Answers

1 Kantar

Notes for meeting

(a) (i) Inheritance tax

Small gifts exemption

The small gifts exemption is available where the total gifts to an individual in a tax year are no more than £250. Accordingly, the exemption was not available in respect of the gifts to Kantar's nephews.

Potentially exempt transfer on 1 February 2014

	£
Value of the land prior to the gift	290,000
Value of the land after the gift	(170,000)
Diminution in value	120,000
Less: annual exemption for 2013/14	(3,000)
annual exemption for 2012/13 (£3,000 – (3 x £400))	(1,800)
	115,200

(ii) Capital gains tax liability for the tax year 2013/14

	£	£
Gift on 1 February 2014		
Proceeds at market value	100,000	
Less: cost (£200,000 x (£100,000/(£100,000 + £170,000)))	(74,074)	
		25,926
Sale on 2 February 2014		
Proceeds	170,000	
Less: cost (£200,000 – £74,074)	(125,926)	
		44,074
Chargeable gains		70,000
Less: annual exempt amount		(10,900)
		59,100
Capital gains tax		
£59,100 x 28%		16,548

Tutorial note: *Rollover relief will not be available in respect of the chargeable gain on the sale of the land, as it is not a business asset.*

(b) (i) Budgeted trading loss for the year ending 31 March 2015

(1) Loss relieved as soon as possible

The loss would be offset against Kantar's general income of the tax year 2013/14. This would reduce his taxable income, and therefore his income tax liability, to nil. The tax saving would therefore be the whole of his liability for 2013/14 of £14,622.

The £50,000 restriction on the offset of trading losses only applies where losses are offset against income other than profits from the same trade. Accordingly, as only £5,000 of the loss is being offset against the property business income, the restriction would not apply to Kantar in the tax year 2013/14.

The loss remaining after the offset against general income could then be offset against Kantar's chargeable gains of 2013/14. Following the offset of the loss against his income, the whole of Kantar's basic rate band would be available when calculating the tax due on the unrelieved taxable gains. The capital gains tax saved would be £4,881 (below).

The total of income tax and capital gains tax saved would be £19,503 (£14,622 + £4,881).

	£
Chargeable gains (from (a)(ii))	70,000
Less: loss relief (£68,000 – (£57,000 + £5,000))	(6,000)
	64,000
Less: annual exempt amount	(10,900)
Taxable gains	53,100
Capital gains tax liability	
£32,010 x 18%	5,762
£21,090 (£53,100 – £32,010) x 28%	5,905
	11,667
Capital gains tax with no loss relief (from (a)(ii))	16,548
Reduction in capital gains tax liability	4,881

(2) Loss carried forward for relief in the future

The loss would be offset against Kantar's trading income for the tax year 2015/16.

	Without loss relief £	With loss relief £
Expected trading profit for the year ended 31 March 2016 (£83,000 + £4,000)	87,000	87,000
Less: trading loss brought forward	–	(68,000)
	87,000	19,000
UK property business income	5,000	5,000
	92,000	24,000
Less: personal allowance	(9,440)	(9,440)
Taxable income	82,560	14,560
Income tax		
£32,010/£14,560 x 20%	6,402	2,912
£50,550 x 40%	20,220	–
	26,622	2,912
Tax saved in respect of the trading loss (£26,622 – £2,912)		23,710

Carrying the loss forward would increase the amount of tax relief obtained. However, Kantar cannot be certain of the level of his future trading profits and carrying the loss forward would also delay the relief obtained.

(ii) Future tax payments assuming the trading loss is carried forward

		Notes	£
2013/14			
Balancing payment 31 January 2015	Income tax (£14,622 – £9,084)	1	5,538
	Capital gains tax (from (a)(ii))		16,548
			22,086
2014/15			
Payments on account		2	Nil
Balancing payment			Nil
2015/16			
Payments on account		3	Nil
Balancing payment 31 January 2017 (from (b)(i)(2))			2,912

Notes:

1. Kantar will have made payments on account equal to his tax liability for 2012/13 (the previous tax year).
2. Kantar should apply to reduce his payments on account to nil as he does not expect to have a tax liability for the tax year 2014/15.
3. Kantar will not have to make any payments on account for the tax year 2015/16 as he will not have a tax liability for the tax year 2014/15.

(c) Reporting of chargeable gains

Any late payment of capital gains tax could result in interest and/or penalties being payable by Kantar.

Failure to disclose the chargeable gains could amount to the criminal offence of tax evasion. It may also be necessary to submit a report under the money laundering rules.

We cannot be associated with a client who has engaged in deliberate tax evasion, as this poses a threat to the fundamental principles of integrity and professional behaviour.

We should not continue to act for Kantar unless he agrees to disclose the chargeable gains to HM Revenue and Customs. If we ceased to act for Kantar, we would notify the tax authorities, although we would not provide them with any reason for our action.

(d) Value added tax (VAT)

Kantar must monitor his sales each month in order to identify when his taxable supplies for a 12-month period exceed £79,000 (the registration threshold). He must notify HM Revenue and Customs within 30 days of the end of the relevant 12-month period and will become registered from the end of the month following the 12-month period.

Once Kantar has registered, he will be able to recover input tax incurred:

– in the four years prior to registration in respect of goods he still owns; and
– in respect of services acquired by him in the six months prior to registering.

Tutorial note: *The recovery of input tax will reduce the expenses incurred by the business. It will also reduce the cost of the equipment purchased in the year ending 31 March 2015 for the purposes of capital allowances.*

2 Bond Ltd

(a) Corporation tax liability of Bond Ltd for the six months ended 30 September 2014

	Notes	£
Tax adjusted trading income		470,000
Add: reduction in capital allowances (£160,000 – £128,150)	1	31,850
		501,850
Less: trading losses brought forward	2	–
		501,850
Chargeable gain	3	40,000
Taxable total profits		541,850
Corporation tax liability		
The upper limit is £375,000 (£1,500,000 x 1/2 x 6/12) so the main rate applies		
Corporation tax at 23%		124,625

Notes

1. **Capital allowances**

The maximum annual investment allowance (AIA) for the six-month period ended 30 September 2014 is £125,000 (£250,000 x 6/12). This is the maximum AIA for Bond Ltd and Ungar Ltd together because they belong to a group of companies. It will be necessary to consider the most beneficial way of allocating this maximum AIA between the two companies in order to, for example, maximise the corporation tax saved in respect of the capital allowances available.

On the assumption that the whole of the AIA is allocated to Bond Ltd, the capital allowances for the period will be calculated as follows.

	Main pool £	Allowances £
Additions qualifying for AIA	160,000	
AIA	(125,000)	125,000
	35,000	
Writing down allowance at 9% (18% x 6/12)	(3,150)	3,150
Tax written down value carried forward	31,850	
Maximum capital allowances		128,150

2. **Trading losses brought forward**

Trading losses brought forward can only be offset against future profits of the same trade. Although Bond Ltd has made some significant changes to the way in which it carries on its trade, it has not changed its trade; the trade continues to consist of baking and selling bread and other baked products.

However, the changes made by Bond Ltd to its products and customers are likely to amount to a major change in the nature or conduct of its trade. This change has occurred within three years of the change in ownership of the company on 1 April 2012. Accordingly, it is likely that the trading losses brought forward cannot be carried forward beyond 1 April 2012, the date of the change of ownership, such that there are no trading losses brought forward for relief in the period ended 30 September 2014.

Tutorial note: *If there has been a major change in the nature or conduct of its trade, the company's corporation tax liabilities for the two previous accounting periods will need to be recalculated because the trading losses brought forward and deducted during those periods will no longer be available for offset.*

3. **Rollover relief**

Rollover relief will be available in respect of the chargeable gain on the land by reference to the qualifying business assets purchased in the four-year period commencing one year prior to the sale of the land. Qualifying business assets consist of land, buildings and fixed plant, purchased for use in a trade.

A capital gains group is treated as a single entity for the purposes of rollover relief. Accordingly, qualifying assets can be purchased by Ungar Ltd whilst it is a member of the Bond Ltd capital gains group, as well as by Bond Ltd. Madison Ltd is not a member of the Bond Ltd capital gains group, as it is not a 75% subsidiary of Bond Ltd.

The whole of Bond Ltd's gain can be rolled over if qualifying assets costing at least £350,000 (the proceeds in respect of the sale of the land) are acquired. Otherwise, there will be a chargeable gain equal to the amount of proceeds not reinvested up to a maximum of the gain of £180,000.

Based on the information we have, the only qualifying purchase is the building acquired by Ungar Ltd. Accordingly, the chargeable gain after rollover relief will be equal to the proceeds not reinvested of £40,000 (£350,000 – £310,000).

It will be possible to defer the whole of the gain if there are further acquisitions of qualifying assets costing at least £40,000, for example, items of fixed plant within the purchases of plant and machinery made by Bond Ltd.

(b) Ungar Ltd – Patent box regime

The patent box regime is likely to be available to Ungar Ltd as it holds patents as a result of having developed new baking processes (the patented inventions). Ungar Ltd would need to submit an election to HM Revenue and Customs in order for the patent box regime to apply.

Under the patent box regime, Ungar Ltd's patent profits would be subject to an effective reduced rate of corporation tax of 10%. The company's patent profits consist of its royalty income in respect of its patents and a proportion of its profits in respect of the sale of products incorporating the use of those patents.

In the early years of the regime, only a proportion of a company's patent profits will benefit from the reduced rate of corporation tax. This proportion will increase gradually over a number of years until the whole of a company's patent profits are included.

(c) Recovery of value added tax (VAT) in respect of the assets acquired by Madison Ltd

Madison Ltd will be able to recover 80% of the VAT incurred in respect of both the building and the machinery in the year ending 30 September 2015, i.e. £112,000 ((£400,000 + £300,000) x 20% x 80%).

The building will be subject to the capital goods scheme because it cost more than £250,000. This means that an adjustment will be made in each of the next nine years to reflect any change in the VAT recovery percentage.

For example, if the VAT recovery percentage in the year ending 30 September 2016 is 75%, Madison Ltd will have to repay VAT to HM Revenue and Customs as follows:

(£400,000 x 20%)/10 x (80% – 75%) = £400.

The capital goods scheme does not apply to machinery and therefore the initial recovery of input tax of £48,000 (£300,000 x 20% x 80%) is final.

3 Cada

(a) The inheritance tax advantages of additional lifetime gifts

Any additional lifetime gifts of quoted shares would have become chargeable on Cada's death on 20 November 2014. However, the value charged to tax would have been the value of the shares at the time of the gift and not their value at the time of death. Any increase in the value of the shares would therefore have been ignored, although relief would have been available if the shares had fallen in value following the gift.

Taper relief would have been available in respect of any gifts made in the period 1 December 2010 to 20 November 2011 (i.e., those gifts made more than three years prior to death). This would only be relevant in respect of that amount of the gifts made which exceeded the nil rate band available of £220,000. In these circumstances, because the gift would have been made between three and four years prior to death, taper relief would have reduced the tax charged on the gift by 20%.

(b) Additional gift to charity

	£	£
House	500,000	500,000
Cash	60,000	60,000
Other assets including share portfolio	440,000	440,000
	1,000,000	1,000,000
Less: gift to charity (£60,000)/((£1,000,000 – £220,000) x 10%)	(60,000)	(78,000)
	940,000	922,000
Less: nil rate band	(220,000)	(220,000)
	720,000	702,000
Inheritance tax at 40%/36%	288,000	252,720
Additional gift to charity (£78,000 – £60,000)		18,000
Reduction in the inheritance tax liability (£288,000 – £252,720)		35,280

Tutorial note: *The reduced rate of 36% applies where the gift to charity is at least 10% of the individual's net estate. The net estate consists of the assets owned at death reduced by liabilities, exemptions, reliefs, and the nil rate band but before taking any deduction for the charitable gift itself.*

(c) Variation of Cada's will

Potential tax advantages

(i) **Gift to charity**

An additional £18,000 gift to charity could be carried out via a variation of Cada's will. This would result in the tax saving set out in (b) above.

(ii) **The house**

There are two reasons to vary the terms of Cada's will, such that the house is left directly to Raymer's son.

Capital gains tax

Without the variation, the proposed gift of the house by Raymer to her son will result in a chargeable gain equal to the excess of the value of the house on 1 July 2015 (the date of the proposed gift) over its probate value of £500,000. The principal private residence exemption would not be available, as Raymer does not intend to live in the house. Gift relief would not be available as a house is not a qualifying asset for this relief.

Inheritance tax

Without the variation, the gift of the house by Raymer to her son would be a potentially exempt transfer for the purposes of inheritance tax and would become a chargeable transfer if Raymer were to die within seven years of the gift.

Procedures

- The variation of the will must be made in writing within two years of death by the person(s) who would benefit under the will – i.e. Raymer.
- It must be stated that the variation is intended to replace the terms of the will for the purposes of inheritance tax and capital gains tax.

(d) Capital gains tax – Beneficial actions in respect of shareholdings

Following her death, the capital gains tax base costs of Cada's shareholdings are equal to their market value as at the date of death. Accordingly, any losses which accrued up to the date of death are no longer available for relief.

Cada could have sold the shares in FR plc (valued at less than cost) prior to her death in order to realise the accrued capital losses. The capital losses could have been offset against any chargeable gains in 2014/15.

A negligible value claim could have been submitted in respect of the shares in KZ Ltd. The shares would have been treated as having been sold and reacquired at their market value, resulting in an allowable capital loss. This loss would have been available for relief against Cada's chargeable gains in 2014/15 (the year in which the claim would have been made) or in either of the two preceding tax years, provided the shares were of negligible value in those years.

Any capital losses in excess of chargeable gains in 2014/15 could have been carried back and offset against gains in the three tax years prior to death, relieving later years before earlier years.

Tutorial note: *Candidates were not required to consider the possibility of a loss arising in respect of the unquoted shares being offset against the taxpayer's income.*

4 Piquet and Buraco

(a) (i) Accounting date changed to 28 February

Piquet must notify HM Revenue and Customs of the change by 31 January 2016 (31 January following the tax year in which the change is made).

Taxable trading profit

	£
2014/15	
16 months ending 28 February 2015	94,000
Less: relief for overlap profits (£15,000 x 4/5)	(12,000)
	82,000
2015/16	
Year ended 28 February 2016	88,000

(ii) 30 April year end – Basis periods and overlap profits

The basis period for the tax year 2014/15 will be the 12 months ended on the new accounting date in the tax year, i.e. the 12 months ended 30 April 2014.

This will create additional overlap profits, as the profits for the six months ended 31 October 2013 have already been subject to tax in the tax year 2013/14. The additional overlap profits will be £27,000 (6/12 x £54,000).

The basis period for the tax year 2015/16 will be the 12 months ending 30 April 2015.

(iii) The advantages of a 30 April year end

It would be financially advantageous for Piquet to have an accounting date earlier in the tax year (30 April) rather than later in the tax year (28 February) because the profits of his business are increasing. The earlier year end date will result in an earlier period of profits, and therefore a lower amount of profits, being subject to tax. For example, in the tax year 2015/16, the profit for the 12 months ending 30 April 2015 will be less than the profit for the 12 months ending 28 February 2016.

The nearer an accounting date is to the start of the tax year, the sooner the taxable profit for that tax year will be known. This means that there will be more time for plans to be made and carried out in relation to, for example, payments on account and pension contributions.

The interval between earning profits and paying the tax on those profits is greater where the year end is earlier rather than later in the tax year. For example, the payments of tax for the year ended 30 April 2016 are due on 31 January 2017 and 31 July 2017, whereas the payments for the year ended 28 February 2016 would be due a year earlier.

Note: Only TWO advantages were required.

Tutorial note: *Credit was also available to candidates who explained the effect of a trader's year end on the basis period in the tax year of cessation.*

(b) (i) Residence status for the tax year 2014/15

Automatic overseas residence tests

Buraco will not satisfy any of the automatic overseas residence tests for the tax year 2014/15 because he will have been in the UK for 46 days or more in that tax year.

Tutorial note: *The 90-day test does not apply to Buraco because he does not work full-time overseas.*

Residence status for 2014/15

Buraco was not UK resident for any of the three previous tax years, accordingly:

– if he is in the UK for between 100 and 120 days, he will be resident if he has three or more of the four relevant UK ties; or
– if he is in the UK for between 121 and 150 days, he will be resident if he has two or more UK ties.

Buraco does not satisfy the tie relating to work, as he does not work in the UK.

Buraco satisfies the close family tie and the accommodation tie, as he has a minor child in the UK and a house which he has stayed in during the year.

Accordingly, as he satisfies two of the ties, he will be UK resident if he is in the UK for more than 120 days.

If he is in the UK for less than 120 days, he will only be resident if he satisfies the final tie relating to time spent in the UK during either of the two previous tax years. This tie will be satisfied if Buraco spent more than 90 days in the UK during the tax year 2013/14.

(ii) Tax implications of claiming the remittance basis

If Buraco claims the remittance basis in 2014/15, he will only be subject to UK tax on his overseas income and overseas chargeable gains remitted to the UK.

However, Buraco would not be entitled to the income tax personal allowance or the capital gains tax annual exempt amount.

There would not be a remittance basis charge because Buraco was not resident in the UK for seven of the nine tax years prior to 2014/15.

5 Klubb plc

(a) Late submission of corporation tax returns

Corporation tax returns are required for the two accounting periods within the long period of account: the 12 months ended 30 November 2012 and the four months ended 31 March 2013.

The returns should have been filed by 31 March 2014 (12 months after the end of the 16-month period of account).

There will be a late-filing penalty of £100 in respect of each of the returns because they were filed within three months of the filing date.

However, this £100 penalty is increased to £500 where the returns for the two preceding accounting periods were also submitted late.

Tutorial note: *It has been assumed that HM Revenue and Customs issued notices requiring the returns to be made prior to 1 January 2014.*

(b) Comparison of a share incentive plan (SIP) with a company share option plan (CSOP)

Employees who must be included in the plan

A CSOP is significantly more flexible than a SIP.

Klubb plc would be able to select particular employees to join a CSOP whereas, under the rules for SIPs, Klubb plc would be required to offer shares to all of its full-time and part-time employees, although a minimum qualifying period of employment may be specified.

The number or value of shares which can be acquired by each plan member

Again, a CSOP is more flexible than a SIP.

Klubb plc can choose to award options to purchase different numbers of shares to each member of a CSOP. The options awarded are simply at the discretion of Klubb plc. However, the award is subject to a maximum whereby a member is only allowed to hold options to purchase shares with a maximum value (at the time the options were granted) of £30,000.

Under the rules for SIPs, free shares up to a maximum value of £3,000 can be given to each member of the plan each tax year. These free shares must be awarded on similar terms to all of the plan members. This means that any variation in the number of free shares awarded must be by reference to objective criteria, for example, length of service or performance targets.

In addition, a member of a SIP can purchase partnership shares (at market value) up to a maximum value of the lower of £1,500 and 10% of salary each tax year. Klubb plc could then give the plan members up to two further free shares (known as matching shares), in respect of each partnership share purchased. This represents additional free shares with a maximum value of £3,000.

Tax implications of acquiring and selling the shares

Under the rules for SIPs, there are no income tax implications when free shares or matching shares are awarded to scheme members. Similarly, there are no income tax implications when shares are withdrawn from the plan if they have been held within the plan for five years. There will be no capital gains tax on the immediate sale of the shares because their base cost is equal to their market value at the time they are withdrawn from the SIP.

The rules for a CSOP are not as generous as those for a SIP.

There would be no tax charged on the grant and exercise of the options (provided the amount paid by the employee for the shares is not less than their market value at the time of the grant of the option).

However, there would be a chargeable gain on the sale of the shares equal to the proceeds received less the amount paid for them.

Tutorial note: *It was not necessary to make all of the above points in order to score full marks for this question.*

(c) (i) Status of Hartz Co and availability of the low profits exemption

Hartz Co is a non-UK resident company. It will be a controlled foreign company (CFC) if it is controlled by UK resident persons. Accordingly, its status depends on the residency of Mr Deck. If he is a UK resident, Hartz Co will be a CFC.

Hartz Co is not expected to satisfy either of the conditions for the low profits exemption. This is because:

– its profits are expected to exceed £50,000; and
– although its profits are expected to be less than £500,000, it will have chargeable gains (non-trading profits) of more than £50,000.

(ii) CFC charge

	£
Chargeable profits of Hartz Co	330,000
Chargeable profits apportioned to Klubb plc (30% x £330,000)	99,000
Corporation tax at 23%	22,770
Less: creditable tax (£330,000 x 11% x 30%)	(10,890)
CFC charge	11,880

Tutorial note: *Chargeable gains are not part of chargeable profits and thus are not included in the calculation of the CFC charge.*

				Available	*Maximum*
1	**(a)**	**(i)**	Small gifts exemption	1·5	
			Potentially exempt transfer	2·5	
				4	4
		(ii)	Chargeable gain in respect of the gift on 1 February 2014	2	
			Chargeable gain in respect of the sale on 2 February 2014	1	
			Capital gains tax liability	1	
				4	4
	(b)	**(i)**	Loss relieved as soon as possible		
			Income tax	1	
			Capital gains tax	3	
			Loss carried forward		
			Taxable incomes	2·5	
			Tax liabilities and saving	2	
			£50,000 restriction	1	
			Evaluation	1	
			Explanatory notes	1·5	
				12	10
		(ii)	Payments required if loss carried forward		
			2013/14	2·5	
			2014/15	1·5	
			2015/16	2	
				6	5
	(c)		Implications for Kantar	2	
			Fundamental principles	1	
			Cease to act	2·5	
				5·5	4
	(d)		When registration required	2	
			VAT incurred prior to registration	2	
				4	4
			Format and presentation	1	
			Analysis	1	
			Quality of explanations	1	
			Quality of calculations	1	
				4	4
			Total		**35**

			Available	Maximum
2	(a)	Corporation tax computation		
		Taxable total profits	2	
		Corporation tax liability	1·5	
		Capital allowances		
		Maximum AIA	1	
		Calculation of adjustment to capital allowances	1·5	
		Group aspect	1	
		Losses brought forward		
		Offset against future profits of the same trade	2	
		Major change in the nature or conduct of the trade	3	
		Rollover relief	5	
		Assumption	1	
			18	17
	(b)	Identification of each relevant point – one mark		
		Possible points include:		
		Availability of scheme		
		Meaning of patent profits		
		10% tax rate on patent profits		
		Example		
		Phasing in of the scheme		
		Election required		
			4	4
	(c)	Initial recovery of input tax	1	
		Capital goods scheme	2	
		Example	2	
			5	4
		Total		**25**
3	(a)	Value frozen		
		Identify issue	1	
		Relief for fall in value	1	
		Taper relief for gifts more than three years prior to death		
		Identify issue	1	
		Explain effect	1·5	
			4·5	4
	(b)	Original liability	2·5	
		Additional gift to charity	2·5	
		Net saving	1	
			6	5
	(c)	Potential tax advantages		
		Additional gift to charity	1	
		House	3·5	
		Procedures	2	
			6·5	6
	(d)	No relief for accrued losses	1	
		Quoted shares where cost exceeds market value	1	
		Unquoted shares	2	
		Use of losses	2	
			6	5
		Total		**20**

				Available	Maximum
4	**(a)**	**(i)**	Date	1	
			Calculations	2	
				3	3
		(ii)	Basis periods	1·5	
			Overlap profits	1·5	
				3	3
		(iii)	Identification of issue – one mark each	2	
			Explanation of issue – one mark each	2	
				4	4
	(b)	**(i)**	Automatic overseas tests	1	
			Days and ties	2·5	
			Work, family and accommodation ties	3	
			90 days tie	1·5	
			Conclusion	1	
				9	7
		(ii)	UK tax on overseas income and gains	1	
			Personal allowance and annual exempt amount	1	
			No remittance basis charge	2	
				4	3
			Total		**20**

			Available	Maximum
5	**(a)**	Two accounting periods	1	
		Filing date	1	
		Penalty	2	
			4	4
	(b)	Employees	2	
		Value		
		SIP	4	
		CSOP	2	
		Tax on realisation of value		
		SIP	2	
		CSOP	2	
			12	9
	(c)	**(i)** Status of Hartz Co	2·5	
		Low profits exemption	2	
			4·5	4
		(ii) Profits apportioned	1·5	
		Calculation of charge	1·5	
			3	3
		Total		**20**