

# Characteristics and objectives of the uk taxation system



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UK source income is generally subject to UK taxation no matter the citizenship nor the place of residence of the individual nor the place of registration of the company.

For individuals this means the UK income tax liability of one who is neither resident nor ordinarily resident in the UK is limited to any tax deducted at source on UK income, together with tax on income from a trade or profession carried on through a permanent establishment in the UK and tax on rental income from UK real estate.

Individuals who are both resident and domiciled in the UK are additionally liable to taxation on their worldwide income and gains. For individuals resident but not domiciled in the UK (a “ non-dom”), foreign income and gains have historically been taxed on the remittance basis, that is to say, only income and gains remitted to the UK are taxed (for such people the UK is sometimes called a tax haven). However from 6 April 2008, a non-dom wishing to retain the remittance basis is required to pay an annual tax of £30, 000. Domicile here is a term with a technical meaning. Very roughly (and this is a considerable simplification) an individual is domiciled in the UK if it is his or her permanent home.

Income tax forms the bulk of revenues collected by the government. Each person has an income tax personal allowance, and income up to this amount in each tax year is free of tax for everyone. For 2009-10 the tax allowance for under 65s is £6, 475. Above this amount there are a number of tax bands – each taxed at a different rate;

This table reflects the removal of the 10% starting rate from April 2008, which also saw the 22% income tax rate drop to 20%. Alistair Darling announced in the 2009 budget (22 April 2009) that, from April 2010 there would be a new 50% income tax rate for those earning more than £150, 000.

The taxpayer's income is assessed for tax according to a prescribed order, with income from employment using up the personal allowance and being taxed first, followed by savings income (from interest or otherwise unearned) and then dividends.

## **Exemptions on Investment**

UK central government expenditure projection for tax year 2008-2009, according to the 2008 Budget.

Certain investments carry a tax favoured status including:

### **UK Government Bonds (Gilts)**

While all income is taxable, gains are exempt for income tax purposes.

### **National Savings and Investments**

Certain investments via the state owned National Savings scheme are not subject to tax including Index linked Certificates (up to £15, 000 per issue) and Premium Bonds a scheme that issues monthly prizes in place of interest on individual holdings up to £30, 000.

### **Individual Savings Accounts.**

These permit up to £7, 200 (Maximum of £3, 600 in cash funds, and the balance being allocated either to mutual funds (Units Trusts and OEICs) or

individual self-selected shares. No tax is deducted, although the 10% tax withheld on UK dividends cannot be reclaimed.

### Pension Funds

These have the same tax treatment as ISAs in terms of growth. Full tax relief is also given at the individual's marginal rate on contributions or, in the case of an employer contributions, it is treated as an expense and is not taxed on the employee as a benefit in kind. Aside from a tax free lump sum of 25% of the fund, benefits taken from pension funds are taxable.

### Venture Capital Trusts

These are investments in smaller companies or funds of holdings in such companies over a minimum term of five years. These are not taxable and qualify for 30% tax relief against an individual's income.

### Enterprise Investment Schemes

A non taxable investment into smaller company shares over three years that qualifies for 20% tax relief. The facility also allows an individual to defer capital gains liabilities (these gains can be stripped out in future years using the annual CGT allowance.)

### Insurance bonds

These include offshore and onshore investment Bonds issued by insurance companies. The main difference between the two is that corporation tax onshore means that gains are treated as if basic rate tax has been paid (this

cannot be reclaimed by zero or starting rate tax payers). With both versions up to 5% for each complete year of investment can be taken without an immediate tax liability (subject to a maximum total of 100% of the original investment. On this basis, investors can plan an income stream while deferring any chargeable withdrawals until they are on a lower rate of tax, are no longer a UK resident, or their death.

## **Capital gains tax**

Capital gains are subject to tax at the 18% (for individuals) or at the applicable marginal rate of corporation tax (for companies).

The basic principle is the same for individuals and companies – the tax applies only on the disposal of a capital asset, and the amount of the gain is calculated as the difference between the disposal proceeds and the “base cost”, being the original purchase price plus allowable related expenditure. However, from 6 April 2008, the rate and reliefs applicable to the chargeable gain differ between individuals and companies. Companies apply “indexation relief” to the base cost, increasing it in accordance with the Retail Prices Index so that (broadly speaking) the gain is calculated on a post-inflation basis (with different rules apply for gains accrued prior to March 1982). The gain is then subject to tax at the applicable marginal rate of corporation tax. Individuals are taxed at a flat rate of 18%, with no indexation relief (but subject to a limited relief for the first £1m of gains for “entrepreneurs”)

## **The tax year**

The Tax Year in the UK, which applies to income tax and other personal taxes, runs from 6 April in one year to 5 April the next (for income tax purposes). Hence the 2008-09 tax year runs from 6 April 2008 to 5 April 2009.

The odd dates are due to events in the mid-18th century. The English quarter days are traditionally used as the dates for collecting rents (on, for example, agricultural properties). The tax system was also based on a tax year ending on Lady Day (25 March). When the Gregorian calendar was adopted in the UK in September 1752 in place of the Julian calendar, the two were out of step by 11 days. However, it was felt unacceptable for the tax authorities to lose out on 11 days' tax revenues, so the start of the tax year was moved, firstly to 5 April and then, in 1800, to 6 April.

The tax year is sometimes also called the Fiscal Year. The Financial Year, used mainly for corporation tax purposes, runs from 1 April to 31 March. Financial Year 2008 runs from 1 April 2008 to 31 March 2009, as Financial Years are named according to the calendar year in which they start.

## **Value added tax**

The third largest source of government revenues is value added tax (VAT), charged at the standard rate of 17.5% (temporarily cut to 15% between December 2008 and December 2009) on supplies of goods and services. It is therefore a tax on consumer expenditure. A document posted on the Parliament website on November 25 2008 suggested that the government was planning a higher 18.5% VAT after this time elapsed, but the Treasury

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has said this was “ an option that was considered and rejected.” Certain goods and services are exempt from VAT, and others are subject to VAT at a lower rate of 5% (the reduced rate, such as domestic gas supplies) or 0% (“ zero-rated”, such as most food and children’s clothing). Exemptions are intended to relieve the tax burden on essentials while placing the full tax on luxuries, but disputes based on fine distinctions arise, such as the notorious “ Jaffa Cake Case” which hinged on whether Jaffa Cakes were classed as (zero-rated) cakes-as was eventually decided-or (fully-taxed) chocolate-covered biscuits. Until 2001, VAT was charged at the full rate on women’s sanitary towels, presumably because they were considered luxury or non-essential articles.

## **Stamp duty**

Stamp duty is charged on the transfer of shares and certain securities at a rate of 0.5%. Modernised versions of stamp duty, stamp duty land tax and stamp duty reserve tax, are charged respectively on the transfer of real estate and shares and securities, at rates of up to 4% and 0.5% respectively.

## **Motoring taxation**

Motoring taxes include: fuel duty (which itself also attracts VAT), and vehicle excise duty. Other fees and charges include the London congestion charge, various statutory fees including that for the compulsory vehicle test and that for vehicle registration, and in some areas on-street parking (as well as associated charges for violations).

## **Business rates**

Business rates is the commonly used name of non-domestic rates, a United Kingdom rate or tax charged to occupiers of non-domestic property. Business rates were introduced in England and Wales in 1990, and are a modernised version of a system of rating that dates back to the Elizabethan Poor Law of 1601. As such, business rates retain many previous features from, and follow some case law of, older forms of rating.

Business rates form part of the funding for local authorities, and are collected by them, but rather than receipts being retained directly they are pooled centrally and then redistributed. In 2005/06, £19.9 billion was collected in business rates, representing 4.35% of the total UK tax income.

Business rates are a property tax, where each non-domestic property is assessed with a rateable value, expressed in pounds. The rateable value broadly represents the annual rent the property could have been let for on a particular valuation date according to a set of assumptions. The actual bill payable is then calculated using a multiplier set by central government, and applying any reliefs.

Income Tax on earnings. At present there are three bands of income tax so the more you earn the more you pay. The first unfairness is revealed here; the more you earn more not only do you pay more but you pay exponentially more because the tax is levied at a higher rate. A simplistic example (not allowing for, I know, the lower rate and allowances etc), you might pay 22% of £10,000 and £2,200 goes in the pot. Earn £50,000, you pay 22% and, fair enough, £11,000 goes in the pot; but, oh no, you pay 40% on the excess



over £28, 000 odd. Good you might say, the higher earner can afford it, but why should they be penalized.

Tax on Shareholdings. Here there is quadruple taxation. Say I buy some shares, hold them for a few years and earn some dividends, and then decide to sell them. I bought the shares with already taxed income but then had to pay stamp duty on their purchase, then pay income tax again on the dividends, and then (potentially) pay capital gains tax on the increase in value of the shares.

### **a) DIRECT TAX VS INDIRECT TAX**

A Direct tax is a kind of charge, which is imposed directly on the taxpayer.

The examples of direct tax include property tax and income tax.

Alternatively, it can be said that a direct tax is one that is taken away from one's salary or wages. When the tax is imposed by the government upon the property, then it is called property tax, which is also a direct tax.

### **Meaning of Direct tax:**

The term direct tax can be defined from two different perspectives. One is from Colloquial point and the other is from U. S. constitutional law point.

Certain taxes may fall under indirect tax categories in the constitutional sense, but fall under direct tax category in the colloquial sense.

### **Examples of Direct Taxes**

Some of the examples of direct taxes include capital gains tax, personal income tax, tax on corporate income, and tax incentives.

## **Difference: Direct and Indirect tax**

In the colloquial sense, a direct tax is levied by the government directly to the taxpayers, whereas the indirect tax (or collected tax) is collected by intermediaries, who eventually file tax returns and passes to the respective department. Examples of direct taxes include income taxes, some corporate taxes and transfer taxes. Examples of indirect taxes include Value Added Tax and Sales Tax.

### b) Progressive Tax vs Rfegressive Tax

A progressive tax is a tax by which the tax rate increases as the taxable amount increases. “ Progressive” describes a distribution effect on income or expenditure, referring to the way the rate progresses from low to high, where the average tax rate is less than the marginal tax rate. It can be applied to individual taxes or to a tax system as a whole; a year, multi-year, or lifetime. Progressive taxes attempt to reduce the tax incidence of people with a lower ability-to-pay, as they shift the incidence increasingly to those with a higher ability-to-pay.

The term is frequently applied in reference to personal income taxes, where people with more disposable income pay a higher percentage of that income in tax than do those with less income. It can also apply to adjustment of the tax base by using tax exemptions, tax credits, or selective taxation that would create progressive distributional effects. For example, a sales tax on luxury goods or the exemption of basic necessities may be described as having progressive effects as it increases a tax burden on high end consumption or decreases a tax burden on low end consumption

respectively. The opposite of a progressive tax is a regressive tax, where the tax rate decreases as the amount subject to taxation increases. In between is a proportional tax, where the tax rate is fixed as the amount subject to taxation increases. The opposite of proportional tax is fixed tax.

A regressive tax is a tax imposed in such a manner that the tax rate decreases as the amount subject to taxation increases. In simple terms, a regressive tax imposes a greater burden (relative to resources) on the poor than on the rich – there is an inverse relationship between the tax rate and the taxpayer's ability to pay as measured by assets, consumption, or income. "Regressive" describes a distribution effect on income or expenditure, referring to the way the rate progresses from high to low, where the average tax rate exceeds the marginal tax rate. It can be applied to individual taxes or to a tax system as a whole; a year, multi-year, or lifetime. Regressive taxes attempt to reduce the tax incidence of people with higher ability-to-pay, as they shift the incidence disproportionately to those with lower ability-to-pay. The opposite of a regressive tax is a progressive tax, where the tax rate increases as the amount subject to taxation increases. In between is a flat or proportional tax, where the tax rate is fixed as the amount subject to taxation increases.

The term is frequently applied in reference to fixed taxes, where every person has to pay the same amount of money. The regressivity of a particular tax often depends on the propensity of the tax payers to engage in the taxed activity relative to their income. In other words, if the activity being taxed is more likely to be carried out by the poor and less likely to be carried out by the rich, then the tax may be considered regressive. To <https://assignbuster.com/characteristics-and-objectives-of-the-uk-taxation-system/>

determine whether a tax is regressive, the income-elasticity of the good being taxed as well as the income-substitution effect must be considered.

### c) Tax Avoidance Vs Tax evasion

Tax avoidance is the legal utilization of the tax regime to one's own advantage, to reduce the amount of tax that is payable by means that are within the law. By contrast tax evasion is the general term for efforts to not pay taxes by illegal means. According to the former British Chancellor of the Exchequer Denis Healey, the difference between tax avoidance and tax evasion is the thickness of a prison wall. The term tax mitigation is a synonym for tax avoidance. Its original use was by tax advisors as an alternative to the pejorative term tax avoidance. Latterly the term has also been used in the tax regulations of some jurisdictions to distinguish tax avoidance foreseen by the legislators from tax avoidance which exploits loopholes in the law.

Some of those attempting not to pay tax believe that they have discovered interpretations of the law that show that they are not subject to being taxed: these individuals and groups are sometimes called tax protesters. An unsuccessful tax protestor has been attempting openly to evade tax, while a successful one avoids tax. Tax resistance is the declared refusal to pay a tax for conscientious reasons (because the resister does not want to support the government or some of its activities). Tax resisters typically do not take the position that the tax laws are themselves illegal or do not apply to them (as tax protesters do) and they are more concerned with not paying for particular government policies that they oppose.

## **Tax avoidance**

Tax avoidance is the legal utilization of the tax regime to one's own advantage, to reduce the amount of tax that is payable by means that are within the law. The United States Supreme Court has stated that " The legal right of an individual to decrease the amount of what would otherwise be his taxes or altogether avoid them, by means which the law permits, cannot be doubted." See Gregory v. Helvering. Examples of tax avoidance include:

## **Country of residence**

One way a person or company may lower their taxes due is by changing one's tax residence to a tax haven, such as Monaco, or by becoming a perpetual traveler. However some countries, such as the U. S., tax their citizens, permanent residents, and companies on all their worldwide income. In these cases, taxation cannot be avoided by simply transferring assets or moving abroad.

## **Double taxation**

Most countries impose taxes on income earned or gains realized within that country regardless of the country of residence of the person or firm. Most countries have entered into bilateral double taxation treaties with many other countries to avoid taxing nonresidents twice — once where the income is earned and again in the country of residence (and perhaps, for US citizens, taxed yet again in the country of citizenship) — however, there are relatively few double-taxation treaties with countries regarded as tax havens. To avoid tax, it is usually not enough to simply move one's assets to a tax haven. One

must also personally move to a tax haven (and, for U. S. nationals, renounce one's citizenship) to avoid tax.

## **Legal entities**

Without changing country of residence (or, if a U. S. citizen, giving up one's citizenship), personal taxation may be legally avoided by creation of a separate legal entity to which one's property is donated. The separate legal entity is often a company, trust, or foundation. Assets are transferred to the new company or trust so that gains may be realized, or income earned, within this legal entity rather than earned by the original owner. Usually one is only personally taxed on property and earnings that one actually owns; thus, by donating assets to a separate legal entity, personal taxation can be avoided, although corporate taxes may still be applicable. If the legal entity is ever liquidated and the assets transferred back to an individual, then capital gains taxes would apply on all profits.

## **Tax evasion**

By contrast tax evasion is the general term for efforts by individuals, firms, trusts and other entities to evade taxes by illegal means. Tax evasion usually entails taxpayers deliberately misrepresenting or concealing the true state of their affairs to the tax authorities to reduce their tax liability, and includes, in particular, dishonest tax reporting (such as declaring less income, profits or gains than actually earned; or overstating deductions).

## **Illegal income and tax evasion**

In the United States, persons subject to the Internal Revenue Code who earn income by illegal means (gambling, theft, drug trafficking etc.) are required

to report unlawful gains as income when filing annual tax returns but they often do not do so. Suspected lawbreakers, most famously Al Capone, have therefore been successfully prosecuted for tax evasion when there was insufficient evidence to try them for their non-tax related crimes. Those who attempt to report illegal income as coming from a legitimate source could be charged with money laundering. By contrast: In the UK law enforcement agencies do not generally have access to tax returns and so illegal earnings can supposedly be safely declared but in practice those carrying on criminal activities generally prefer not to do so, and so can sometimes be prosecuted for tax evasion rather than for other crimes.

### **Evasion of customs duty**

Customs duties are an important source of revenue in the developing countries. The importers purport to evade customs duty by (a) under-invoicing and (b) misdeclaration of quantity and product-description. When there is ad valorem import duty, the tax base is reduced through underinvoicing. Misdeclaration of quantity is more relevant for products with specific duty. Production description is changed match an H. S. Code commensurate with a lower rate of duty

## **Part C**

### **Capital Gain**

A capital gain is a profit that results from investments into a capital asset, such as stocks, bonds or real estate, which exceeds the purchase price. It is the difference between a higher selling price and a lower purchase price, resulting in a financial gain for the seller. Conversely, a capital loss arises if

the proceeds from the sale of a capital asset are less than the purchase price.

Capital gains may refer to “ investment income” that arises in relation to real assets, such as property; financial assets, such as shares or bonds; and intangible assets such as goodwill.

Many countries impose a tax on capital gains of individuals or corporations, although relief may be available to exempt capital gains: in relation to holdings in certain assets such as significant common stock holdings, to provide incentives for entrepreneurship, or to compensate for the effects of inflation.

## **Part D**

### **CALCULATION FOR CAPITAL ALLOWANCE**

#### **Capital Allowances**

In the United Kingdom and Ireland, an allowance against income or corporation tax available to businesses or sole traders who have purchased plant and machinery for business use. The rates are set annually and vary according to the type of fixed asset purchased, for example, whether it is machinery or buildings. This system effectively removes subjectivity from the calculation of depreciation for tax purposes.

Capital Allowances Rates for 2008/09

#### **Plant and Machinery:**

Power saving items which are not harmful to the environment, vehicles which run electricity and emit low CO<sub>2</sub> (up to 110 g/km), natural gas and <https://assignbuster.com/characteristics-and-objectives-of-the-uk-taxation-system/>



hydrogen refuelling machinery qualify for a tax deduction of 100% in the year of purchase.

Annual investment allowance (AIA) of 100% is given on the first £50, 000 of expenditure provided those items do not already qualify for a 100% deduction by way of another relief.

Non annual investment allowance expenditure can qualify for a standard capital writing down allowance (see below).

Items classified as having a long life can receive an annual allowance of 10%

The standard tax allowable deduction for capital items not belonging to any other category is 20%. The amount of the deduction is limited to £3000 in any one year for cars.

### **Buildings:**

The capital allowance for Industrial and agricultural buildings and hotels is calculated on the original cost of the item and is given at a rate of 3%.

A maximum allowance of 100 can be claimed against expenditure in a designated Enterprise Zone, where sections of commercial buildings are converted to flats and for the substantial repairs of commercial buildings and premises.