

# ASSOCIATION OF ACCOUNTING TECHNICIANS

## GUIDANCE NOTES

### AAT ACCOUNTING QUALIFICATION – DIPLOMA PATHWAY

### UNIT 18, PREPARING BUSINESS TAXATION COMPUTATIONS (BTC)

### FINANCE ACT 2004, FOR AAT EXAMS IN JUNE AND DECEMBER 2005

## Introduction

Unit 18, Preparing Business Taxation Computations, concerns the calculation of taxation liabilities for:

- Sole traders
- Partnerships
- Limited companies

In calculating the tax liability of a limited company, Form CT600 Corporation Tax Return may need to be completed.

## Guidance by element

### *Element 18.1, Prepare capital allowances computations*

#### Performance criteria

- Classify expenditure on capital assets in accordance with the statutory distinction between capital and revenue expenditure
- Ensure that entries and calculations relating to the computation of capital allowances for a company are correct
- Make adjustments for private use by business owners
- Ensure that computations and submissions are made in accordance with current tax law and take account of current Inland Revenue practice
- Consult with Inland Revenue staff in an open and constructive manner
- Give timely and constructive advice to clients on the maintenance of accounts and the recording of information relevant to tax returns
- Maintain client confidentially at all times

#### Guidance

This element is not to be seen in isolation. It has an impact on both Element 18.2 and 18.4. This is because both 18.2 and 18.4 require the calculation of Schedule D Case I/II profits or losses, and capital allowances need to be deducted as an allowable expense.

Specific areas that need to be covered are:

1. Awareness of the kind of expenditure on which capital allowances will be available:

- What is plant and machinery?
- What is an industrial building?
- When is expenditure for capital purposes and when is it for revenue purposes?

2. The ability to calculate capital allowances on:

- Plant and machinery. This includes special rules on:
  - Motor vehicles, including those attracting 100% first year allowance (FYA);
  - Short life assets;
  - Information and communications technology;
  - First year allowances;
  - Private use assets (unincorporated businesses only)
- Industrial buildings allowance. This only includes buildings that have continuously been used for industrial purposes.

These calculations need to be made for both unincorporated and incorporated businesses. The rules governing opening, continuing and ceasing organisations need to be considered.

Writing down allowances, balancing allowances and balancing charges are required.

Students must consider the rationale behind these calculations, so that they can provide a written explanation of the calculations, for instance, when dealing with client queries.

### ***Element 18.2, Compute assessable business income***

#### **Performance criteria**

- A. Adjust trading profits and losses for tax purposes
- B. Make adjustments for private use by business owners
- C. Divide profits and losses of partnerships amongst partners
- D. Apply the basis of assessment for unincorporated businesses in the opening and closing years
- E. Identify the due dates of payment of Income Tax by unincorporated businesses, including payments on account
- F. Identify the National Insurance Contributions payable by self-employed individuals
- G. Complete correctly the self-employed and partnership supplementary pages to the Tax Return for individuals, together with relevant claims and elections, and submit them within statutory time limits
- H. Consult with Inland Revenue staff in an open and constructive manner
- I. Give timely and constructive advice to clients on the maintenance of accounts and the recording of information relevant to tax returns
- J. Maintain client confidentiality at all times

#### **Guidance**

The purpose of this element is to demonstrate the ability to calculate Schedule D Case I/II profits or losses.

Firstly, students should be able to determine whether trading is taking place, for instance, through the use of the badges of trade.

In calculating the adjusted Schedule D Case I/II profit or loss of the business, a sound knowledge is required of how to adjust the accounting profit or loss. Only a few of the adjustments required are specifically mentioned in the Knowledge and Understanding. This list should be viewed as being indicative, rather than exhaustive. Part of these adjustments is the ability to correctly identify, and adjust for, private usage of expenditure as shown in the accounting profit and loss account.

If the trade is being carried on by a partnership, students need to be able to determine how profits are to be split between the partners according to the rules laid down by the Inland Revenue. This includes changes in the profit-sharing agreement or a change in the composition of the partnership, such as when a partner joins or leaves the business.

For both a sole trader and a partnership, a sound knowledge is required of the rules for opening, continuing and closing years of trade. This includes overlap profits. However, the rules for the change of accounting date are excluded. Such calculations will be expected in round tax months, not in days.

Once determined, students need to demonstrate understanding of the use of the profit or loss in the inclusion of the income tax return. The dates for submission of the return and payment of income tax must be considered, together with the implications of making a late filing of the return. However, the completion of the actual income tax return and completion of the income tax computation is assessable under Unit 19.

If the Schedule D Case I/II figure results in a loss, students must have knowledge of the ways in which such a loss can be relieved. S.385, S.380, S.381 and S. 388 ICTA 1988 should all be covered, but detailed and complex loss relief provisions will not be assessed. Excluded from this are losses for partnerships.

For National Insurance Contributions, knowledge of both Class 2 and Class 4 is required.

### ***Element 18.3, Prepare capital gains computations***

#### **Performance criteria**

- A. Identify and value correctly any chargeable assets that have been disposed of
- B. Identify shares disposed of by companies
- C. Calculate chargeable gains and allowable losses
- D. Apply reliefs, deferrals and exemptions correctly
- E. Ensure that computations and submissions are made in accordance with current tax law and take account of current Inland Revenue practice
- F. Consult with Inland Revenue staff in an open and constructive manner
- G. Give timely and constructive advice to clients on the maintenance of accounts and the recording of information relevant to tax returns
- H. Maintain client confidentiality at all times

#### **Guidance**

This element deals with the calculation of capital gains for businesses only. This includes chargeable disposals by individuals and companies of business assets, and of the business itself. Disposal of private assets held by individuals is assessable under Unit 19. Taper relief is therefore included where an individual disposes of a business asset, but the treatment of capital gains for a partnership is excluded.

Capital gains computations may include:

- Shares and securities, including rights issues and bonus issues, FA 1985 pool and matching rules
- Chattels
- Part disposal of assets
- Improvement expenditure
- Indexation allowance
- Tapering relief as appropriate to individuals

A capital gain computation will not be required on any assets acquired before 31 March 1982.

In addition, students should have an understanding of business reliefs, including rollover relief and relief for gifts. Students should be able to demonstrate knowledge about the conditions for such relief and be able to complete basic calculations. ~~Complex calculations will not be required, for example assets with non-business use, depreciating assets or partial reinvestment or gift. Also, retirement relief is now excluded from the standards.~~

The capital tax implications for leases are ~~also~~ excluded.

### ***Element 18.4, Prepare Corporation Tax computations***

#### **Performance criteria**

- A. Enter adjusted trading profits and losses, capital allowances, investment income and capital gains in the Corporation Tax computation
- B. Set-off and deduct loss reliefs and charges correctly
- C. Calculate Corporation Tax due, taking account of marginal relief
- D. Identify and set-off Income Tax deductions and credits
- E. Identify the National Insurance Contributions payable by employers
- F. Identify the amount of Corporation Tax payable and the due dates of payment, including payments on account
- G. Complete Corporation Tax returns correctly and submit them, together with relevant claims and elections, with statutory time limits
- H. Consult with Inland Revenue staff in an open and constructive manner
- I. Give timely and constructive advice to clients on the maintenance of accounts and the recording of information relevant to tax returns
- J. Maintain client confidentiality at all times

#### **Guidance**

The student must be able to compute the Schedule D Case I profit or loss of a company using the same rules for capital allowances and adjustment of profit as detailed in Elements 18.1 and 18.2 respectively. A capital gains computation from Element 18.3 may also be included in a full Corporation Tax computation. For periods of accounts, students should be able to understand how those shorter or longer than twelve months affect the CT computation.

If the company has made a loss, knowledge is expected of how to deal with that loss under S.393(1) and S393A(1) ICTA 1988. This includes computational aspects of loss relief, together with the ability to provide clients with advice on the best option to take for the most tax effective way of handling the loss, albeit in a simple way. The impact of charges on loss relief is restricted to non-trade charges only, given the change in classification of patent royalties from 1 April 2002. Students should be able to deal with company losses other than Schedule D Case I, such as capital losses and Schedule A.

When determining the amount of Corporation Tax payable, the following knowledge is required:

- The impact of the starting rate
- The use of upper and lower limits for small company rate purposes
- The use of the marginal relief calculation, together with the impact of associated companies on the limits for the marginal relief.
- The implications of Non-Company Distributions as introduced by Finance Act 2004. Students will not be required to understand the transitional arrangements for this area
- The deduction of Income Tax
- Calculation of Mainstream Corporation Tax payable

Students should also be able to state the due date of payment and be able to explain the self-assessment rules. Translation of these figures to the short version of Form CT600 may also be required.

For National Insurance Contributions, students should be able to compute the NIC payable by companies for their employees who are not contracted out. This includes an understanding of the definition of earnings, on which the NIC will be based.

Excluded topics from this element are:

- Close companies and close investment holding companies
- Investment companies
- Groups and consortium structures

- Group capital gains tax
- Overseas aspects, including double tax relief
- Calculation of Schedule A rental income (assessable under Unit 19)
- Corporation tax regime for intangible fixed assets

### **Assessment strategy**

This unit is assessed by examination only.

The examination will last for 3 hours, plus 15 minutes of reading time. It will be divided into two sections Section 1 will be concerned predominately with the taxation of sole traders and partnerships, whilst Section 2 will cover the taxation of limited companies. Capital allowances and capital gains can appear in both sections, either as a separate calculation or a part of the full tax computation.

#### **Section 1**

This section could have the following types of activity:

- Schedule D Case I/II computation, leading to either a profit or a loss. This could be for either a sole trader or a partnership
- Set-off of income tax losses for individuals
- Capital allowances computation for industrial buildings and/or plant and machinery
- Capital gains computation for business asset disposals for an individual
- National Insurance Contributions for the self-employed
- Opening and closing rules for unincorporated businesses, including overlap profits
- Completion of the supplementary pages to the Tax Return for individuals

#### **Section 2**

This section could have the following types of activity:

- Schedule D Case I computation, leading to either a profit or a loss
- Set-off of Schedule D Case I losses, restricted to a scenario involving four years
- Capital allowances computation for industrial buildings and/or plant and machinery
- Capital gains computation for limited companies
- Calculation of the Corporation Tax payable, including small company marginal relief, MCT and the dates of payment
- National Insurance Contributions for the employees of companies
- Completion of the Corporation Tax returns

It is not anticipated that students will be required to compute certain topics more than once during the examination. For instance, capital allowances for industrial buildings and plant and machinery will only be assessed once in either Section 1 or Section 2. The same principle applies for capital gains, although it may be appropriate to assess the disposal of a business in Section 1 and the disposal of shares in Section 2.