The Chartered Institute of Taxation

Advanced Technical

Taxation of Owner-Managed Businesses

May 2026

Suggested answers

Question 1

As the period of account exceeds 12 months, there are two accounting periods for corporation tax purposes. The first accounting period is for the year ended 31 December 2025 and the second accounting period is for the 3-month period ended 31 March 2026.

Total taxable profits

		Year ended 31 December 2025	3-month period ended 31 March 2026
		£	£
Tax adjusted trading profits before Capital Allowances	(W1)	385,600	96,400
Capital Allowances	(W2 & W3)	(144,508)	(251,413)
Trading profit/(loss)		241,092	nil
Non-trade loan relationship income	Note 1	2,200	6,600
Chargeable gain	Note 2		2,000
Total profits (before QCDs)		243,292	8,600
Current year loss relief	Note 3		(8,600)
Carry back loss relief	Note 4	(146,413)	
Qualifying charitable donations	Note 5	(3,750)	Unrelieved
Total taxable profits (TTP)		93,129	nil
Corporation Tax payable at 25% (£93,129 x 25%)		23,282	
Less: Marginal Relief ((3/200) x (£250,000-£93,129) x (£93,129 ÷ £93,129))		(2,353)	
Corporation Tax liability		20,929	nil

The Corporation Tax liability of £20,929 for the accounting period ended 31 December 2025 is payable by 1 October 2026. The filing deadline for both Corporation Tax returns is 31 March 2027.

Loss memorandum for the period ended 31 March 2026:

	£
Trade losses for period ended March 2026 (£251,413 – £96,400)	155,013
Current period loss relief (s.37(3)(a) CTA 2010)	(8,600)
Carry back loss relief (s.37(3)(b) CTA 2010)	(146,413)
	0

Notes

1. The non-trade loan relationship income arose from 1 December 2025 to 31 March 2026 (4 months). Therefore, one month (£2,200) is included in the accounting period ended 31 December 2025 and three months (£6,600) are included in the accounting period ended 31 March 2026.

2. When the plough was sold, Loralan Ltd realised a gain. As Capital Allowances were claimed, the gain is chargeable for Corporation Tax purposes.

   As the disposal proceeds (£7,200) exceeded £6,000 but the original cost (£5,000) was less than £6,000, the 5/3rd rule applies under s. 262 TCGA 1992. The chargeable gain of £2,200 is therefore restricted to £2,000 (5/3 x (£7,200 - £6,000)).

   The disposal date of 14 February 2026 falls into the accounting period ended 31 March 2026.

3. The trading loss can be offset against the total profits, reducing them to nil. However, this means the tax relief available for the qualifying charitable donations is wasted.

4. After a current year claim under s.37(3)(a) CTA 2010, Loralan Ltd can make a claim under s.37(3)(b) CTA 2010 to carry the loss back against the total profits of the previous 12 months. By making this election, Loralan Ltd saves Corporation Tax of £38,800 (((£239,542 x 25%) - ((3/200) x ((£250,000 - £239,542) x (£239,542/£239,542))) - £20,929).

5. Qualifying charitable donations are allocated to the accounting period in which they are paid. £3,750 (£750 x 5) is allocated to the accounting period ended 31 December 2025 and £2,250 (£750 x 3) is allocated to the accounting period ended 31 March 2026.

<u>(W1) Tax-adjusted trading profits for the 15-month period ended 31 March 2026</u>

	£	£
Profits as per draft accounts		405,400
Add back:		
Depreciation	86,600	
Qualifying charitable donations (QCDs) (£750 x 8)	6,000	
		92,600
Deduct:		
Interest income (non-trade)	(8,800)	
Gain on disposal	(7,200)	
		(16,000)
Trading profits for the 15-month period ended 31 March 2026		482,000

The trading profits are time-apportioned between the two accounting periods, with £385,600 (£482,000 x 12/15) being allocated to the year ended 31 December 2025 and £96,400 (£482,000 x 3/15) being allocated to the 3-month period ended 31 March 2026.

(W2) Capital Allowances for the year ended 31 December 2025:

	Notes		Main pool	Special rate pool	Allowances
			£	£	£
TWDV b/fwd			16,600		
Additions:					
Tractor		76,000			
Portable on-site cabin		62,400			
Less: AIA at 100%	a)	(138,400)			138,400
Double-cab pick-up truck	b)			52,000	
WDA at 18% (£16,600 x 18%)			(2,988)		2,988
WDA at 6% (£52,000 x 6%)				(3,120)	3,120
TWDV c/fwd			13,612	48,880	
Total Allowances					144,508

(W3) Capital Allowances for the 3-month period ended 31 March 2026:

	Notes		Main pool	Special rate pool	Allowances
			£	£	£
TWDW b/fwd			13,612	48,880	
Additions:					
Combine Harvester	c)	256,500			
Less: AIA at 100% (£1m x 3/12)	d)	(250,000)			250,000
Transfer to main pool		(6,500)	6,500		
Disposal of plough	e)		(5,000)		
			15,112		
WDA at 18% (£15,112 x 18% x 3/12)			(680)		680
WDA at 6% (£48,880 x 6% x 3/12)				(733)	733
TWDV c/fwd			14,432	48,147	
Total Allowances					251,413

Notes

a) Both the tractor and the portable on-site cabin qualify for both full expensing and the annual investment allowance (AIA). AIA is claimed in priority to full expensing in order to potentially avoid a balancing charge on disposal.
b) The double-cab pickup was purchased after 1 April 2025 and is therefore treated as a car. As it has emissions above 50g/km, it is special rate pool expenditure. Neither AIA nor full expensing is available on cars.
c) The Combine Harvester qualifies for AIA, but not full expensing as it is second-hand.
d) As the 3-month period ended 31 March 2026 is a short period, the AIA allowance of £1,000,000 is pro-rated by 3/12ths (£1,000,000 x 3/12 = £250,000). As the Combine Harvester cost £256,500, the remaining £6,500 is transferred to the main pool.
e) The disposal proceeds of the plough are restricted to the original cost of £5,000.

MARKING GUIDE

TOPIC	**MARKS**
Corporation Tax	
Recognition and identification of the two accounting periods	0.5
Add back depreciation	0.5
Add back Qualifying Charitable Donations (QCDs)	0.5
Deduct interest received	0.5
Deduct gain on disposal	0.5
Allocate interest received to correct accounting periods	0.5
Allocate trade profits to the correct accounting periods	0.5
Calculate capital gain on disposal of the plough, correctly apply chattels exemption and allocate to correct accounting period	1.5
Current year loss relief claim (s.37(3)(a))	1
Carry back loss relief claim (s.37(3)(b))	1
Allocate QCDs to the correct accounting periods	0.5
Recognise that QCDs in period ended 31 March 2026 are wasted	0.5
Calculation of Corporation Tax due and the due date	1.5
Due date for filing of the Corporation Tax returns	0.5
Capital Allowances	
Identification that two separate computations are required	1
AIA on tractor	0.5
AIA on portable on-site cabin	1
AIA claimed in priority to full expensing on the tractor and portable on-site cabin	1
Double-cab pick-up (car, special rate pool and no AIA/full expensing)	1.5
WDA at 18% and WDA at 6%	1
AIA on Combine Harvester	1
Pro-rata of AIA for short period	1
Disposal proceeds restricted to cost for the plough	1
Pro-rating of WDA	1
TOTAL	20

Question 2

Option 1 - EMI option

Income Tax on Grant

There will be no Income Tax charge on the grant of the EMI options.

Income Tax on Exercise

When Tom exercises his share options, he will be subject to Income Tax on the difference between the amount that he pays for the shares and the lower of the market value of the shares at grant or exercise. As the estimated value of the shares at exercise will be higher than at grant, the Income Tax position is as follows:

	£
Market value of shares at grant (£150 x 100)	15,000
Less: Amount paid by Tom	(7,000)
Amount charged to Income Tax as employment income	8,000

Corporation Tax

s.1010 CTA 2009 - the company will have a Corporation Tax deduction in the period in which the options are exercised by Tom. The Corporation Tax deduction is equal to the difference between the market value of the shares when the options are exercised (£35,000) and any consideration paid by Tom (£7,000).

There would be a Corporation Tax deduction of £28,000 available to the company.

Employer's Class 1 National Insurance

If Tom exercises his shares at the point at which a sale has been agreed, this will be considered a trading arrangement and so the shares will be "readily convertible assets".

As the shares are readily convertible, this means that Class 1 employee's and employer's National Insurance must be operated via the payroll. The employer's National Insurance paid by Jet Away Ltd will attract a further Corporation Tax deduction.

PAYE

As the shares are readily convertible, PAYE must be operated by Jet Away Ltd as opposed to Tom declaring the income on his self-assessment tax return. Jet Away Ltd must account for the Income Tax and National Insurance due on Tom's £8,000 of "employment income".

There is no restriction on the amount of tax and employee's National Insurance to be withheld through PAYE. If the tax exceeds Tom's salary for the month, Jet Away Ltd will be required to pay all the Income Tax and National Insurance and then recover the additional tax and employee's National Insurance from Tom. Any shortfall must be reimbursed by Tom no later than 90 days after the end of the tax year in which the shares were received.

Option 2 - Immediate issue of shares at par value

Employer's Class 1 National Insurance will be payable by Jet Away Ltd if the shares are readily convertible assets on the date of issue.

On 1 June 2026, the shares are not "readily convertible" under general rules because Jet Away Ltd is unlisted and there are no trading arrangements in place. However, the shares may still be treated as readily convertible if Jet Away Ltd is not entitled to a Corporation Tax deduction.

A Corporation Tax deduction is available if:

- The shares are awarded under a tax advantaged scheme; or
- The shares are ordinary shares with no special rights in either a listed company or a company which is not under the control of another company.

Whilst the shares would not be awarded under a tax advantaged scheme if they are issued at par, Jet Away Ltd is not wholly owned by another company. This means that the Corporation Tax deduction would be available.

The shares will therefore not be considered readily convertible on 1 June 2026.

The Corporation Tax deduction is based on the difference between the market value and the amount paid for the shares. Based on a market value of £150 per share and a cost of £1 per share, this would mean a deduction of £14,900.

As the shares are not "readily convertible", Tom will need to declare income of £14,900 (the difference between the market value and the cost per share) on his self-assessment tax return for the 2026/27 tax year.

MARKING GUIDE

TOPIC	**MARKS**
Option 1 - EMI option	
No Income Tax charge on grant	1
Income Tax on exercise	2
Corporation Tax deduction	2
Readily convertible assets	2
Operate PAYE	1
90 day rule	1
SUBTOTAL	9
Option 2 - Immediate issue of shares at par value	
Consider RCA position under general rules on date of issue	2
Discuss Corporation Tax deduction	2
Conclude and quantify Corporation Tax deduction	1
Self-assessment requirements for Tom	1
SUBTOTAL	6
TOTAL	**15**

Question 3

Part 1 – Capital Gains Tax and Income Tax implications

Gifts

The gift of the shares in Carolwood Ltd, the shares in Silverbrook Ltd and the warehouse will be disposals for Capital Gains Tax purposes. As each disposal is to a connected person (Marianne's daughters), the proceeds of each disposal will be deemed to be the assets' market value at the date of disposal.

However, as the assets are being gifted, gift relief may be able to be claimed. The effect of a gift relief claim is that the immediate capital gain is reduced, potentially to nil, and the donee's base cost in the assets is correspondingly reduced.

Gift relief can be claimed where the assets are unquoted shares in a trading company. Assets owned by an individual and used in their personal trading company will also qualify for relief.

Carolwood Ltd and Silverbrook Ltd are wholly trading companies and the warehouse is owned by Marianne and used in the business of Carolwood Ltd, a company in which she holds more than 5% of the shares. All transfers will therefore qualify for gift relief.

However, gift relief will need to be restricted in relation to the warehouse, as it is only partially used by Carolwood Ltd. As 25% of the building is rented to third parties, only 75% of Marianne's gain can be deferred. The remaining 25% of Marianne's gain will be immediately taxable.

Business asset disposal relief may have been available as the disposal will be associated with the disposal of the shares. However, it will not be available as a market rate rent is charged to the company.

The shares acquired by Aurelia (in Silverbrook Ltd) and Oakley (in Carolwood Ltd) may be Employment Related Securities for Income Tax purposes, as they are employees of the companies. However, as the opportunity to acquire the shares was made available by an individual and due to a family relationship, this will not be the case.

Share repurchase

Provided certain conditions are met, the repurchase will automatically be treated as giving rise to a capital payment to Marianne, rather than any part being treated as an income distribution.

The company must be an unquoted trading company. In addition, the transaction must:

- Be wholly or mainly for the purposes of benefitting a trade carried on by the company; and
- Not be part of a scheme, the main purposes of which is the avoidance of tax;

Marianne must:

- Be resident in the UK at the time of the purchase;
- Have owned the shares for at least five years;
- Have a 'substantial reduction' (>25%) in her shareholding; and
- Not be connected (>30%) with the company immediately after the repurchase.

Carolwood Ltd is an unquoted, trading company. The repurchase is being undertaken as part of the exit of Marianne, who is retiring, from the ownership and management of the company. This should be seen as benefitting the ongoing trade of the company. There is no indication that the transaction is being undertaken for a tax avoidance purpose.

Marianne is resident in the UK and has owned the shares since 2017.

Marianne's shareholding is reducing from 30% (after the gift to Oakley) to nil as a result of the transaction. Although the shareholdings of associates are aggregated together, adult children are not associates for these purposes. She will therefore have a "substantial reduction" in her shareholding.

As Marianne will not hold any of the company's shares after completion, she is not connected with the company. The same point as above applies in relation to the shareholding of associates.

As such, the disposal should meet the requirements for capital treatment. The only computation required in this case would be a capital gains computation. The capital disposal should also qualify for business asset disposal relief, as Marianne has held more than 5% of the company's share capital for more than two years and has been a director over that period.

Advance clearance is available from HMRC, and a notification must be submitted to HMRC within 60 days of completion.

Part 2 – Business property relief

Business property relief is available, in principle, for shares in unlisted trading companies, with no minimum shareholding requirement. The rate of relief is 100% [on the first £1m of value, and 50% on the excess, subject to certain conditions. [*Since originally proposed, the government announced that business property relief will now be available on the first £2.5 million of value – candidates who state £2.5 million instead of £1 million will receive full credit.]*

The shares must have been held for two years in order to qualify, so she will not qualify until two years have passed from the date of transfer.

Relief is also restricted if the company holds "excepted assets". To the extent that the cash balance of £380,000 (after paying out £270,000 for Marianne's shares) is not required for future use in the business, it is likely to be an excepted asset. The amount of business property relief will be limited based on how much of the company's total value of £900,000 is made up of excepted cash.

Marking guide

Part 1 – Capital Gains Tax and Income Tax implications	**12**
Gifts	
Market value disposals	0.5
Effect of gift relief claim	1
Qualifying assets	2
Restriction of warehouse gain	1
Business asset disposal relief	1
Employment Related Securities	1
Share repurchase	
Capital or income	0.5
Unquoted trading company	0.5
Benefit of the trade	1
Residence and ownership	0.5
Substantial reduction	1
Post-completion connection	0.5
Capital Gains Tax treatment	0.5
Business asset disposal relief claim possible	0.5
Return required	0.5
Part 2 – Business property relief	**3**
General	1
Holding period	1
Excepted cash	1
Total	**15**

Question 4

Qualifying expenditure

Staff costs

Name	Salary	Employer's NIC	Company pension contributions	Total	Qualifying %	Qualifying cost
	£	£	£	£		£
Elias Norwood	12,570	535	6,000	19,105	85	16,239
Roy Kingswell	12,570	535	6,000	19,105	85	16,239
Miles Ryman	25,000	-	2,000	27,000	-	-
Agnes Lott	29,000	-	2,320	31,320	85	26,622
James Harper	23,000	-	1,840	24,840	85	21,114
Total						£80,214

Subcontractor costs

The Ravenscroft expenditure is qualifying sub-contractor expenditure as it is reasonable to assume that, when entering into the contract, the company intended or contemplated that specific R&D would be undertaken to meet those obligations. As the company is unconnected to Norwood Kingswell Ltd, qualifying expenditure is limited to 65% of the payment of £371,524, and further restricted by the amount of R&D not undertaken in the UK, as cost is not a qualifying reason.

The Thornbridge expenditure is not qualifying expenditure for Norwood Kingswell Ltd, even though R&D takes place, as the work is not directed by the company.

Total qualifying sub-contractor payments - £371,524 x 65% x 75% = £181,118

IT costs

Software costs which are directly related to the technological developments on the project (such as data analysis) are eligible for relief.

The costs of the online data subscription are also qualifying costs.

Total qualifying software costs - £16,962

Property costs

Rent, rates, utilities and repairs are not costs which fall within any of the qualifying heads of expenditure.

The total qualifying expenditure for the year ended 31 March 2026 is therefore:

	£
Staff costs	80,214
Subcontractor costs	181,118
IT costs	16,962
	£278,294

Applicable scheme

The company is an SME for the period, as it has fewer than 500 employees and turnover not exceeding €100 million.

The company meets the R&D intensity condition, as the company's qualifying R&D expenditure (£278,294) is at least 30% of the company's total expenditure (£691,249), being 40.3%.

The company has made a trading loss in the period.

The company can therefore claim relief under the enhanced R&D intensive support (ERIS) regime.

Maximum cash repayment and losses

An additional trading deduction of 86% is available to the company as a result of the claim.

£278,294 x 86% = £239,333

The adjusted loss for Corporation Tax purposes for the year ended 31 March 2026 is therefore £764,691 (£525,358 + £239,333).

The company can surrender the lower of:

- Its unrelieved trading loss (£764,691); or
- 186% of its qualifying expenditure (**£517,627**)

for a payable tax credit of 14.5% - equal to £75,056.

However, the payable tax credit is limited to the cap relating to PAYE and National Insurance liabilities. The amount of this cap is £20,000 plus 3 × the company's relevant PAYE and National Insurance liabilities.

The relevant PAYE and National Insurance liabilities, in this case, is the total amount of the company's PAYE and (primary and secondary Class 1) National Insurance liabilities, for all employees. The amount of the cap is therefore:

£20,000 + 3 x (£7,858 (total PAYE) + £1,070 (total employer's National Insurance) + £3,142 (total employee's National Insurance) = £56,210

The maximum cash repayment is therefore limited to £56,210.

In order to obtain a cash tax credit of £56,210, losses of £387,655 (£387,655 x 14.5%) must be surrendered. This leaves trading losses to be carried forward of £377,036 (£764,691 - £387,655).

Marking guide

Qualifying expenditure:	
Staff costs	2
Ravenscroft costs	2
Thornbridge costs	1
Qualifying sub-contractor expenditure	0.5
IT costs	1
Property costs	0.5
Applicable scheme:	
SME tests	1
R&D intensity	1
Loss-making	0.5
ERIS applies	0.5
Maximum cash repayment and losses:	
Increased loss	1
Surrender at 14.5%	1.5
PAYE cap	1.5
Calculation of losses	1
Total	**15**

Question 5

Adjusted taxable profit

	Notes	£	£
Profit per accounts			15,430
Add:			
Accrued pension contribution	1)	180	
Personal pension contribution	2)	4,100	
One half of premises costs sublet	3)	6,800	
Van actual running costs	4)	3,800	
Car private percentage	5)	1,435	
Legal and Professional fees	6)	0	
Accountancy fees	7)	380	
Equipment costs	8)	0	
Training fees	9)	200	
Medical costs	10)	650	
Gifts	11)	840	
Donation	12)	160	
Personal use of stock	13)	210	
Personal drawings		55,000	
			73,755
Less			
Van mileage rate	4)	(5,350)	
Rent received	3)	(6,000)	
Interest received		(1,100)	
Client gifts	14)	(200)	
Capital Allowances	15)	(546)	
			(13,196)
Adjusted profit			75,989

Income Tax:

	Notes	Non- Savings £	Savings £	£
Adjusted profits		75,989		
Rental profits	16)	0		
Bank interest			1,100	
Gross income		75,989		
Personal allowance		(12,570)		
Taxable income		63,419	1,100	
Non-Savings	Notes		£	£
Basic rate band	17)	43,025 x 20%	8,605	
Higher rate band		20,394 x 40%	8,158	
				16,763
Savings				
Savings allowance	18)	500 x 0%	0	
Higher rate band		600 x 40%	240	
				240
Total Income Tax due				17,003
Class 4 National Insurance:				
		12,570 x 0%	0	
		37,700 x 6%	2,262	
		25,719 x 2%	514	
Total National Insurance due				2,776
Total Income Tax and Class 4 National Insurance liability				19,779

Notes:

1) No relief for accrued pension contributions.

2) The personal pension contributions for Dee will be treated as drawings.

3) Half of the premises costs relate to the subletting to a third party.

4) As Dee elected to use the flat rate mileage allowance for the van then the actual costs are added back. Relief will be claimed based on the allowable mileage rate of 45p per business mile for the first 10,000 miles and 25p per business mile thereafter.

5) Private use proportion of the car running costs disallowed:
£4,100 x 35% = £1,435

6) The costs associated with a successful legal defense for the business will be allowable, as will the costs of debt collection.

7) The personal tax return fees not related to the completion of the self-employment pages will be disallowed.

8) As the accounts are prepared on a cash basis then full relief can be claimed for equipment costs.

9) Staff training costs will be fully allowable. Dee's participation will be disallowed as this is a new skill.

10) Personal medical treatment will have a duality of purpose and will be treated as primarily for personal benefit.

11) The cost of the gifts will be disallowed as these are food items (s.47 ITTOIA 2005).

12) This is not a local charity and there is no direct benefit to the business.

13) The use of personal stock must be reflected at cost where cash accounting is applied. The free provision of services has no impact on the taxable profit.

14) An unsolicited gift unrelated to the business will not be a taxable receipt.

15) Capital allowances

	Private use car	Private use 35%	Allowances
	£	£	£
TWDV b/fwd	14,000		
WDA @ 6%	(840)	294	546
TWDV c/fwd	13,160		

16) Rental income

		£
Rental income		6,000
Let element of premises costs	£13,600 x 50%	(6,800)
Net loss to carry forward		(800)

17) The basic rate band of £37,700 is increased by the grossed up equivalent of Dee's personal pension contribution (£4,100 x 10/8 = £5,125) and her Gift Aid donation (£160 x 10/8 = £200).

18) Savings allowance for interest income is £500 as Dee is a higher rate taxpayer.

MARKING GUIDE

	Marks
Calculation of taxable profit	
Accrued pension provision	0.5
Personal pension contribution	0.5
Disallow premises costs related to sub-letting	0.5
Disallow actual van running cost and claim relief for business mileage	1.5
Private use adjustment for the full car running costs	0.5
Allow cost of successful business related legal expense	0.5
Legal costs of debt collecting fully allowable	0.5
Personal accountancy cost	1.0
Full relief for equipment cost claimed through p/l	1.0
Allow training costs for employee but disallow those for Dee	2.0
Disallow medical cost	1.0
Disallow business gifts	1.0
Disallow donation	0.5
Tax personal use of stock at cost price not market value	1.0
No adjustment for personal provision of services	1.0
Unsolicited gifts are not taxable	1.0
Private use capital allowances adjustment	1.0
Personal tax computation	
Rental income adjustment	1
Extension of the basic rate tax band for pension contributions	1
Nil rate band on interest limited to £500	1
Calculation of Class 4 National Insurance due	2
Total	20

Question 6

PAYE Summary

	Note	Taxable?
Bonus payment (£3,500)	1	Yes (s.62)
Statutory redundancy payment (£6,000)	2	s.401
Pension scheme payment (£4,000)		No, exempt per s.408
Outplacement counselling (£1,000)	3	s.401
Ex-gratia and redundancy payment (£49,000)	4	s.401
Loan write off (£7,500)	5	Yes (s.62)

Notes:

1. The bonus of £3,500 is included in Summer's employment contract. It is therefore taxable under s.62 ITEPA 2003 and subject to PAYE and employee and employer Class 1 National Insurance.

2. The statutory redundancy payment is charged to tax under s.401 ITEPA 2003.

2. The payment into Summer's personal pension scheme is a tax-exempt benefit and so will not be subject to PAYE or National Insurance (under s.408 ITEPA 2003).

3. The provision of outplacement counselling will not be an exempt benefit because whilst Summer has been employed for two years, it is not available to all employees (s.310 ITEPA 2003). This would therefore be taxable under s.401 ITEPA 2003.

4. The ex gratia and redundancy payment are both covered by s.401 ITEPA 2003 as they are voluntary payments made outside of the employment contract.

5. The write off of an employment related loan is taxable under s.62 ITEPA 2003.

If a payment is taxable under s.401 ITEPA 2003, it is only charged to tax to the extent it exceeds £30,000.

However, Summer has a three-month notice period and left the company immediately. This means that some of the ex-gratia payment will be post-employment notice pay (PENP). This element will not be eligible for the £30,000 exemption as it is treated as earnings.

PAYE payable

Calculation of PENP:

Basic pay (BP)	£11,000
Months in the post-employment notice period (D)	3
Pay period in months (P)	1
Amounts otherwise taxable as earnings under s.62	£7,500

PENP = $\frac{£11,000 \times 3}{1}$ - £7,500 = £25,500

Bonus payments on termination are specifically excluded from the PENP calculation.

As per the above, amounts taxable as general earnings = £7,500 + £25,500 + £3,500 = £36,500

Total ex-gratia payment = £6,000 + £1,000 + £49,000 = £56,000

Of this, £25,500 is treated as PENP which leaves £30,500. The £30,000 exemption can then be deducted. The balance of £500 will be subject to PAYE.

PAYE payable

As the termination payment was made after the P45 has been issued, a 0T tax code on a week one/month one basis will have been used.

The total amount subject to PAYE is £33,000 (general earnings) plus the £3,500 bonus plus £500 (balance after accounting for the £30,000 exemption). This totals £37,000.

The monthly PAYE will be calculated as follows:
Basic rate - 1/12 x £37,700 = £3,142
Higher rate - 1/12 x £87,440 = £7,287
Additional rate - excess over £10,429 (£3,142 + £7,287)

		£
£3,142	@ 20%	628
£7,287	@ 40%	2,915
£26,571	@ 45%	11,957
Total PAYE		£15,500

National Insurance

Class 1 National Insurance for both the employee and employer will be due on the bonus, loan write off and PENP as they are treated as general earnings arising under the contract of employment.

Employee's Class 1 National Insurance will be calculated as follows:

		£
£1,048	@ 0%	0
£3,141	@ 8%	251
£32,311	@ 2%	646
£36,500		897

Employee's Class 1 National Insurance totals **£897**

Employer's Class 1 National Insurance totals (15% x (£36,500 - £417) = **£5,412**

Class 1A National Insurance is payable by Efficient Energy Ltd on the balance of the ex-gratia payment over the £30,000 threshold. As above, the balance is £500 (s.10(1A) SSCBA 1992).

Class 1A National Insurance – 15% x £500 = **£75**

There is no employee National Insurance payable on any part of the ex-gratia payment that are not PENP, even though it exceeds the £30,000 threshold.

MARKING GUIDE

TOPIC	MARKS
PAYE:	
Bonus and loan write off	1
Pension	0.5
Statutory redundancy	0.5
Outplacement counselling	1
Ex-gratia payments	1.5
S.401 and PENP explanation	1
PENP calculation	2
Calculate ex-gratia payment subject to PAYE	0.5
0T code	0.5
Calculation of PAYE	1.5
National Insurance:	
Bonus	0.5
Pension	0.5
Class 1 due on general earnings	0.5
Calculation of Class 1 employee and employer's National Insurance	1.5
Class 1A	1
No Class 1 on s.401 even if >£30k	1
TOTAL	**15**