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Taxation, Retail Investment and Pensions

Assignment 3 Notes

*(Part 2 – The UK Tax System)*

*Recommended Time: 3 Hours*

1. **Identify the main legislation that governs personal taxation in the UK.**

**5 marks**

Answer should cover:

The main legislation takes three forms:

* + Primary legislation
  + Secondary legislation
  + Case law

The main source of new legislation is the annual Finance Act.

A full answer could include a little further detail on each and possibly an example.

Relevant section of the manual is Part 2 Overview

**5 marks**

1. **Outline the different types of income for the purposes of Income Tax.**

**5 marks**

Answer should cover:

The main division is between earned and unearned income.

Earned Income

Income arising both directly and indirectly from employment.

. Earnings by an individual from a trade, profession or vocation whether carried on alone or in partnership are all taxed as self-employed earnings. Most pensions income, State, company and personal, including State pensions (Basic and earnings-related), public and private pensions, foreign pensions, annuities, and drawdown payments to the holders of personal pensions. In addition, State unemployment benefits (Jobseeker’s Allowance etc.), Carer’s Allowance, Widow’s Pension, Statutory Sick Pay, Maternity Pay, Adoption Pay and Paternity Pay.

Unearned income broadly encompasses all investment income, including dividends, rental income, and chargeable gains on life insurance policies. It includes income from business-like activities that involve some management involvement but fall short of amounting fully to a trade: the prime example of this being property income where the main source of income is the letting of the property as distinct from the provision of services. Annual interest received, including interest payments from building societies and banks is perhaps the most common type of unearned income.

Relevant section of the manual is Part 2 Chapter 1.1

**5 marks**

1. **A client based overseas has asked you for an explanation of how the residency rules for UK Income Tax may impact on an individual working abroad. Prepare some notes for use in a conference call with the client.**

**15 marks**

Answer should cover:

Establishing residency and hence the liability for Income Tax is crucial for an individual working abroad.

There are several options under the following headings:

* + Statutory residence - anyone who is present in the UK on 183 days or more in the tax year is UK-resident.
  + Automatic overseas tests - • First automatic overseas test: resident in the UK for one or more of the three tax years preceding the tax year, spending fewer than 16 days in the UK in the tax year. If an individual dies during the tax year this test does not apply. • Second automatic overseas test: resident in the UK for none of the three tax years preceding the tax year, spending fewer than 46 days in the UK in the tax year. • Third automatic overseas test: working full-time overseas over the tax year, without any significant breaks during the tax year from overseas work. For the third automatic test to apply the individual needs to spend fewer than 91 days in the UK in the tax year.
  + Ordinary Residence -If resident in the UK year after year, an individual was treated as ordinarily resident here.
  + Domicile -For Income Tax and Capital Gains Tax purposes, whether or not an individual is domiciled in the UK may affect what UK tax is paid on any foreign income and gains during a tax year.

These should be linked to the concept of working abroad.

This question is looking for a specified format, notes for use in a call and therefore answers could take the form of bullet points perhaps arranged under relevant headings. Two to three marks would be available for each category and the balance for format and coherence.

Relevant sections of the manual are Part 2 Chapter 1.2, 1.6 and 1.7.

* + 1. **marks**

1. **Write short notes on:**

* 1. **taxable benefits in kind**
  2. **tax free benefits in kind.**

**10 marks**

This question is literally seeking notes on the two types of benefits, approximately 5 marks for each.

Answers should include and explanation of benefits in kind: Benefits in kind are perks provided by an employer as part of an overall remuneration package.

Benefits in Kind Benefits in kind are perks provided by an employer to an employee as part of the overall remuneration package. Benefits are treated as employment income.

Examples of taxable and tax-free benefits should be included as well as the tax treatment of such benefits. A full answer might include comment on the use of salary sacrifice.

Taxable benefits

• the provision of living or other accommodation, including light, heat, council tax and domestic or other services (unless essential to do job e.g., caretaker)

• the use of any asset provided by the employer or another person acting on the employer’s behalf, for example the use of a motorcycle, equipment, furniture, or a TV set

Non-taxable benefits

• Free or subsidised meals

• Meal vouchers

• Expenses of providing a pension

Relevant sections of the manual are Part 2 Chapter 1.5.2 and 1.5.3.

**10 marks**

1. **In connection with Inheritance Tax, describe the differences between an Exempt Transfer and a Potentially Exempt Transfer. Illustrate your description with an example.**

**20 marks**

A full answer should begin with a brief explanation of Inheritance Tax to provide the context for answering the specific question. The definition of an exempt transfer and a potentially exempt transfer are found within the study manual and up to 5 marks would be available for defining each correctly. A further 5 marks are available for explaining the difference between them.

This question asks for an example, and one should be provided worth up to 5 marks.

Exempt Transfers - Certain transactions and gifts, regardless of the type of property they are, are not regarded as transfers of value. Hence even when a transfer of property which is not excluded property takes place, exempt transfers do not attract IHT. Small gifts exemption – any number of gifts is allowed up to a value of £250 per fiscal year per person (but not for anyone who has received the £3,000 annual exemption amount)

• gifts made in consideration of marriage, provided the value of the gift does not exceed £5,000. This includes outright gifts by a parent to a party to a marriage

A Potentially Exempt Transfer is a lifetime transfer of value made by an individual on or after 18 March 1986 comprising one of the following:

• a gift to another individual

• a transfer into a trust for the disabled which is not otherwise covered by an exemption.

PETs are exempt transfers unless the transferor dies within seven years. As a result, there is no liability to IHT at the time of the transfer. If the transferor dies within seven years, the gift becomes taxable and treated as made at the time of the original transfer but with the rates of tax at the date of death being applied, subject to a tapering relief depending on the number of years between gift and death

Relevant sections of the manual are Part 2 Chapter 4.2.5 and 4.2.7.

**20 marks**

1. **In connection with Capital Gains Tax outline the concept of Entrepreneurs’ Relief.**

**10 marks**

Answer should provide an overview of Entrepreneurs’ Relief, qualifying assets and any restrictions following the disposal of assets lent to the business.

Entrepreneurs’ Relief (ER) means that tax can be paid at 10% on qualifying assets, instead of the rate of 20% (which would apply for a higher rate taxpayer for non-residential property assets)

Qualification for relief arises on disposal of any of the following:

• all or part of a business as a sole trader or business partner – including the business’s assets after it closed;

• shares or securities in a company where at least 5% of shares and voting rights are held (this is known as a “personal company”);

• shares obtained through an Enterprise Management Incentive scheme (EMI) after 6 April 2013;

• assets lent to the business/personal company

Relevant section of the manual is Part 2 Chapter 3.4.

**10 marks**

1. **In an email to a client describe the different rates of Stamp Duty Land Tax and the available exemptions.**

**15 marks**

This question asks for a specific format and therefore 2 -3 marks would be available for answers that comply with the request.

A full answer would include a brief explanation of Stamp Duty Land Tax (It is generally payable on the purchase or transfer of property or land in the UK) before describing the different rates and exemptions. Significant changes were made to Stamp Duty Land Tax in December 2014 and a note of the impact of the changes and main differences would be relevant.

Residential land or property SDLT rates and thresholds 25 March 2010 to 3 December 2014 Purchase price/lease premium or transfer value- SDLT rate

Up to £125,000 0%

£125,001 to £250,000 1%

£250,001 to £500,000 3%

£500,001 to £1,000,000 4%

£1,000,001 to £2,000,000 5%

Over £2,000,000 7%

Following the Chancellor’s Autumn Statement on 3 December 2014 the following new rates apply.

The current SDLT threshold is £125,000 for residential properties.

The rates for residential properties

Residential land or property SDLT rates and thresholds 25 March 2010 to 3 December 2014 Purchase price of property- Rate of SDLT (percentage of portion of purchase price)

£0 - £125,000 0%

£125,001 - £250,000 2%

£250,001 - £925,000 5%

£925,001 - £1.5 million 10%

Over £1.5 million 12%

Exemptions include:

* + Disadvantaged areas (claims for this relief required before 6 May 2014)
  + SDLT is not payable on any part of the purchase price that is attributable to such things as carpets, curtains, and any other items which the vender leaves in the property.
  + when property is left to another person in a will.
  + when a couple get divorced or separate – or end their civil partnership – and the parties agree to split their property and land between them, or the property is split under the terms of a court order.

Relevant section of the manual is Part 2 Chapter 5.1.

* + 1. **marks**

1. **A new colleague has asked you for an explanation of VAT rates. He has told you he knows there are only two rates but is confused about exempt goods and zero-rated goods. Prepare a note for your colleague confirming the different rates and correcting any confusion he may have on them.**

**20 marks**

This question asks for a specific format and therefore 2 -3 marks would be available for answers that comply with the request.

A full answer should include a brief explanation of VAT: a tax that is charged on most goods and services provided in the UK. 3 marks are available. It should then include explanation and ideally examples of the different rates of VAT depending on the goods and services provided, these are:

* + Standard rate of 20 %
  + Reduced rate of 5 %
  + Zero rate
  + Exempt Goods and Services, where a business supplies exempt goods and services they do not charge VAT on them, and they normally cannot claim back the VAT on related purchases.
  + Zero- rated Supplies, if a business makes zero-rated supplies, it does not add VAT to the selling price but can still reclaim input tax on purchases and expenses

Approximately 3-4 marks available for each.

Relevant section of the manual is Part 2 Chapter 6.2.

**20 marks**