



BARNES ROFFE LLP
CHARTERED ACCOUNTANTS



Barnes Roffe Guide EBook

A Guide to Self Assessment

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A Guide to Self Assessment

This guide has been written in layman's terms to explain the broad effects of Self Assessment and to give examples of how it may affect various individuals. It has been produced as a general guide to Barnes Roffe clients and contacts and it is not intended to be a definitive summary of the complex law and regulations in this area.

Anybody who is in anyway unsure as to their position under Self-Assessment should contact their Barnes Roffe liaison partner or their own accountants for appropriate professional advice. Barnes Roffe cannot accept any responsibility for any liability which may arise from any action either taken or not taken as a result of reading this guide.



Background

Self-Assessment constitutes the biggest change to the way in which income tax is collected since the introduction of PAYE in 1944. Simply stated the onus for driving the assessment and payment of tax has been shifted from the Inland Revenue to the taxpayer and to “encourage prompt and accurate assessment and payment of tax”; a new system of interest charges, surcharges, penalties and also random audit powers have been introduced.

There have been knock-on effects for employers. Whilst employers are not directly affected by Self-Assessment, because employees need a large amount of information to enable them to self assess themselves, the rules regarding the provision of information by employers to employees has had to be changed. Accordingly, there are new rules concerning the production of forms P45, forms P60 and forms P11D all of which add to the PAYE compliance burden of employers.

Self Assessment commenced on 6th April 1996 and the first Self-Assessment tax returns being those for the tax year 1996/97 will be issued on or around 6th April 1997. Unfortunately it was not deemed possible to introduce the rules fully for the 1996/97 tax year. Thus, certain transitional provisions apply to 1996/97. These particularly affect the basis on which income tax payments on account for 1996/97 are due and partnerships which were in existence before 6th April 1994 are also treated for 1996/97, broadly as if Self-Assessment did not exist.

Calculation of Tax Due

It is at first worth stating that if the taxpayer does not wish to do so he or she does not have to self-assess in the literal meaning of that phrase. An individual can request the Inland Revenue to do the calculations; however, this does not mean that the old rules will continue to apply in such circumstances.

On the contrary, whilst the Inland Revenue will calculate the amount of the tax due under Self-Assessment providing they have all the information on time (see below) the calculation will still constitute a "Self-Assessment" and all the rest of the Self-Assessment legislation will apply.

The previous tax legislation was based on a so-called schedular system under which different parts of the tax code applied to different types of income. For example, employment income was assessable under Schedule E whereas income from property was assessable under Schedule A. These rules were a throwback to the days when a gentleman did not want a single Inland Revenue official knowing the whole of his affairs. Accordingly, different parts of his affairs would be handled by different tax offices raising different assessments. Clearly such a system was anachronistic and under Self-Assessment a single calculation will be undertaken to arrive at the appropriate tax liability. The result is that the Inland Revenue will no longer issue a multitude of assessments against which the taxpayer can appeal before a further multitude of revised assessments are issued. Accordingly, it will no longer be appropriate for a taxpayer to wait until the Inland Revenue issues an assessment before deciding whether to make a payment of tax or to submit his accounts, tax return etc. Under Self-Assessment the onus of paying the right amount of tax at the right time and for submitting the Self-Assessment tax return lies firmly with the taxpayer and a stringent system of surcharges and penalties will apply if this does not take place.

Previously, certain sources of income were assessed on a so-called prior year basis of assessment. This particularly applied to income from trades and professions assessable under Schedule D Cases I and II and also to untaxed interest and foreign sources of income assessable under Schedule D Cases III, IV and V. As part of the movement towards Self-Assessment, the prior year basis of assessment has been abandoned and now all such income is assessable on a current year basis. Special rules have had to be introduced to manage the transition from the prior year basis of assessment to the current year basis of assessment. The effect of these rules is that for continuing sources of trading income or investment income, a proportion (generally one-half) of income receivable in 1995/96 and 1996/97 will be taxable as 1996/97's income. The rules in this regard are complex and if anybody requires detailed guidance of how they apply in particular circumstances they should obtain suitable professional advice.

Submission of S-A Tax Returns

Any taxpayer issued with a Self-Assessment tax return is under a legal obligation to complete it and return it to the Inland Revenue. If a taxpayer intends to calculate his or her own tax liability (this will normally be the case) the Self-Assessment tax return must be submitted to the Inland Revenue by 31 January following the end of the tax year. Thus, for the 1996/97 tax year, Self-Assessment tax returns will be issued on or around 6 April 1997 and these must be fully completed and returned to the Inland Revenue by 31 January 1998. It should be noted that the tax return must be fully complete in all respects.

A tax return which includes incomplete information or with information labelled "to be advised" or "to follow" will not be regarded as a complete tax return and will therefore be liable to the imposition of penalties.

For individuals who are directors or employees, it will no longer be possible for them to mark their tax return "per PAYE", "per P11D" etc. They must report the precise quantum of their taxable income including expenses payments and benefits-in-kind; failure to do so will mean that their Self-Assessment tax return is incomplete and invalid. There is now a requirement for employers to provide employees not only with forms P60 but also with copies of forms P11D (providing they are employed at 5 April at the end of the tax year). Furthermore, the new style form P45 has a further part (part IA) which is for the employee to keep so that employees are aware of how much income they have received from each employment during the year and how much tax has been deducted therefrom.

If a taxpayer requires the Inland Revenue to calculate the tax liability, the tax return must be with the Inland Revenue by 30 September following the end of the tax year concerned. Thus, for a 1996/97 Self-Assessment tax return, this would have to be with the Inland Revenue by 30 September 1997 if the intention was for the Inland Revenue to calculate the tax liability.

What if no Self-Assessment tax return is received? If the person has no liability to tax, or has a liability to tax which is fully settled by tax deducted at source (eg under PAYE) or tax credits on investment income, the person need do nothing. However, if the person has an income tax or capital gains tax liability for the year, he must notify the Inland Revenue of this liability by 5 October following the end of the tax year. Thus, for 1996/97 anybody who does not receive a Self-Assessment tax return who believes that they have a liability to income tax or capital gains tax must notify the Inland Revenue of this liability by 5 October 1997. Failure to do so will result in interest and penalties being charged.

In the case of partnerships, each partner must enter on his or her Self-Assessment tax return their share of the partnership's assessable profits for the year. It will no longer be possible simply to note the tax return "per accounts" or something similar. The partnership itself will have to make a partnership tax return giving details of the partnership income for the appropriate year together with details of how this is to be split between the various partners. The partnership return must be submitted to the Inland Revenue by 31 January following the end of the tax year. Thus, for 1996/97, each partnership must ensure that its partnership tax return is submitted to the Inland Revenue by 31 January 1998.



Payment of Tax

It should firstly be stressed that Self-Assessment has in no way affected the rules regarding the deduction of tax at source under eg PAYE or from eg interest payments or royalties; nor has it affected the so-called imputational system of corporation tax under which dividends paid by UK companies have an associated tax credit which can be used to satisfy all or part of the income tax liability arising in respect of the dividend payment. Thus, a large proportion of the working population will not be adversely affected by Self-Assessment. They will continue to have a code number operated against their wages and, hopefully, the correct amount of tax will be deducted from their wages under the PAYE regulations. It is likely that these people will not receive a Self-Assessment tax return to complete in the same way that most ordinary employees do not receive annual tax returns under the existing system.

However, individuals with substantial amounts of investment income in respect of which higher rate tax is payable, or individuals with sizeable and varying benefits-in-kind which often give rise to income tax underpayments, or individuals with self employed or untaxed investment income in respect of which they have hitherto paid tax by assessment will be affected by Self-Assessment.

The tax payments under Self-Assessment fall into two distinct categories:-

- a.** the final payment necessary when the Self-Assessment return has been completed and the tax calculation has been performed; and
- b.** any payments on account which may also be necessary.

Let us look at each of these categories separately.

a. Final Payment

The final payment due when the Self-Assessment return has been completed and when the calculation has been performed must be paid by 31 January following the end of the tax year. This payment will include any additional income tax due for the year plus any capital gains tax due. It does not matter whether the individual is doing the self-assessment calculation himself or whether, having submitted the Self-Assessment tax return to the Inland Revenue before 30 September, the Inland Revenue have done the calculations for the individual.

Thus, there will be a great many people whose only effective contact with the Inland Revenue will be on or around 31 January following the tax year. That is the date by which they must submit their Self-Assessment tax return to the Inland Revenue and that is also the date by which they must pay the balance of any income tax due for the year together with any capital gains tax due for the year.

b. Payments On Account

It is possible that individuals will also have to make payments on account of the ultimate income tax (but not capital gains tax) liability. These payments on account are based on the income tax liability for the previous year. The question of payments on account for 1996/97 is somewhat complex because it is the so-called transitional year, however 1996/97 payments on account may be necessary in respect of certain sources of untaxed income, the payments being based upon the liability on such untaxed income as shown by the final tax assessments for 1995/96. If anybody is in anyway unsure as to their payments on account position for 1996/97 they should immediately contact their Barnes Roffe client liaison partner or their own accountant.

For 1997/98 and subsequent years, the position is more straightforward. Effectively, there are two rules which need to be considered when determining whether payments on account of the ultimate income tax liability must be made.

These are as follows:-

a. Is the tax payment due for the previous year less than £500? If so no payment on account is necessary for the year in question. Thus, if the 1996/97 Self-Assessment tax return reveals an income tax liability of £450, that amount would have to be paid on or before 31 January 1998 but no further income tax payment would be necessary before 31 January 1999 which tax would then be based on the 1997/98 Self-Assessment tax return. However, if the tax due is £500 or more, payments on account may be necessary- see question b.

b. Is the net income tax due for the previous year greater than 20% of the total income tax liability before account is taken of tax deducted at source or tax credits? If not, no payments on account are required.

However if it is, payments on account are required. If payments on account are required, because the net tax due for the previous year is both greater than £500 and greater than 20% of the total tax liability before credit is given for tax deducted at source, how much has to be paid on account and when? Two payments on account are required, one on 31 January during the tax year and one on 31 July following the tax year. The payments on account are each 50% of the net income tax liability for the previous year. Accordingly, let us suppose that a person's Self-Assessment tax return for 1996/97 shows income tax due of £2,000. This is obviously greater than £500 and let us assume that it also fails the 20% test mentioned in (b.) above. The individual will have to pay the following amounts: -

Re 1996/97 - £2,000 on 31 January 1998

Re 1997/98 - £1,000 on 31 January 1998 and £1,000 on 31 July 1998

As mentioned earlier payment on accounts do not apply to capital gains tax. Capital gains tax will always be payable as one sum on 31 January following the end of the tax year in question.

Penalty Procedures

The Inland Revenue have extensive powers to police the Self-Assessment rules. There are powers to charge interest and surcharges in respect of late paid tax and also to charge penalties in respect of late or incorrect Self-Assessment tax returns.

a. Interest

The Revenue have long had interest charging powers which have been progressively tightened since 1975. Under Self-Assessment, interest will automatically accrue if any payment is made late. This applies not only to the final balancing payments but also to any payments which should have been made on account. The rate at which interest will be charged has recently been revised; it will now be charged at 2.5% over the average base rate of the six leading banks. Previously the rate was discounted to reflect the fact that interest on overdue tax is not tax deductible but that discount has recently been abolished. Accordingly, the rate of interest chargeable is currently 8.5%

b. Surcharges

The Inland Revenue have never regarded the interest which they charge as being in anyway penal. They regard it as commercial restitution for the use of the money. Accordingly, under Self-Assessment any balancing payment shown as payable by a Self-Assessment tax return which remains unpaid for more than 28 days shall be liable to a surcharge equal to 5% of the tax unpaid. Additionally, where the tax still remains unpaid six months after the due date, a further 5% surcharge may be imposed. If after the surcharge has been imposed, it remains unpaid 30 days after its imposition, interest will be charged on the surcharge.

c. Penalties

There will be an automatic penalty of £100 if a taxpayer fails to deliver his Self-Assessment tax return on time. If the return is over six months late the penalty automatically increases to £200. Additionally, if the failure persists an officer of the Board of the Inland Revenue can apply to the Tax Commissioners for further penalties of up to £60 per day to be charged for each day in which the failure to submit the return continues.

If the return is over a year late, the Inland Revenue can then impose a further penalty of an amount up to the amount of tax liability revealed by the Self-Assessment Return.

Random Audit Powers

A further, and very important, weapon in the Inland Revenue's armoury to police Self-Assessment is the power to investigate a taxpayer's affairs at random without giving the taxpayer any reason for doing so.

The Inland Revenue have to give formal notice of their intention to enquire into a tax return and this must be made by a specified time. Broadly speaking, for a Self-Assessment tax return filed on time (ie before 31 January following the end of the tax year) the Inland Revenue must give notice to enquire into the return before the following 31 January. If they do not do so, the return can be regarded as final subject to the Inland Revenue's power to "discover" if a taxpayer has been guilty of negligent or fraudulent conduct.

Whilst the Inland Revenue will apparently select cases at random, common sense dictates that they will actually select cases which they consider to be ripe for investigation. This will be based on information which they receive from third parties or from their knowledge of the activities of a particular individual.

The disturbing thing is that up to now the Inland Revenue have been somewhat inhibited from embarking on unwarranted "fishing expeditions" due to various Inland Revenue codes of practice on investigations. These will no longer apply and the Inland Revenue will be able to launch an investigation into a Self-Assessment tax return without giving the taxpayer or his agent any reason for doing so.

Record Keeping

The self-assessment legislation introduces a legal requirement for taxpayers to keep the records on which the Self-Assessment tax return is based.

The records must be kept for a minimum period of time which depends upon whether the taxpayer in question is or is not engaged in a business. It should be borne in mind that a business activity is deemed to include the letting of property; if someone is engaged in a business activity the requirement to maintain records extends not only to the records of the business itself but also to all the other records necessary for the preparation of the Self-Assessment tax return.

Broadly speaking, a "non-business" taxpayer must keep records at least until the first anniversary of the filing date for the Self-Assessment tax return. Thus, for 1996/97, records will have to be kept at least until 31 January 1999. However, records may have to be kept for a longer period if the tax return was issued late or if an investigation has been commenced into the tax return.

For a taxpayer with a business connection, the time limit for which records must be kept is the fifth anniversary of the normal filing date. Thus, for 1996/97, records would have to be kept until 31 January 2003.

If suitable records are not kept or preserved, a penalty of up to £3,000 may be imposed for each failure. Thus, a taxpayer who fails to maintain appropriate records for a number of years could in theory be faced with penalties running into many thousands of pounds.



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