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Taxation

Finance Act 2021

Twenty-seventh edition

Alan Melville
FCA, BSc, Cert. Ed.

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Preface

The main aim of this textbook is to describe the UK taxation system in sufficient depth and with sufficient clarity to meet the needs of those undertaking a first course of study in taxation. The book has not been written with any specific syllabus in mind but should be useful to anyone who is studying taxation as part of a university or college course in accounting, finance or business studies. The book should also be of value to students who are preparing for the taxation examinations of the professional accounting bodies. A list of relevant examinations is given on the back cover of the book.

Every effort has been made to explain the tax system as clearly as possible. There are numerous worked examples and each chapter (except Chapter 1) concludes with a set of exercises which thoroughly test the reader's grasp of the new topics introduced in that chapter. The book also contains four sets of review questions, drawn mainly from the past examination papers of the professional accounting bodies. The solutions to most of these exercises and questions are located at the back of the book but solutions to those exercises and questions marked with an asterisk (*) are provided in a separate Instructor's Manual.

This twenty-seventh edition is up-to-date in accordance with the provisions of Finance Act 2021, which is based upon the March 2021 Budget proposals. At the time of writing, the Finance Act has not yet passed through all of its parliamentary stages but is expected to be granted Royal Assent during the summer of 2021.

Alan Melville
May 2021

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- Association of Chartered Certified Accountants (ACCA)
- Chartered Institute of Public Finance and Accountancy (CIPFA)
- Association of Accounting Technicians (AAT).

I must emphasise that the answers provided to these questions are entirely my own and are not the responsibility of the accounting body concerned. I should also point out that the questions which are printed in this textbook have been amended (in some cases) so as to reflect changes in taxation law which have occurred since those questions were originally published by the accounting body concerned.

I would also like to thank the Office for National Statistics for granting me permission to reproduce the table of Retail Price Indices given in Chapter 24. Furthermore, I am very grateful to Richard Poole, who has provided the sets of multiple choice questions which accompany this edition of the book.

Please note that, unless material is specifically cited with a source, any company names used within this text have been created by me and are intended to be fictitious.

Alan Melville
May 2021

Summary of Tax Data

Income Tax

	2021-22	2020-21
TAX RATES AND BANDS†		
Basic rate	20%	20%
Higher rate	40%	40%
Additional rate	45%	45%
Basic rate limit‡	£37,700	£37,500
Higher rate limit	£150,000	£150,000

† *Different tax rates and bands apply to the non-savings income of Scottish taxpayers (see below)*
‡ *Basic rate limit frozen at £37,700 until the end of tax year 2025-26*

	2021-22	2020-21
Starting rate for savings	0%	0%
Starting rate limit for savings	£5,000	£5,000
Personal savings allowance (basic rate taxpayer)	£1,000	£1,000
Personal savings allowance (higher rate taxpayer)	£500	£500
Dividend ordinary rate	7.5%	7.5%
Dividend upper rate	32.5%	32.5%
Dividend additional rate	38.1%	38.1%
Dividend allowance	£2,000	£2,000

	2021-22	2020-21
SCOTTISH TAX RATES AND BANDS†		
Starter rate	19%	19%
Basic rate	20%	20%
Intermediate rate	21%	21%
Higher rate	41%	41%
Top rate	46%	46%
Starter rate limit	£2,097	£2,085
Basic rate limit	£12,726	£12,658
Intermediate rate limit	£31,092	£30,930
Higher rate limit	£150,000	£150,000

† *These tax rates and bands apply only to the non-savings income of Scottish taxpayers*

PERSONAL ALLOWANCES

	2021-22	*2020-21*
Personal allowance†	£12,570	£12,500
Marriage allowance	£1,260	£1,250
Blind person's allowance	£2,520	£2,500
Married couple's allowance:		
Born before 6 April 1935	£9,125	£9,075
Minimum amount	£3,530	£3,510
Income limit for basic personal allowance	£100,000	£100,000
Income limit for married couple's allowance	£30,400	£30,200

† *Personal allowance frozen at £12,570 until the end of tax year 2025-26*

CAR AND FUEL BENEFIT

Zero emissions	1%	0%
*1-50 g/km (depending upon electric range)	2%-14%	2%-14%
*51g/km to 54g/km	15%	15%
*55g/km to 59g/km	16%	16%
*60g/km to 64g/km	17%	17%
*65g/km to 69g/km	18%	18%
*70g/km to 74g/km	19%	19%
*75g/km	20%	20%
Each additional 5g/km	+1%	+1%
Maximum charge	37%	37%
Amount used in car fuel benefit calculation	£24,600	£24,500

* *These percentages are 1% lower in 2021-22 and 2% lower in 2020-21 if the car was registered on or after 6 April 2020*

CAPITAL ALLOWANCES

Writing Down Allowance (WDA)		
Main pool of plant and machinery	18%	18%
Special rate pool of plant and machinery	6%	6%
Annual Investment Allowance (AIA)	100%	100%
AIA annual limit from 1 January 2016†	£200,000	£200,000
First Year Allowances (FYAs)	100%	100%
Structures and Buildings Allowances (SBAs)	3%	3%

† *AIA annual limit temporarily raised to £1m between 1 January 2019 and 31 December 2021*

PENSION SCHEMES

Annual allowance	£40,000	£40,000
Lifetime allowance†	£1,073,100	£1,073,100

† *Lifetime allowance frozen at £1,073,100 until the end of tax year 2025-26*

National Insurance Contributions

	2021-22	*2020-21*
CLASS 1		
Lower earnings limit (weekly)	£120	£120
Primary threshold (weekly)	£184	£183
Upper earnings limit (weekly)	£967	£962
Secondary threshold (weekly)	£170	£169
Upper secondary threshold (weekly)	£967	£962
Employee contributions		
Rate on earnings between primary threshold and UEL	12%	12%
Rate on earnings beyond UEL	2%	2%
Employer contributions		
Rate on earnings beyond secondary threshold	13.8%	13.8%
Employment allowance	£4,000	£4,000
CLASS 1A		
Rate	13.8%	13.8%
CLASS 2		
Weekly contribution	£3.05	£3.05
Small profits threshold	£6,515	£6,475
CLASS 3		
Weekly contribution	£15.40	£15.30
CLASS 4		
Lower profits limit	£9,568	£9,500
Upper profits limit	£50,270	£50,000
Rate on profits between lower and upper limit	9%	9%
Rate on profits beyond upper limit	2%	2%

Capital Gains Tax

	2021-22	*2020-21*
Standard rate†	10%	10%
Higher rate†	20%	20%
Business asset disposal relief rate	10%	10%
Business asset disposal relief lifetime limit	£1,000,000	£1,000,000
Annual exempt amount‡	£12,300	£12,300

† *Taxable gains on the disposal of residential property are taxed at 18% and 28%*
‡ *Annual exempt amount frozen at £12,300 until the end of tax year 2025-26*

Corporation Tax

Financial Year	*FY2021*	*FY2020*	*FY2019*	*FY2018*	*FY2017*
Main rate†‡	19%	19%	19%	19%	19%
Patent box (effective rate)	10%	10%	10%	10%	10%
R&D SMEs payable credit	14.5%	14.5%	14.5%	14.5%	14.5%
R&D expenditure credit	13%	13%	12%	12%	11%

† *The main rate for FY2022 will be 19%*

‡ *The main rate for FY2023 will be 25%. However, a "small profits rate" of 19% will apply to companies with profits not exceeding £50,000. Companies with profits between £50,000 and £250,000 will be subject to the main rate, but reduced by a marginal relief.*

Inheritance Tax

Date of transfer	*Nil rate band†‡*	*Rate on life-time transfers*	*Rate on death*	*Lower rate*
6 April 2006 to 5 April 2007	0 - £285,000	20%	40%	-
6 April 2007 to 5 April 2008	0 - £300,000	20%	40%	-
6 April 2008 to 5 April 2009	0 - £312,000	20%	40%	-
6 April 2009 to 5 April 2012	0 - £325,000	20%	40%	-
6 April 2012 to 5 April 2022	0 - £325,000	20%	40%	36%

† *Residence nil rate band for 2021-22 is £175,000*

‡ *Nil rate band and residence nil rate band both frozen until the end of tax year 2025-26*

Value Added Tax

Standard rate	20%	(from 4 January 2011)
Reduced rate†	5%	
Registration threshold‡	£85,000	(from 1 April 2017)
Deregistration threshold‡	£83,000	(from 1 April 2017)

† *A temporary reduced rate of 5% applies to the hospitality and tourism sector between 15 July 2020 and 30 September 2021. This rate rises to 12.5% between 1 October 2021 and 31 March 2022 and then reverts to the standard rate of 20% as from 1 April 2022.*

‡ *Thresholds frozen until April 2024*

Part 1

INCOME TAX AND NATIONAL INSURANCE

Chapter 1

Introduction to the UK tax system

Introduction

The purpose of this first chapter is to provide an overview of the UK tax system. The principal UK taxes are introduced and classified and the main sources of taxation law are explained. This chapter also deals with:

(a) the structure and functions of Her Majesty's Revenue and Customs (HMRC) which is the organisation responsible for the administration of the UK tax system

(b) the annual procedure which is used to determine the tax liability of an individual.

The chapter concludes by distinguishing between tax avoidance and tax evasion.

UK taxes

The UK taxation system is composed of a number of different taxes, some of which are *direct* taxes and some of which are *indirect* taxes:

(a) Direct taxes are charged on income, profits or other gains and are either deducted at source or paid directly to the tax authorities. The main direct taxes which are payable by individuals are income tax, capital gains tax and inheritance tax. The main direct tax that is payable by companies is corporation tax. All of these taxes are administered by HM Revenue and Customs (HMRC), which was formed in April 2005 when the Inland Revenue and HM Customs and Excise were merged together. National Insurance contributions, which can also be looked upon as a form of direct taxation, are administered by the NICs and Employer Office of HMRC.

(b) Indirect taxes are taxes on spending. They are charged when a taxpayer buys an item and are paid to the vendor as part of the purchase price of that item. It is then the vendor's duty to pass the tax on to the tax authorities. The indirect taxes include value added tax (VAT), stamp duty, customs duties and the excise duties levied on alcohol, tobacco and petrol. The only indirect tax considered in this book is VAT, which is also administered by HM Revenue and Customs.

Sources of tax law

There is no single source of UK taxation law. The basic rules are laid down in Acts of Parliament but it is left to the courts to interpret these Acts and to provide much of the detail of the tax system. In addition, HMRC issues a variety of statements which explain how the law is implemented in practice. These statements explain the tax authorities' interpretation of the law and will be adhered to unless successfully challenged in the courts.

Statute law

The basic rules of the UK tax system are embodied in a number of tax *statutes* or Acts of Parliament. The main statutes currently in force for each tax are as follows:

Tax	*Statute*	*Abbreviation*
Income tax	Capital Allowances Act 2001	CAA 2001
	Income Tax (Earnings and Pensions) Act 2003	ITEPA 2003
	Income Tax (Trading and Other Income) Act 2005	ITTOIA 2005
	Income Tax Act 2007	ITA 2007
National Insurance	Social Security Contributions and Benefits Act 1992	SSCBA 1992
Capital gains tax	Taxation of Chargeable Gains Act 1992	TCGA 1992
Inheritance tax	Inheritance Tax Act 1984	IHTA 1984
Corporation tax	Taxation of Chargeable Gains Act 1992	TCGA 1992
	Capital Allowances Act 2001	CAA 2001
	Corporation Tax Act 2009	CTA 2009
	Corporation Tax Act 2010	CTA 2010
Overseas aspects of tax	Taxation (International and Other Provisions) Act 2010	TIOPA 2010
Value added tax	Value Added Tax Act 1994	VATA 1994
Administration of }	Taxes Management Act 1970	TMA 1970
the tax system }	Customs and Excise Management Act 1979	CEMA 1979

These statutes are amended each year by the annual Finance Act, which is based upon the Budget proposals put forward by the Chancellor of the Exchequer. Some of the tax statutes provide for the making of detailed regulations by *statutory instrument*. A statutory instrument (SI) is a document which is laid before Parliament and (in most cases) automatically becomes law within a stated period unless any objections are raised to it.

European Union law

Until 1 February 2020, the UK was a member of the European Union (EU) and was required to comply with EU law. Member states of the EU do not adopt a common tax system but must implement EU Directives, some of which are concerned with taxation (principally VAT). As from 1 February 2020, the UK entered a transition period during which EU law continued to apply. But this period came to an end on 31 December 2020 and EU law ceased to have effect in the UK as from 1 January 2021.

Although the UK has now left the EU, some aspects of the UK tax system were originally devised so as to comply with EU Directives and these will continue unless amended or repealed by subsequent legislation. Much of the UK VAT law falls into this category.

Furthermore, when the UK was a member of the EU, it was necessary to seek EU "State aid" approval for UK tax-advantaged schemes such as the Enterprise Investment Scheme (see Chapter 6) or the R&D tax credits scheme (see Chapter 23). These schemes had to be designed within the constraints of EU law, but the UK is now at liberty to amend such schemes or to introduce new ones as it sees fit.

Case law

Over the years, taxpayers and the tax authorities have frequently disagreed over the interpretation of the tax Acts. As a result, many thousands of tax cases have been brought before the courts. The decisions made by judges in these cases form an important part of the tax law of the UK and some of the more significant cases are referred to in this book.

Statements made by the tax authorities

The main statements and other documents produced by HM Revenue and Customs as a guide to the law on taxation are as follows:

(a) **Statements of Practice**. An HMRC Statement of Practice (SP) sets out the HMRC interpretation of tax legislation and clarifies the way in which the law will be applied in practice. For example, SP 4/97 (the fourth SP issued in 1997) deals with the taxation treatment of commissions, cashbacks and discounts.

(b) **Extra-Statutory Concessions**. An Extra-Statutory Concession (ESC) consists of a relaxation which gives taxpayers a reduction in liability to which they are not entitled under the strict letter of the law. In general, concessions are made so as to resolve anomalies or to relieve hardship. For example, ESC A91 deals with the taxation treatment of living accommodation provided by reason of employment.

    A process of giving statutory effect to certain ESCs is currently underway. This is generally being done by means of statutory instruments.

(c) **Announcements**. Announcements are issued by HMRC throughout the year on a wide variety of tax-related subjects. Of especial interest are the documents issued on Budget day, which provide a detailed explanation of the Budget proposals.

(d) **Internal Guidance Manuals**. HMRC produces a comprehensive set of internal tax manuals for the guidance of its own officers. These manuals may be accessed on the HMRC website (see below).

(e) **Explanatory publications**. Leaflets, factsheets and booklets are aimed at the general public and explain the tax system in non-technical language. These can usually be accessed online, though some are still available in printed form.

Most of the above information is now available on the HMRC website, the address of which is www.gov.uk/government/organisations/hm-revenue-customs.

The tax year

The changes to the tax system that are proposed in the annual Budget speech are usually intended to take effect as from the start of the next *tax year*. Tax years for individuals and for companies are identified as follows:

(a) For individuals, a tax year runs from 6 April to the following 5 April. For instance, tax year 2020-21 began on 6 April 2020 and ended on 5 April 2021. Tax years are also referred to as *fiscal years* or *years of assessment*.

(b) For companies, a corporation tax *financial year* runs from 1 April to the following 31 March and is identified by the year in which it begins. For instance, the financial year referred to as FY2020 began on 1 April 2020 and ended on 31 March 2021.

This book takes into account the provisions of Finance Act 2021‡ (which is based on the March 2021 Budget†) and describes the UK taxation system for fiscal year 2021-22 and corporation tax financial year FY2021.

† *In 2016, the Government announced its intention of moving back the annual Budget from March (its traditional slot in the legislative timetable) to Autumn of the previous year. However, the Budget planned for November 2020 was delayed because of the coronavirus outbreak and eventually took place on 3 March 2021. Future Budgets are expected to revert to an Autumn date.*

‡ *At the time of writing, Finance Act 2021 (which implements the March 2021 Budget proposals) has not yet passed through all of its parliamentary stages but is expected to be granted Royal Assent during the summer of 2021.*

Structure of HM Revenue and Customs

Her Majesty's Revenue and Customs (HMRC) consists of a large body of civil servants which is headed by the *Commissioners for Revenue and Customs*. The Commissioners are appointed by Her Majesty The Queen in accordance with recommendations made by the *Treasury*. This Government department has overall responsibility for the public finances of the UK and is managed by the *Chancellor of the Exchequer*. The main duties of the Commissioners for Revenue and Customs are as follows:

(a) to implement the law relating to direct and indirect taxation
(b) to provide advice to the Chancellor of the Exchequer on taxation matters
(c) to administer the divisions and offices into which HMRC is organised.

The routine work of HMRC is carried out by officials known as *Officers of Revenue and Customs*. With regard to direct taxation, the main function of these officials is generally to check a taxpayer's own self-assessment of the tax liability (see below) and then to ensure that the correct amount of tax is paid. The functions of HMRC with regard to indirect taxation (and VAT in particular) are explained later in this book (see Chapter 30).

HMRC has specialist offices which deal with such matters as pension schemes, charities and so forth but most of the day-to-day work relating to direct taxation takes place in local area offices. These offices are responsible for routine assessment and collection of tax and for ensuring that taxpayers comply with tax regulations. Until recently, HMRC had 170 local offices but these are being consolidated into 13 regional centres.

Support for taxpayers who need help with their tax affairs is provided by means of specialist expert advice either given over the telephone or delivered by mobile advisors at convenient locations in the community or at a taxpayer's home or workplace.

Administration of the tax system

The remainder of this chapter describes the administration system which is used to assess an individual's liability to income tax and capital gains tax in each tax year. This system is known as "Self Assessment". Under this system, the taxpayer (*not* HMRC) is primarily responsible for ensuring that:

(a) the tax liability for each tax year is properly assessed, and

(b) the correct amount of tax is paid on the due date or dates.

Later chapters of this book explain the administration systems which are used for the purposes of corporation tax, inheritance tax and VAT.

Self Assessment

If an individual's tax liability for a tax year cannot be collected entirely by deduction at source (see Chapter 2) or via the PAYE system (see Chapter 7), then the liability must be formally assessed. The starting point in the assessment process is usually the completion of a *self assessment tax return*†‡. The annual procedure is as follows:

(a) At the end of every tax year, a statutory "notice to file" is normally issued to each taxpayer who is required to submit a self assessment tax return. Such a notice requires that a return is made and delivered to HMRC either on paper or electronically. Paper tax return forms (for those taxpayers who need them) can be downloaded and printed from the HMRC website or may be obtained by telephoning HMRC. Voluntary tax returns (i.e. returns submitted without a notice to file) are accepted and valid.

† *In certain circumstances, HMRC is empowered to make an assessment of an individual's income tax or capital gains tax liability without that person being first required to complete a tax return. This "simple assessment" procedure may be used in straightforward cases where HMRC already has sufficient information about the individual to make the assessment.*

‡ *The Government intends to replace tax returns with online "digital tax accounts" as part of the "Making Tax Digital" project (see later in this chapter).*

(b) The main paper tax return consists of a basic eight-page form. There are also several sets of supplementary pages, each of which deals with a different type of income or gains (e.g. income from self-employment). Taxpayers are required to complete only those supplementary pages that are relevant to their circumstances.

(c) A short tax return (STR) is available for taxpayers with less complex tax affairs.

(d) Rather than completing a paper tax return, taxpayers can file returns electronically by means of the internet and are encouraged to do so. Over 95% of self assessment tax returns for tax year 2019-20 were in fact filed electronically.

(e) The information requested in a tax return relates to the tax year that has just ended. For instance, the tax return notices issued in April 2021 required taxpayers to declare their income and gains for tax year 2020-21.

(f) A tax return must be completed in full. It is not permissible to omit figures or to make entries such as "see accounts" or "as submitted by employer". Unless asked to submit accounts or other supporting documentation with the return, a taxpayer is under no obligation to do so. However, it is necessary to retain all supporting documentation in case HMRC enquires into the accuracy of a return.

(g) If a main tax return is submitted on paper, the taxpayer has the option of calculating his or her own tax liability (using "tax calculation summary" pages) and submitting this calculation to HMRC as part of the return. HMRC will calculate the tax liability for taxpayers who do not take up this option or for those who submit the short tax return (which does not include a self-calculation facility). However, if a paper return is submitted late (see below), HMRC does not guarantee to advise the taxpayer of the liability in time for the correct amount of tax to be paid on the correct date.

If a tax return is filed electronically, the tax liability is calculated by computer software. In all cases, the resulting assessment is referred to as a "self-assessment".

(h) Self assessment tax returns must normally be filed (i.e. submitted to HMRC) on or before the following dates:

- for paper returns, 31 October following the end of the tax year
- for returns filed electronically, 31 January following the end of the tax year.

However, if the return notice is issued after 31 July following the end of the tax year (but not after 31 October) the taxpayer has three months from the date of the notice to submit a paper return. The deadline for electronic filing in such a case remains at 31 January. If the notice is issued after 31 October, the taxpayer has three months from the date of the notice to submit the return either on paper or electronically.

(i) Penalties are imposed if a return is filed late. Furthermore, the submission of a late return may mean that the tax liability for the year is not determined until after the due date of payment (see below). A taxpayer who pays tax late will incur interest and may also incur a late-payment penalty (see Chapter 15).

(j) The 31 January which follows the end of a tax year is known as the "filing date" for that year. For example, the filing date for tax year 2021-22 is normally 31 January 2023. However, if a return notice is issued after 31 October, the filing date becomes the date which falls three months after the issue date of the notice.

(k) HMRC is empowered to correct a tax return (so as to rectify any obvious errors or omissions or anything else that is believed to be incorrect) within nine months of the date on which the return is filed. Similarly, the taxpayer has the right to amend his or her tax return within 12 months of the filing date for that return.

(l) A taxpayer who has paid an amount of tax but now believes that this tax should not have been paid (a situation that could be caused by an error in a tax return) may make a claim for recovery of the overpaid tax. Such a claim must be made within four years of the end of the tax year to which it relates. Depending upon the circumstances of the case, HMRC may or may not accept the claim.

(m) The tax due in relation to a self-assessment is normally payable as follows:

  (i) A first payment on account (POA) is due on 31 January in the tax year to which the self-assessment relates.
  (ii) A second POA is due on the following 31 July.
  (iii) A final balancing payment is due on the following 31 January.

  For example, the tax due in relation to a 2021-22 self-assessment would normally be payable on 31 January 2022 (first POA), 31 July 2022 (second POA) and 31 January 2023 (balancing payment). Further information is given in Chapter 15 of this book.

(n) An employed taxpayer whose balancing payment does not exceed £3,000 may require that this should be collected via the PAYE system (see Chapter 7). In such a case, taxpayers who file their tax returns electronically must do so by 30 December so as to give HMRC sufficient time to make the necessary arrangements.

Notification of chargeability to tax

An individual who has not received a notice to submit a tax return, but has taxable income (or gains) of which HMRC is not aware, must notify HMRC of his or her chargeability to tax within six months of the end of the tax year in which the income arises. However, notification of chargeability is *not* required if *all* of the following conditions are satisfied:

(a) the individual has no capital gains
(b) the individual is not liable to tax at a rate which exceeds basic rate (see Chapter 2)
(c) all of the individual's income has been subject to deduction of income tax at source (see Chapter 2) or has been dealt with via the PAYE system (see Chapter 7)
(d) the individual is not liable to a high income child benefit charge (see Chapter 7).

An individual who fails to notify chargeability within the permitted six-month period will incur a penalty (see Chapter 15).