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FINANCE ACT 2017

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Taxation

Finance Act 2017

Twenty-third edition

Alan Melville
FCA, BSc, Cert. Ed.

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Preface

The main aim of this book 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-third edition includes the provisions of Finance Act 2017, which is based upon Finance (No. 2) Bill 2017. This Bill was fast-tracked through Parliament before the June 2017 general election and omitted many of the proposals made in the March 2017 Budget. The remaining Budget proposals are explained in the relevant chapters of this book, but it is made abundantly clear that these are merely proposals and have not yet been enacted. Some of the more significant areas affected are:

- The timetable for the Making Tax Digital (MTD) project (Chapter1)
- A planned reduction in the dividend allowance (Chapter 2)
- The property and trading income allowances (Chapters 5 and 9)
- The cash basis for property income (Chapter 5)
- Corporation tax loss reliefs (Chapter 26)
- Corporate interest relief restrictions (Chapter 28)
- The deemed domicile rules (Chapter 32).

The Government has stated that there will be a Summer Finance Bill but (at the time of writing) it is not known which measures will be included in this Bill and whether the implementation date of any of them will be delayed. An analysis of the Summer Finance Bill will be made available as soon as possible on the website which accompanies this book. The website address is www.pearsoned.co.uk/melville.

Alan Melville
June 2017

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I would like to thank the following accounting bodies for granting me permission to use their past examination questions:

- 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.

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
June 2017

Summary of Tax Data

Income Tax

	2017-18	2016-17
TAX RATES AND BANDS		
Basic rate	20%	20%
Higher rate	40%	40%
Additional rate	45%	45%
Basic rate limit	£33,500†	£32,000
Higher rate limit	£150,000	£150,000
Starting rate for savings	0%	0%
Starting rate limit for savings	£5,000	£5,000
Personal savings allowance (maximum)	£1,000	£1,000
Dividend allowance	£5,000‡	£5,000‡

† *Basic rate limit applicable to non-savings income of Scottish taxpayers in 2017-18 is £31,500*

‡ *Rates of tax on dividends in both years are 7.5%, 32.5% and 38.1%*

ALLOWANCES	£	£
Personal allowance	11,500	11,000
Marriage allowance	1,150	1,100
Blind person's allowance	2,320	2,290
Married couple's allowance:		
Born before 6 April 1935	8,445	8,355
Minimum amount	3,260	3,220
Income limit for basic personal allowance	100,000	100,000
Income limit for married couple's allowance	28,000	27,700
CAR AND FUEL BENEFIT		
Not exceeding 50g/km	9%	7%
51g/km to 75g/km	13%	11%
76g/km to 94g/km	17%	15%
95g/km	18%	16%
Each additional 5g/km	+1%	+1%
Maximum charge	37%	37%
Amount used in car fuel benefit calculation	£22,600	£22,200
PENSION SCHEMES	£	£
Annual allowance	40,000	40,000
Lifetime allowance	1,000,000	1,000,000

Capital Allowances

Writing Down Allowance (WDA)	
Main pool of plant and machinery	18%
Special rate pool of plant and machinery	8%
Annual Investment Allowance (AIA)	
AIA annual limit from 1 January 2016	£200,000
AIA rate	100%
First Year Allowance (FYA) on qualifying plant and machinery	
Low emission cars	100%
Gas refuelling equipment†	100%
Energy saving or water efficient technology	100%
Zero-emission goods vehicles	100%

† *The Government has proposed that expenditure on charging points for electric vehicles should also be eligible for a 100% FYA.*

National Insurance Contributions

	2017-18	*2016-17*
CLASS 1		
Lower earnings limit (weekly)	£113	£112
Primary threshold (weekly)	£157	£155
Upper earnings limit (weekly)	£866	£827
Secondary threshold (weekly)	£157	£156
Upper secondary threshold (weekly)	£866	£827
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%
CLASS 1A		
Rate	13.8%	13.8%
CLASS 2		
Weekly contribution	£2.85	£2.80
Small profits threshold	£6,025	£5,965
CLASS 3		
Weekly contribution	£14.25	£14.10
CLASS 4		
Lower profits limit	£8,164	£8,060
Upper profits limit	£45,000	£43,000
Rate on profits between lower and upper limit	9%	9%
Rate on profits beyond upper limit	2%	2%

Capital Gains Tax

	2017-18	*2016-17*
Standard rate†	10%	10%
Higher rate†	20%	20%
Entrepreneurs' relief rate	10%	10%
Entrepreneurs' relief lifetime limit	£10,000,000	£10,000,000
Annual exempt amount	£11,300	£11,100

† *Taxable gains on the disposal of residential property are taxed at 18% and 28%*

Corporation Tax

Financial Year	*FY2017*	*FY2016*	*FY2015*	*FY2014*
Main rate	19%	20%	20%	21%
Small profits rate	-	-	-	20%
Lower limit	-	-	-	£300,000
Upper limit	-	-	-	£1,500,000
Marginal relief fraction	-	-	-	1/400

Note:
The main rate for FY2018 is 19%.

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 2018	0 - £325,000	20%	40%	36%

Note:
The main residence nil rate band for 2017-18 is £100,000.

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)

†*Standard rate 17.5% prior to 4 January 2011*

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 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. 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 the item. It is then the vendor's duty to pass the tax on to the tax authorities. 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 tax 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, notices and leaflets which explain how the law is implemented in practice. These statements have no legal backing but they 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 then automatically becomes law within a stated period unless any objections are raised to it.

European Union law

Membership of the European Union (EU) involves adherence to EU law †. Member states are not required to adopt a common system of taxation but some parts of the UK system are nonetheless influenced by EU requirements. At present, the main impact is on VAT, where the prevailing legislation takes the form of EU Directives. These are binding on the UK and dictate the results which the internal legislation of the UK must bring about.

Additionally, EU "State aid" approval must sometimes be sought for amendments to UK tax-advantaged schemes such as the Enterprise Investment Scheme (see Chapter 6) or the R&D tax credits scheme (see Chapter 23). Furthermore, decisions made in the European courts may trigger changes to UK tax law, as occurred in relation to the tax treatment of the losses of overseas subsidiary companies (see Chapter 32).

† *In view of the Referendum result on 23 June 2016, it seems safe to say that EU influence over the UK tax system will eventually cease to exist.*

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**. A 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 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 (and other notices and documents) are issued by HMRC throughout the year on a wide variety of tax-related subjects. Of especial interest are the documents which are issued on Budget day and 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 2016-17 began on 6 April 2016 and ended on 5 April 2017. 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 FY2016 began on 1 April 2016 and ended on 31 March 2017.

This book takes into account the provisions of Finance Act 2017 (which is based on the March 2017‡ Budget) and describes the UK taxation system for fiscal year 2017-18 and corporation tax financial year FY2017.

† *The Budget traditionally takes place in March but is now being moved back to the Autumn of the previous year. The final Spring Budget occurred in March 2017. The first Autumn Budget will occur in Autumn 2017 and will lay out the Government's tax plans for the following tax year.*

‡ *Many of the proposals made in the March 2017 Budget were removed from the ensuing Finance Bill so as to expedite the Bill's progress through Parliament before the general election of June 2017. At the time of writing, it seems likely that these proposals will be re-introduced and will form the basis of a second Finance Act in 2017. Further information will be made available on the website which accompanies this book. The address is www.pearsoned.co.uk/melville.*

Structure of HM Revenue and Customs

Her Majesty's Revenue and Customs (HMRC) consists of a large body of civil servants 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 and for ensuring that taxpayers comply with tax regulations. At present, HMRC has 170 local offices but these are to be consolidated into 13 regional centres over the next ten years.

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) Tax returns†‡ are normally issued in April each year to those taxpayers who are likely to need them. Each tax return includes a formal notice requiring a return to be made and delivered to HMRC. Paper tax returns are not sent to taxpayers who submitted the previous year's return electronically (see below) but such taxpayers are still sent a notice requiring a return to be made and can request a paper tax return if they so wish. Returns can also be downloaded and printed from the HMRC website.

† *As from tax year 2016-17, 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 where HMRC already has sufficient information about the individual to make the assessment.*

‡ *By 2020, 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 dealing 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 straightforward 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. Approximately 90% of self assessment tax returns are in fact filed electronically.

(e) The information requested in a tax return relates to the tax year just ended. For example, the tax returns issued in April 2017 required taxpayers to declare their income and gains for tax year 2016-17.

(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 2017-18 is normally 31 January 2019. 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 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 2017-18 self-assessment would normally be payable on 31 January 2018 (first POA), 31 July 2018 (second POA) and 31 January 2019 (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 ask that this should be collected via the PAYE system (see Chapter 7). In such a case, taxpayers who file their returns electronically are advised to 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 a higher-rate taxpayer (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).