

Tax Classification

Tax is classified into two categories:

1. Direct Tax
2. Indirect Tax

Direct Tax

Tax on individual's wealth/income.

- Examples:
1. Income Tax
 2. Capital Gains Tax

Indirect Tax

Tax on an individual's transactions

- Example:
1. VAT
 2. Insurance Tax

What profits are subject to income tax?

Trading profits of UK residents are subject/chargeable to income tax

Determination of trading vs. capital transactions

By applying the '6 Badges of Trade'.

If one or more apply, then the transaction is considered a trade, though final decision is made by the courts.

Sole Trader (self-employed) vs. Company

Tax: Self-employed face lighter taxes (20% income tax vs 25% corporation tax).

Liability: Companies limited liability vs. sole traders risk losing everything.

Setup and Maintenance: Sole trader simpler set-ups vs. Companies require legal administration paperwork and costs to maintain.

Ownership & Flexibility: Companies owned via shares, thus, are offer more flexibility for raising capital, investment, or selling, unlike sole traders.

The Six Badges of Trade

1. Subject of Matter of Transaction
2. Length of Period of Ownership
3. Frequency of Transactions
4. Supplementary Work
5. Reason for Sale
6. Motive of Transaction

Tax Evasion

Illegal actions like hiding income or falsifying tax return, is punishable by fines or imprisonment.

Activities Classified as Trading for Tax Purposes

Activities that involve repeated buying and selling, particularly to make profit.

Tax Avoidance

Legal but crafty use of loopholes to reduce tax, often through artificial schemes, although legal, the HMRC see it as exploitation of rules against their intended purposes.

HMRC

Her Majesty's Revenue and Customs

Responsible for collecting taxes, administering benefits, and enforcement of tax and customs law.

Tax Year for Individuals - UK

Individuals Fiscal Year	6th April to 5th April (e.g. Assessment Year).
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Addressing/reducing tax evasion/avoidance

1. Targeted Anti-avoidance Rule (TAAR)
2. General Anti-abuse Rule (GAAR)
3. Disposal of Tax Avoidance Schemes (DOTAS)

Impact of measures to reduce tax evasion/avoidance

Decline of creative tax planning by making avoidance schemes increasingly difficult and risky.

HMRC Criteria for Self-employment

- Control
- Holidays and Sickness
- Equipment
- Work Performance and Correction
- Exclusivity
- Remuneration and Financial Risk

Tax Application to Limited Companies

- Limited companies pays:
1. **Salary to employees** (20% income tax & 8% national insurance).
 2. **Dividends** (taxed at 8.5% - basic rate).
 3. **Corporation tax** (25%) on profits before dividends.

Tax Year for Corporations - UK

Corporation Tax Year	1st April to 31st March inclusive (e.g. Financial Year).
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Self-employment vs. Employment

Self
Employment

- Higher risk and reward.

- More expenses allowed (lower tax).

- Taxes paid later.

- No compulsory national insurance.

- More control over Activities.

Employment

- Fewer expenses allowed.

- Taxes paid via PAYE.

- Compulsory national insurance (8%).

- Holiday and sick pay.

- Social security benefits.

Tax Application to Sole Traders

Sole traders are **taxed** on business profits under income tax rules, with no corporation tax or dividends.

- Income tax is **20%** on profits.

