Taxes in the United Kingdom

2013/14

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1. Introduction

There are various taxes that apply in the United Kingdom which can affect limited companies, individuals, businesses and various types of transactions.

Taxes are a method of funding the country's obligations. Whilst these can be assigned various names e.g. taxes and contributions below, generally they amount to levies which find their way into the government "coffers". Among these you can find:

1.1 Taxes

Internal

a) Income tax
b) Value added tax
c) Excise duties e.g. tax on road fuel, alcohol etc.
d) Inheritance tax
e) Stamp duty
f) Various taxes on motor vehicles – road fund tax etc.
g) Gaming machine duty
h) Capital gains tax (applicable to both companies and individuals)

Foreign trade

a) Customs duties

1.2 Contributions

a) Social security contributions (National Insurance).

Here are the main features of the most relevant taxes:

2. Corporation Tax on UK Registered Companies

2.1 Determination of the taxable income or loss

The tax is calculated on net taxable income. To determine the net amount, the gross figure is taken and has all expenses necessarily incurred to obtain, maintain and preserve it subtracted. In case of loss, it can be utilised against profits in a variety of ways – either carried back for one year or carried forward against future taxable profits.

Business expenses deductible will generally include the following:

- Interest paid and bank charges
- Taxes and fees
- General business expenses
- Insurance premiums
- Extraordinary damages
- Specific provision for doubtful debts
- Losses
- Payroll costs including contributions to pension and retirement plans

Certain expenses, whilst chargeable against profits for accounting purposes, may be disallowed or treated differently for tax purposes:

- Research and development – an enhanced deduction may be allowable against taxable profits based on a multiple of the expenditure actually incurred
- Depreciation (added back to taxable profits and “capital allowances” given as a deduction)
- General or round sum provisions for doubtful debt

2.2 Corporation Tax Rates

The tax rate is set for a period of one year which runs from 1st April – 31st March. The rate is based on the taxable profits of the company as computed. If the accounting date does not align with the year shown above, the profits are calculated on a time apportionment basis and taxed accordingly. For instance, a company with a 30 September year end will have 6 months at one rate and six months at the new rate.

The profits are taxed at one rate up to £300,000, and then any profits between this level and £1.5m are taxed at a different (higher) rate. If profits exceed £1.5m, they are all taxed at the rate shown.

The rates proposed for the next few years are:-

	Tax rate on profits		
	<£300,000	£300,001-£1,500,000	>£1,500,000
2012 (1 April 2012 - 31 March 2013)	20%	25%	24%
2013 (1 April 2013 - 31 March 2014)	20%	23.75%	23%
2014 (1 April 2014 - 31 March 2015)	20%	21.25%	21%
2015 (1 April 2015 - 31 March 2016)	20%	20%	20%

As can be seen, there is the expectation of a flat rate of 20% on profits from April 2015, meaning the complexities of the marginal tax rates will be removed.

2.5 Tax Procedures and Payment Dates

2.5.1 Tax Procedures

Companies calculate their own tax liabilities – a method known as self-assessment. A company completes a tax return (CT600) although there may be supplementary pages that also require completion. These returns need to be filed online with Her Majesty's Revenue and Customs (HMRC). These returns, along with the accounts themselves, need to be filed in iXBRL format (a reporting language readable both by the human eye and software). Generally a company incorporated in the UK has a default accounting date for the first period of accounts set to 12 months to the end of the month in which it is formed. So a company formed on 14 January 2013 will need to prepare accounts to 31 January 2014, although this can be changed if the company so wishes. An added complication is that a company tax return can only be for a period of up to 12 months, so profits need to be time apportioned, and two returns need to be filed with HMRC – the first for 14/1/2013 - 13/2/2014 and a second one for the period 14/2/2014 - 28/2/2014. Returns are due for filing 12 months after the end date of the relevant period.

2.5.2 Payments

Whilst the returns are not due with HMRC until 12 months after the relevant date, tax is actually payable 9 months after the relevant date! Therefore, in our example above, there will be a payment due on (or before) 13/11/2014 and another amount due on 30/11/2014. There will then be a cycle of payments every 30 November thereafter. However, if profits exceed a certain figure, then a quarterly payment cycle comes into operation.

2.5.3 Tax Administration

HM Revenue and Customs (HMRC) has two separate departments. The Inspector of Taxes is responsible for ensuring that the tax returns submitted are correct and the Collector of Taxes is responsible for actually ensuring the tax calculated under self-assessment is paid.

2.6 Dividends Paid or Credited

A feature of the UK tax system is that dividends received by companies from other companies are not subject to corporation tax in the hands of the recipient company. Conversely, the dividends are not tax deductible by the paying company. The tax position for personal taxpayers is covered shortly.

2.7 Gains on Sales of Fixed Assets and Shares

Gains on disposal of shares and land are considered capital gains and are determined by deducting from the sale price or value of the respective asset the acquisition or production cost. For gains made by limited companies, it is also possible to add an index factor to the cost, based on the increase in inflation between acquisition and disposal. These capital gains are then taxed inside the company.

2.8 Tax Incentives

There are certain incentives and allowances for tax purposes.
The laws of major tax incentives include:

- Promoting the film industry
- Technology
- Renewable energy incentives and special regimes
- Enhanced capital allowances on expenditure on certain assets
- Research and development expenditure (applies only to incorporated businesses)

3. Income Tax of Individuals

3.1 UK Residents

Those living in the UK are generally liable to UK tax on income derived both in the UK and any income from abroad.

3.2 Residence

The concept of residence and liability to UK tax has been updated and changed very recently, due to some high profile tax cases in the courts. This is a complex area and professional advice should be sought.

3.3 Determination of the Taxable Income or Loss

Individual taxpayers running a business that is not a limited company will be running an unincorporated business and will generally be referred to as "self-employed". The method of trading will either be as a sole proprietor, in partnership with others or in a special partnership structure known as an LLP (Limited Liability Partnership). In calculating profits of the business, there may be deducted from the gross income generated the expenses necessary to obtain, maintain and retain taxable income, as established in the regulations.

The tax base is determined by considering the taxable income and allowable deductions provided by law. The section concerning companies dealt with allowable and disallowable expenses, which apply equally to the unincorporated business. However there are certain deductions that are peculiar to unincorporated businesses and are not deductible for tax purposes. These include:

a) "Wages" and "salaries" paid to the proprietors of the business – more commonly known as "drawings"
b) Tax liabilities based on trading profits
c) National insurance contributions payable by the self-employed

3.4 Rates of Tax and Allowances

Everyone in the United Kingdom has a "personal allowance" – an amount that can be earned before tax becomes payable. This is set each year and the rate applies for the tax year. The UK tax year runs from 6 April – 5 April, so the 2013/14 tax year is from 6 April 2013 – 5 April 2014.

Rates of tax are a basic rate of 20%, a higher rate (currently 40%) and an additional rate (currently 45% from 6 April 2013). These are applied to bands of taxable income. The rates for 2013/14 are as follows:

Amount of taxable income	Tax rate
Up to £32,010	20%
Between £32,011 and £150,000	40%
All taxable income over £150,000	45%

3.5 Tax Procedures and Payment

3.5.1 Tax Procedures

Whilst it is not obligatory for all UK residents to submit a tax return, it is obligatory to notify HMRC if there are sources of income which will give rise to tax liabilities. A system of self-assessment is in place so that the individual submits a tax return to HMRC. Whilst the vast majority of tax returns are filed online, there is still the facility to file a paper return, although the timescale to file on paper is shorter than the online filing deadline. A paper return has to be submitted by 31 October following the end of the tax year, whereas the deadline for online filing is 31 January following the tax year end. For example, the 2013/14 tax return would need to be filed by 31 October 2014 if paper-based, or 31 January 2015 if filed online.

For those running a business, the profits assessed are based on any accounts ending during the relevant tax year. So if accounts are prepared to 31 December each year, the taxable profits in the year to 31 December 2013 would be taxed in 2013/14. There are special rules that apply to any startup business which does not have an accounting date of 31 March/5 April, but this is not covered in this paper.

3.5.2 Payments

Tax is generally payable twice a year, on 31 January and 31 July. As mentioned above, special rules apply to new unincorporated businesses; it is not possible, however, to cover these rules in this paper. The example below therefore applies to an ongoing business. The concept of payment is that there is a provisional payment, based on the prior year's tax liability, and a "catch up" when the actual income is known and tax calculated for a year.

3.5.3 Tax Procedures

Applies as indicated in section 2.5.3.

3.6 Dividends and Distributed Profits

The UK tax system treats dividends paid by UK companies as having 10% tax paid, so a dividend of £9,000 is treated as £10,000 gross income and £1,000 tax paid. This is deemed to satisfy the basic rate tax due. Therefore if the only UK income is £9,000 from dividends, no further tax is payable. If taxable income exceeds the basic rate band in 3.4 above, further tax will become due. At the 40% rate the tax payable based on the NET dividend is 30.56%, and at the 45% rate is 36.11%.

3.7 Gains on Sales of Fixed Assets and Shares

Gains on disposal of shares and land are considered capital gains and are determined by deducting from the sale price or value of the respective asset the acquisition cost, or the market value of the asset in 1982 if held since before that date. There are special rules for business assets and a 10% tax rate applies if the asset qualifies under this heading. Otherwise tax is payable at 18% or 28%, depending on income levels.

3.8 Tax Incentives

As in 2.8 above, some of the reliefs also apply to individuals. There are also tax allowances on contributions to pension schemes for retirement funding, and tax free saving schemes.

4. Income Tax for Foreign Residents

4.1 Non-Residents

Those treated as a non-UK resident might still have to pay UK Income Tax and Capital Gains Tax on their UK income or capital gains. The rules are the same whether the individual became non-resident when moving from the UK to live or work full time abroad, or whether the individual has always been based abroad but has UK income or gains.

4.2 Taxable Income

Apply as shown in section 4.1.

4.3 Tax Conventions and International Agreements

To avoid double taxation, there are various tax treaties in force between the UK and many other countries throughout the world.

5. Statements, Payment and Tax Procedures

5.1 Tax Year

The income tax fiscal year runs form 6th April to the following 5th April. A system of self assessment is in place and the individual is obliged to notify HM Revenue and Customs of a liability to UK tax. A tax return needs to be filed before 31 October for HM Revenue and Customs to calculate the tax liabilities, otherwise you do need to calculate them yourself. HM Revenue and Customs will however check these calculations.

5.2 Payments

For those in employment, there is a scheme called Pay as You Earn (PAYE). The amount of PAYE is determined by the employer based on the tax code and National Insurance category. The tax code is determined by HM Revenue and Customs (HMRC) based on the employee's expected tax allowances, exemptions and reliefs for the full tax year, and partly by the employee's expected other income. Published tables apply the tax code to determine the amount of tax to be deducted from the salary or wage paid to the employee. The employer is responsible for sending the tax on to HMRC each month.

PAYE is applied to sick pay, maternity pay, directors' fees and pensions (but not the state pension), as well as wages and salaries. Because the tax code reflects other income (including the state pension), the PAYE system typically results in the correct amount of tax being paid on all the income of a taxpayer, making a tax return redundant. However, if the taxpayer's affairs are complicated, a tax return may be required to determine the amount of tax payable or refundable.

Where there is a trade, (self-employment either as an individual or in partnership), or where there are untaxed sources of income such as rents, a tax return is required. Tax is than paid as outlined in 3.5.2 above.

5.3 Tax Procedures

Applies as indicated in section 2.5.3

6. Value Added Tax (VAT)

6.1 Introduction

The value added to a product by or with a business is the sale price charged to its customer, minus the cost of materials and other taxable inputs. A VAT is like a sales tax in that ultimately only the end consumer is taxed. It differs from the sales tax in that, with the latter, the tax is collected and remitted to the government only once, at the point of purchase by the end consumer. With VAT, collections, remittances to the government and credits for taxes already paid occur each time a business in the supply chain purchases products.

6.2 Determination of Tax or Credit Balance

VAT returns are usually prepared on a 3-monthly basis, and the excess of VAT collected (outputs) over VAT spent (inputs) is payable to HM Revenue and Customs. Some trades may have excess inputs so would then be entitled to a repayment. There are various special schemes in place such as annual accounting, flat rate schemes etc. which deal with the reporting and payment slightly differently.

6.3 Rates

Rates of VAT

There are different rates of VAT, depending on the type of goods or services your business provides. At the moment there are three different rates. They are:

- standard rate - 20 per cent
- reduced rate - 5 per cent
- zero rate - 0 per cent

There are also some goods and services that are:

- exempt, so no VAT is charged on them
- outside the scope of the UK VAT system altogether

6.3.1 Exemptions

Goods and services that are exempt from VAT include:

- insurance (but there is an Insurance Premium Tax (IPT) that may apply instead)
- some services from doctors and dentists
- some types of education and training

If you sell or otherwise supply only VAT-exempt goods or services, you cannot register for VAT and you cannot charge VAT. If you buy exempt goods or services, you aren't charged VAT so there is none to claim back.

6.4 Statements, Payment and Tax Procedures

Payments

It is now mandatory to send HM Revenue & Customs (HMRC) VAT returns online and pay any VAT electronically. HMRC recommends payment by Direct Debit. As outlined in 6.2 above, VAT is usually payable on a quarterly basis.

Tax Procedures

Applies as indicated in section 2.5.3

The Directorate General of Internal Revenue has distributed local administrations in strategic geographical areas that are responsible for meeting the formalities of taxpayers, and to monitor compliance with their tax obligations.

7.0 UK Social Security System (DSS)

7.1 Institution Responsible for the Provision of Services

The UK has a comprehensive social security system, funded from general taxation and from National Insurance (NI) payments.

The social security system provides state benefits for those unable to work due to illness or industrial injury, as well as unemployment, maternity, childcare, disability and carer benefits. It also administers retirement pensions.

From the age of 65, both men and women become eligible for the state retirement pension. Most families with dependent children are eligible for Child Tax Credits, while employees who are on a low-income may qualify for Working Tax Credits. All benefits are means-tested.

7.2 National Insurance Contributions

You usually only have to pay national insurance contributions if you are employed or self-employed in Great Britain or Northern Ireland, and you live in the UK.

7.3 NI Rates and Dues

Whilst the rates are relatively constant, the thresholds and bandings for these rates tend to be amended each year.

In 2013/14 an employee will pay NI at 12% on earnings between £149 and £797 per week, and at 2% on earnings over that limit. These are deducted under the PAYE scheme from the wages.

An employer pays NI at 13.8% on the employee’s wages, at 13.8% on income in excess of £148 per week.

The self-employed pay a flat rate of £2.70 per week, but also 9% on profits between £7,755 and £41,450 per annum and 2% on profits in excess of £41,450.

There are also many other variations of NI contribution.