of the CAP.
- If a company is 'large' it will pay in instalments.
 - Day 14 month 7 of cap
 - Day 14 month 10 of cap
 - Day 14 month 1 of next cap
 - Day 14 month 4 of next cap
- NB tax is due before the tax return has to be filed.

2. Individuals – Income tax

- First payment on account – 31st January within tax year.
- Second payment on account – 31st July after the tax year.
- Final payment – 31st January after the tax year.

Fines, penalties

- Late payment of balancing payment
 - 5% of tax due
 - Plus further 5% if unpaid by 31st July
 - Plus a further 5% if over 12 months overdue.
- Late filing
 - £100 penalty
 - Over 3 months additional £10 per day upto £900
 - Over 6 months additional £300 or 5% tax due (higher of)
 - Over 12 months late a further £300 or 5% tax due (higher of)
- Errors
 - Unprompted disclosure
 - Careless 0-30%
 - Deliberate 20-70%
 - Deliberate and concealed 30-100%
 - Prompted disclosure
 - Careless 15-30%
 - Deliberate 35-70%
 - Deliberate and concealed 50-100%

The examiner says

Unfortunately, learners are struggling with this topic, with only 36% of learners meeting the required standard. Of those, only 12% exceeded the minimum required standard. There are several reasons for this:

1. Inability to work out dates: using the example in the sample assessment, it can be seen that learners need to know what the two payment dates are in the calendar year 2013. Whilst this may seem very basic, in equivalent live assessments, it is clear that learners struggle with this. 30 June, 1 January and 1 October are often given dates.

2. Inability to work out the payments: it is very disheartening how many learners think that there are three payments on account, and simply take the tax liability for the relevant tax year, and divide it by three. This makes all computations wrong. Many learners simply confuse which tax year is paid on what dates – practicing this over and over is a must because if one date is wrong, then they all tend to be wrong. For example, using the sample assessment again, learners will show payments for 31 January 2013 and 31 July as $£33,900 / 3 = £11,300$, with the remaining £11,300 being paid on 31 January 2014.

3. Inability to work out which penalty regime applies to which errors: for example, it is very common for learners to give the penalties that apply to late filing to a question about late payment, and vice versa. This usually results in no marks being allocated to a question on this topic. There are just two main penalty regimes to study, so make sure there are studied in depth.

4. Inability to read and digest the question fully before starting the answer: too many times, learners will give very generic, basic answers that may be technically correct, but are not directly related to the scenario given. A common style question will give a small scenario and learners will need to apply their knowledge to it – giving generic answers will not necessarily cover all the aspects required.

So, learners must study payment dates and amounts in much more detail and ensure that when giving a written answer, it applies to the scenario given.

Karen Mustard

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Task 8 Tax returns
8 marks. Human marked

Self-employed return

Partnership return

Corporation tax return CT600

The examiner says

Typical errors made in each return are:

1. Self-employed return: there are two main errors made by learners here. One is to forget to adjust for the depreciation shown in the first column. Learners are expected to show any depreciation in box 44. Also, some learners simply list the disallowed figures in the first boxes in the second column, in any order. So, if there are five adjustments to be made, boxes 32 to 36 would be completed.
2. Partnership return: the most recurring error here is to fail to gross up any interest received by the partnership, which would be posted in box 22, and then failing to complete box 25 for the tax element of that interest.
3. Corporation tax return, boxes 1 to 37: given the amount of content for page 2 of the CT600 (Short) form, it has been split between boxes 1 to 37 and boxes 38 to 46. For the top half, most learners perform really well and take their time ensuring that sub-totals are also completed.
4. Corporation tax return, boxes 38 to 46: of the four returns, this seems to be the one that learners struggle with the most. Failing to gross up dividends, understanding how to state the financial year, and using the correct rate of tax all seems to cause difficulties.

Task 9 Basics of capital gains tax

8 marks

CGT, chargeable/exempt

Exempt:

- Gifts to charities
- Disposals on death

Chargeable:

- Disposals of something you inherited.
- Part disposals.
- Husband wife – but no gain no loss.

Individuals calculate CGT

Proceeds

Less incidental costs of disposal

Net Proceeds

Less

Original cost

Less incidental costs of acquisition

GAIN

- Some things are exempt:
- Transfer to spouse etc; no gain, no loss
- Losses
 - Offset against gain this year
 - Deduct exempt amount
 - Unused loss is cfwd

Ltd Companies calculate CGT

Use indexation allowance – be careful of the dates.

Proceeds

Less incidental costs of disposal

Net Proceeds

Less

Original cost

Indexation allowance on cost

Costs of improvement

Indexation allowance on costs of improvement

GAIN

Karen Mustard

The examiner says

Indexation factors are:

| | |
|------------------------------|-------|
| January 1997 to October 2004 | 0.222 |
| January 1997 to July 2013 | 0.632 |
| October 2004 to July 2013 | 0.341 |

Another way that this information could be presented is:

| | | |
|--------------|--------------|-----------|
| | October 2004 | July 2013 |
| January 1997 | 0.222 | 0.632 |
| October 2004 | | 0.641 |

Learners seem to find the table format of presenting this information confusing, although the reason for giving it in tables was to help! A common mistake would be to add 0.222 to 0.632 to get the indexation factor that would apply to an asset bought in January 1997 and sold in July 2013. Careful studying of how indexation factors work is therefore important.

Another area that appears to be causing problems is how capital gains tax applies to connected persons. Who is connected to whom and the impact of that is often assessed but learners are struggling to show understanding of this area.

Task 10 Taxation of shares

10 marks. Human marked.

Shares, individuals.

If shares in the same company are bought at different prices we use MATCHING RULES to determine which shares are being disposed of.

- Shares bought on the **same day** as disposal.
- Shares bought in the **30 days after** the disposal. No indexation allowance is available.
- Finally, **FA 1985 pool**. (only costs)

Shares, ltd companies

If shares in the same company are bought at different prices we use MATCHING RULES to determine which shares are being disposed of.

- Shares bought on the **same day** as disposal.
- Shares bought in the **9 days before** the disposal. No indexation allowance is available.
- Finally, **FA 1985 pool**. (only costs)

Use indexation allowance – be careful of the dates.

a. FA 1985 pool.

Introduced in the 1985 Finance Act.

4 columns. Reindex at every transaction

| Detail of transaction | Number of shares | Cost of shares | Indexed cost |
|-----------------------|------------------|----------------|--------------|
|-----------------------|------------------|----------------|--------------|

Karen Mustard

The examiner says

This task is the last of humanly marked tasks, and only covers capital gains tax for share disposals. Learners can expect questions on disposals by individuals, disposals by companies, bonus issues, rights issues, disposals several years earlier than the tax year in question and matching rules. The sample assessment for BTAX FA13 shows five transactions with shares, and learners can easily expect this level of complexity.

Pleasingly, learners have covered this topic in great detail and the statistics show the highest number of learners exceeding the minimum standard of any task in this assessment. 65% have exceeded, with nearly 80% competence overall.

Whilst this is good news, learners must not become complacent and assume that this task is easy – to get high marks, they really do need to know the rules and know how to apply them. The most commonly recurring error in this task is the handling of matching rules where shares are bought 30 days after (for individuals) or 9 days before (for companies). It is common for learners to ignore the matching rules completely and simply show one large pool that takes events in strict chronological order.

Task 11 Capital gains tax exemptions, losses, reliefs and tax payable

6 marks

Gift relief.

- Even if the donor receives nothing for an item (it was a gift) then it is treated as if they received market value and they may be liable for CGT.
- If an individual gives away a 'business asset' the transaction can qualify for gift relief.
- Both parties must agree.
- The donor has no CGT liability.
- The recipient: the base cost = market value less deferred gain.

Entrepreneur's relief.

- Available on disposal of all or part of a trading business,
- Available on shares in a personal trading business (must hold at least 5%). Conditions met for 1 year min.
- Lifetime limit of £10,000,000.
- 10% tax rate.

Rollover relief.

- Applies when one business is sold and another is bought.
- All the proceeds of the first asset must be reinvested in the second asset. If not they form a chargeable gain. In this case the rollover relief is the balancing figure.
- The gain on the first asset is rolled over (deferred) into the second. The gain on the second asset would then include the gain on the first asset.
- Available from one year and upto three years after.

The examiner says

By far the worst answered task in the whole assessment, this task covers a variety of topics. Capital gains losses and the impact of the annual exempt amount on those losses is a common question. Also, the impact that income tax bands have on capital gains payable is assessed, as is reliefs such as entrepreneurs', rollover and gift.

It is possibly due to the range of small areas that are assessable within this one task that has caused the poor pass rate – only 35% of learners achieved the required standard.

An area that learners are clearly struggling with is the capital gains tax payable when an individual's income tax information is given.

The examiner went on to say that many students lost marks by giving tax payable instead of tax chargeable.

Another common error with this style question is not to read the information carefully and to deduct the annual exempt amount from the gain. This is despite the question clearly stating that the exempt amount has already been deducted.