Professional Level – Options Module

Advanced Taxation (United Kingdom)

Friday 5 December 2014

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

This paper is divided into two sections:

Section A – BOTH questions are compulsory and MUST be attempted

Section B – TWO questions ONLY to be attempted

Tax rates and allowances are on pages 2–5

Do NOT open this paper until instructed by the supervisor.
During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.
This question paper must not be removed from the examination hall.

The Association of Chartered Certified Accountants

Paper P6 (UK)

ACCA

SUPPLEMENTARY INSTRUCTIONS

1. You should assume that the tax rates and allowances for the tax year 2013/14 and for the financial year to 31 March 2014 will continue to apply for the foreseeable future unless you are instructed otherwise.
2. Calculations and workings need only be made to the nearest £.
3. All apportionments should be made to the nearest month.
4. All workings should be shown.

TAX RATES AND ALLOWANCES

The following tax rates and allowances are to be used in answering the questions.

Income tax

		Normal rates %	Dividend rates %
Basic rate	£1 – £32,010	20	10
Higher rate	£32,011 – £150,000	40	32·5
Additional rate	£150,001 and over	45	37·5

A starting rate of 10% applies to savings income where it falls within the first £2,790 of taxable income.

Personal allowances

	£
Personal allowance	
Born on or after 6 April 1948	9,440
Born between 6 April 1938 and 5 April 1948	10,500
Born before 6 April 1938	10,660
Income limit	
Personal allowance	100,000
Personal allowance (born before 6 April 1948)	26,100

Residence status

Days in UK	Previously resident	Not previously resident
Less than 16	Automatically not resident	Automatically not resident
16 to 45	Resident if 4 UK ties (or more)	Automatically not resident
46 to 90	Resident if 3 UK ties (or more)	Resident if 4 UK ties
91 to 120	Resident if 2 UK ties (or more)	Resident if 3 UK ties (or more)
121 to 182	Resident if 1 UK tie (or more)	Resident if 2 UK ties (or more)
183 or more	Automatically resident	Automatically resident

Child benefit income tax charge

Where income is between £50,000 and £60,000, the charge is 1% of the amount of child benefit received for every £100 of income over £50,000.

Car benefit percentage

The relevant base level of CO_2 emissions is 95 grams per kilometre.

The percentage rates applying to petrol cars with CO_2 emissions up to this level are:

	%
75 grams per kilometre or less	5
76 grams to 94 grams per kilometre	10
95 grams per kilometre	11

Car fuel benefit

The base figure for calculating the car fuel benefit is £21,100.

Individual savings accounts (ISAs)

The overall investment limit is £11,520, of which £5,760 can be invested in a cash ISA.

Pension scheme limits

Annual allowance	£50,000
Lifetime allowance	£1,500,000
Maximum contribution that can qualify for tax relief without any earnings	£3,600

Authorised mileage allowances: cars

Up to 10,000 miles	45p
Over 10,000 miles	25p

Capital allowances: rates of allowance

	%
Plant and machinery	
Main pool	18
Special rate pool	8
Motor cars	
New cars with CO_2 emissions up to 95 grams per kilometre	100
CO_2 emissions between 96 and 130 grams per kilometre	18
CO_2 emissions over 130 grams per kilometre	8
Annual investment allowance	
First £250,000 of expenditure (since 1 January 2013)	100

Cap on income tax reliefs

Unless otherwise restricted, reliefs are capped at the higher of £50,000 or 25% of income.

Corporation tax

Financial year	2011	2012	2013
Small profits rate	20%	20%	20%
Main rate	26%	24%	23%
	£	£	£
Lower limit	300,000	300,000	300,000
Upper limit	1,500,000	1,500,000	1,500,000
Standard fraction	3/200	1/100	3/400

Marginal relief

Standard fraction x (U – A) x N/A

Patent box – deduction from net patent profit

Net patent profit x ((main rate – 10%)/main rate)

Value added tax (VAT)

Standard rate	20%
Registration limit	£79,000
Deregistration limit	£77,000

Inheritance tax: nil rate bands and tax rates

	£	
6 April 2013 to 5 April 2014	325,000	
6 April 2012 to 5 April 2013	325,000	
6 April 2011 to 5 April 2012	325,000	
6 April 2010 to 5 April 2011	325,000	
6 April 2009 to 5 April 2010	325,000	
6 April 2008 to 5 April 2009	312,000	
6 April 2007 to 5 April 2008	300,000	
6 April 2006 to 5 April 2007	285,000	
6 April 2005 to 5 April 2006	275,000	
6 April 2004 to 5 April 2005	263,000	
6 April 2003 to 5 April 2004	255,000	
6 April 2002 to 5 April 2003	250,000	
6 April 2001 to 5 April 2002	242,000	
6 April 2000 to 5 April 2001	234,000	
6 April 1999 to 5 April 2000	231,000	
Rate of tax on excess over nil rate band	– Lifetime rate	20%
	– Death rate	40%

Inheritance tax: taper relief

Years before death:	% reduction
Over 3 but less than 4 years	20
Over 4 but less than 5 years	40
Over 5 but less than 6 years	60
Over 6 but less than 7 years	80

Capital gains tax

	%
Rate of tax – Lower rate	18
– Higher rate	28
Annual exempt amount	£10,900
Entrepreneurs' relief – Lifetime limit	£10,000,000
– Rate of tax	10%

National insurance contributions
(not contracted out rates)

			%
Class 1	Employee	£1 – £7,755 per year	Nil
		£7,756 – £41,450 per year	12·0
		£41,451 and above per year	2·0
Class 1	Employer	£1 – £7,696 per year	Nil
		£7,697 and above per year	13·8
Class 1A			13·8
Class 2		£2·70 per week	
		Small earnings exception limit – £5,725	
Class 4		£1 – £7,755 per year	Nil
		£7,756 – £41,450 per year	9·0
		£41,451 and above per year	2·0

Rates of interest (assumed)

Official rate of interest	4·0%
Rate of interest on underpaid tax	3·0%
Rate of interest on overpaid tax	0·5%

Stamp duty land tax

	%
£150,000 or less (1)	Nil
£150,001 – £250,000	1
£250,001 – £500,000	3
£500,001 – £1,000,000	4
£1,000,001 – £2,000,000 (2)	5
£2,000,001 or more (2)	7

(1) For residential property, the nil rate is restricted to £125,000.
(2) The 5% and 7% rates apply to residential properties only. The 4% rate applies to all non-residential properties where the consideration is in excess of £500,000.

Stamp duty

Shares	0·5%

This is a blank page.
Question 1 begins on page 7.

Section A – BOTH questions are compulsory and MUST be attempted

1 Your manager has had a meeting with Kantar. Kantar recently appointed your firm to be his tax advisers. Extracts from the memorandum recording the matters discussed at the meeting and from an email from your manager are set out below.

Extract from the memorandum

Kantar was born on 1 May 1962. He is resident and domiciled in the UK.

Kantar has owned and operated his unincorporated business since 2001. In February 2014 Kantar disposed of some land. He used the proceeds to purchase equipment and vans on 1 May 2014 in order to expand his business.

Kantar's only other income consists of UK property business income of £5,000 per year.

Capital transactions

1 November 2012	Kantar inherited eight acres of land from his uncle. Kantar's uncle had purchased the land for £70,000 in 1996. At the time of the uncle's death, the land was worth £200,000.
5 November 2012	Kantar gave £400 to each of his three nephews.
1 February 2014	On this date, when the eight acres of land were worth £290,000, Kantar gave two acres, valued by an independent expert at £100,000, to his son. Capital gains tax gift relief was not available in respect of this gift.
2 February 2014	Kantar sold the remaining six acres of land at auction for £170,000.

Kantar has not made any disposals for the purposes of capital gains tax other than those set out above.

Kantar has not made any transfers of value for the purposes of inheritance tax other than those set out above.

Kantar's business

Kantar's business provides delivery services. The majority of its customers are members of the public. Kantar is not registered for the purposes of value added tax (VAT).

The recent actual and budgeted results of the business are set out below.

	Year ended 31 March		
	Actual 2013	**Actual 2014**	**Budgeted 2015**
	£	**£**	**£**
Sales	48,000	65,000	96,000
Expenses	(6,000)	(8,000)	(13,000)
Profit per the accounts	42,000	57,000	83,000
Adjustments for tax purposes	2,000	1,000	4,000
Capital allowances	(1,000)	(1,000)	(155,000)
Tax adjusted profit/(loss)	43,000	57,000	(68,000)
Income tax liability for the tax year	9,084	14,622	Nil

In the year ending 31 March 2016, no capital allowances will be available to Kantar. With the exception of capital allowances, the results for the year ending 31 March 2016 are expected to be the same as those for the year ended 31 March 2015.

Extract from an email from your manager

Additional information

– The income tax liabilities in the memorandum take account of Kantar's UK property business income as well as his trading income and are correct.
– Kantar pays all of his tax liabilities on or before the due dates.

Please prepare notes for use in a meeting with Kantar. The notes should address the following issues:

(a) Capital transactions

(i) Inheritance tax

– The availability of the small gifts exemption in respect of Kantar's gifts to his nephews.
– A calculation of the potentially exempt transfer on 1 February 2014 after deduction of any available exemptions.

(ii) A calculation of Kantar's chargeable gains and capital gains tax liability for the tax year 2013/14.

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

(i) Calculations, with **brief** supporting explanations where necessary, of the tax which would be saved in respect of the offset of the trading loss for the tax year 2014/15 if:

(1) the loss is relieved as soon as possible;
(2) the loss is carried forward for relief in the future.

A brief evaluation of your findings and the relevance to Kantar of the £50,000 restriction on the offset of trading losses.

(ii) On the assumptions that the trading loss is carried forward and that Kantar wishes to maximise his cash flow position, prepare a schedule of the dates and amounts of the payments on account and balancing payments Kantar would expect to make, post 1 January 2015, in respect of his tax liabilities for 2013/14, 2014/15 and 2015/16. Include brief explanations of the payments on account amounts.

(c) Reporting of chargeable gains

Kantar does not intend to report his chargeable gains on his income tax return as he believes that the tax authorities should be able to obtain this information from other sources. Explain the implications for Kantar, and our firm, of Kantar failing to report the chargeable gains to HM Revenue and Customs.

(d) Value added tax (VAT)

Explain, without performing any calculations, Kantar's obligation to compulsorily register for VAT; and state Kantar's ability, following registration, to recover the input tax incurred prior to registering.

Tax manager

Required:

Prepare the meeting notes requested in the email from your manager. The following marks are available:

(a) Capital transactions.

(i) Inheritance tax. (4 marks)

(ii) Capital gains tax. (4 marks)

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

(i) Offset of the trading loss. (10 marks)

(ii) Further tax payments if the loss is carried forward.

Note: Ignore national insurance contributions and value added tax (VAT). (5 marks)

(c) Reporting of chargeable gains. (4 marks)

(d) Value added tax (VAT). (4 marks)

Professional marks will be awarded for the clarity of the calculations, analysis of the situation, the effectiveness with which the information is communicated, and the quality of the overall presentation. (4 marks)

(35 marks)

2 You have received an email with an attachment from your manager relating to a new client of your firm.

The attachment is a memorandum prepared by the client, Mr Stone, who owns the whole of the ordinary share capital of Bond Ltd. The email from your manager contains further information in relation to the Bond Ltd group of companies and sets out the work you are to perform. The attachment and the email are set out below.

Attachment – Memorandum from Mr Stone

Bond Ltd group of companies

Formation of the group

The Bond Ltd group consists of Bond Ltd, Ungar Ltd and Madison Ltd.

1 April 2012	I purchased the whole of the ordinary share capital of Bond Ltd.
1 December 2012	Bond Ltd purchased the whole of the ordinary share capital of Ungar Ltd.
1 October 2014	Madison Ltd was incorporated on 1 October 2014. Bond Ltd acquired 65% of the ordinary share capital of Madison Ltd on that date.

Bond Ltd – Results for the six months ended 30 September 2014

	£	Notes
Trading losses brought forward	(20,000)	1
Tax adjusted trading income for the period	470,000	2, 3
Chargeable gain	180,000	4

Notes

1. On 31 March 2012, Bond Ltd had trading losses to carry forward of £170,000. The company's total taxable trading income for the two years ended 31 March 2014 was only £150,000, such that on 31 March 2014 it had trading losses to carry forward of £20,000.
2. Bond Ltd's trade consists of baking and selling bread and other baked products. Up to 31 March 2014, its main product had always been low-cost bread which was sold to schools, hospitals and prisons. In April 2014, Bond Ltd introduced a new range of high quality breads and cakes. This new range is sold to supermarkets and independent retailers and, for the six months ended 30 September 2014 represents 65% of the company's turnover and 90% of its profits.
3. In order to produce the new product range, Bond Ltd invested £160,000 in plant and machinery in April 2014. The tax adjusted trading income is after deducting capital allowances of £160,000, i.e. 100% of the cost of the plant and machinery.

   The tax written down value brought forward on the company's main pool as at 1 April 2014 was zero and there were no other additions or disposals of plant and machinery in the period.
4. The chargeable gain arose on the sale of a plot of land on 1 May 2014 for proceeds of £350,000. The land had always been used in the company's business but was no longer required.

Ungar Ltd

The trade of Ungar Ltd consists of baking high quality cakes. Ungar Ltd trades from premises purchased on 1 July 2013 for £310,000.

Ungar Ltd also develops new baking processes and techniques which it has patented. It uses these processes and techniques itself and licenses the patents to other manufacturers.

Madison Ltd

Madison Ltd purchased a building for £400,000 (plus 20% value added tax (VAT)) and machinery for £300,000 (plus 20% VAT) and began to trade on 1 October 2014.

Madison Ltd is partially exempt for the purposes of VAT. In the year ending 30 September 2015, its VAT recovery percentage is expected to be 80%. However, I expect this percentage to fall slightly in future years.

Email from your manager

Additional information – Bond Ltd, Ungar Ltd and Madison Ltd are all resident in the UK. – Bond Ltd and Ungar Ltd had always prepared accounts to 31 March. However, in 2014 it was decided to change the group's year end to 30 September and accounts have been prepared for the six months ended 30 September 2014. – The original cost of the land sold by Bond Ltd on 1 May 2014 was £150,000. The chargeable gain of £180,000 is after the deduction of indexation allowance and is correct. Please carry out the following work: **(a) Corporation tax liability of Bond Ltd** Calculate the corporation tax liability of Bond Ltd for the six months ended 30 September 2014 based on the information provided by Mr Stone. You should review Mr Stone's capital allowances figure of £160,000 and assume the company will claim the maximum possible rollover relief. Include notes on the following matters. (i) The capital allowances available. (ii) The use of Bond Ltd's trading losses brought forward bearing in mind that Mr Stone only recently acquired the company. (iii) The availability of rollover relief in respect of the chargeable gain on the land. You should **ignore VAT** when carrying out this work. We will need to do further work in order to finalise this computation. In the meantime, make a note of any assumptions you have made in order to complete the computation as far as possible for now. **(b) Ungar Ltd – Patent box regime** State, giving reasons, whether or not the patent box regime is available to Ungar Ltd and briefly describe the operation of the regime. **(c) Madison Ltd – Recovery of input tax** Explain how much of the input tax in respect of the purchase of the building and machinery can be recovered by Madison Ltd in the year ending 30 September 2015 and how this may be adjusted in future years. Include an example of a possible adjustment in the year ending 30 September 2016. Tax manager

Required:

Carry out the work required as requested in the email from your manager. The following marks are available:

(a) Corporation tax liability of Bond Ltd.

Note: For guidance, approximately two-thirds of the available marks relate to the written notes. (17 marks)

(b) Ungar Ltd – Patent box regime. (4 marks)

(c) Madison Ltd – Recovery of input tax. (4 marks)

(25 marks)

Section B – TWO questions ONLY to be attempted

3 Your firm has been asked to provide advice in connection with inheritance tax and capital gains tax following the death of Cada. The advice relates to the implications of making lifetime gifts, making gifts to charity, varying the terms of a will and other aspects of capital gains tax planning.

Cada and her family:
- Cada, who was UK domiciled, died on 20 November 2014.
- Cada is survived by two daughters: Raymer and Yang.
- Raymer has an adult son.
- Yang has no children.

Cada – Lifetime gifts and available nil rate band:
- Cada had not made any lifetime gifts since 30 November 2010.
- Cada's nil rate band available at the date of her death was £220,000.

Cada's death estate and the details of her will:
- Cada owned assets valued at £1,000,000 at the time of her death.
- Cada left her house, valued at £500,000, to Raymer.
- Cada left cash of £60,000 to a UK national charity.
- Cada left her remaining assets (including a portfolio of shares) valued at £440,000, to Yang.
- None of the remaining assets qualified for any inheritance tax reliefs.

Raymer:
- Is not an accountant, but has some knowledge of the UK tax system.
- Has made four observations regarding her mother's estate and her inheritance.

Raymer's four observations:
- 'My mother should have made additional gifts in her lifetime.'
- 'The tax rate on the chargeable estate should be less than 40% due to the gift to charity.'
- 'I do not intend to live in the house but will give it to my son on 1 July 2015.'
- 'My mother paid capital gains tax every year. However, when she died, some of her shareholdings had a value of less than cost.'

Cada's shareholdings at the time of her death:
- Quoted shares in JW plc valued at more than cost.
- Quoted shares in FR plc valued at less than cost.
- Unquoted shares in KZ Ltd valued at £nil.

Required:

(a) Explain the inheritance tax advantages, other than lifetime exemptions, which could have been obtained if Cada had made additional lifetime gifts of quoted shares between 1 December 2010 and her death. (4 marks)

(b) Calculate the increase in the legacy to the charity which would be necessary in order for the reduced rate of inheritance tax to apply and quantify the reduction in the inheritance tax liability which would result. (5 marks)

(c) Explain the capital gains tax and inheritance tax advantages which could be obtained by varying the terms of Cada's will and set out the procedures required in order to achieve a tax-effective variation. (6 marks)

(d) In relation to capital gains tax, explain what beneficial actions Cada could have carried out in the tax year of her death in respect of her shareholdings. (5 marks)

(20 marks)

4 Your firm has been asked to provide advice to two unrelated clients, Piquet and Buraco. Piquet, an unincorporated sole trader, requires advice on a proposed change to the date to which he prepares his accounts. Buraco requires advice on his residence status and the remittance basis.

(a) Piquet:

- Began trading as an unincorporated sole trader on 1 January 2007.
- Has always prepared accounts to 31 October.
- Has overlap profits of £15,000 for a five-month overlap period.
- Is planning to change his accounting date to 28 February 2015.

Actual and budgeted tax adjusted trading profit of Piquet's business:

	Profit per month	Profit for the period
	£	£
Year ended 31 October 2013	4,500	54,000
16 months ending 28 February 2015	5,875	94,000
Year ending 28 February 2016	7,333	88,000
Year ending 28 February 2017	9,000	108,000

Alternative choice of accounting date:

- Piquet is also considering a year end of 30 April.
- To achieve this, Piquet would prepare accounts for the 18 months ending 30 April 2015 and annually thereafter.

Required:

(i) On the assumption that Piquet changes his accounting date to 28 February, state the date by which he should notify HM Revenue and Customs of the change, and calculate the taxable trading profit for each of the tax years 2014/15 and 2015/16. (3 marks)

(ii) On the assumption that Piquet changes his accounting date to 30 April, state the basis periods for the tax years 2014/15 and 2015/16 and the effect of this change on Piquet's overlap profits. (3 marks)

(iii) Identify and explain TWO advantages for Piquet of using a year end of 30 April rather than 28 February. (4 marks)

(b) Buraco's links with the country of Canasta:

- Buraco is domiciled in Canasta.
- Buraco owns a home in the country of Canasta.
- Buraco's only income is in respect of investment properties in Canasta.
- Buraco frequently buys and sells properties in Canasta.

Buraco's links with the UK:

- Buraco's ex-wife and their 12-year-old daughter moved to the UK on 1 May 2013.
- Buraco first visited the UK in the tax year 2013/14 but was not UK resident in that year.
- Buraco did not own a house in the UK until he purchased one on 6 April 2014.
- Buraco expects to live in the UK house for between 100 and 150 days in the tax year 2014/15.

Required:

(i) Explain why Buraco will not satisfy any of the automatic overseas residence tests for the tax year 2014/15, and, on the assumption that he does not satisfy any of the automatic UK residence tests, explain how his residence status will be determined for that tax year. (7 marks)

(ii) On the assumption that Buraco is resident in the UK in the tax year 2014/15, state the tax implications for him of claiming the remittance basis for that year and explain whether or not there would be a remittance basis charge. (3 marks)

(20 marks)

5 Klubb plc, a client of your firm, requires advice on the penalty in respect of the late filing of a corporation tax return, the establishment of an approved tax-efficient share scheme, and its shareholding in an overseas-resident company.

Klubb plc:
- Is a UK resident trading company.
- Has been charged a penalty in respect of the late filing of corporation tax returns.
- Intends to establish an approved tax-efficient share plan.
- Purchased 30% of the ordinary share capital of Hartz Co from Mr Deck on 1 April 2014.

Late filing of corporation tax returns:
- Klubb plc prepared accounts for the 16-month period ended 31 March 2013.
- The corporation tax returns for this period were filed on 31 May 2014.

Approved tax-efficient share plan:
- The plan will be either an approved share incentive plan (SIP) or an approved company share option plan (CSOP).
- If a SIP, the shares would be held within the plan for five years.
- If a SIP, members will not be permitted to reinvest dividends in order to purchase further shares.
- If a CSOP, the options would be exercised within five years of being granted.
- In both cases it can be assumed that the plan members would sell the shares immediately after acquiring them.

Klubb plc wants the share plan to be flexible in terms of:
- The employees who can be included in the plan.
- The number or value of shares which can be acquired by each plan member.

Hartz Co:
- Is resident in the country of Suta.
- Mr Deck continues to own 25% of the company's ordinary share capital.
- Kort Co, a company resident in the country of Suta, owns the remaining 45%.

Budgeted results of Hartz Co for the year ending 31 March 2015:
- Trading profits of £330,000.
- Chargeable gains of £70,000.
- All of Hartz Co's profits have been artificially diverted from the UK.
- Hartz Co will pay corporation tax at the rate of 11% in the country of Suta.
- Hartz Co will not pay a dividend for the year ending 31 March 2015.

Required:

(a) State the corporation tax returns required from Klubb plc in respect of the 16-month period ended 31 March 2013 and the due dates for filing them. Explain the penalties which may be charged in respect of the late filing of these returns. (4 marks)

(b) Compare and contrast an approved share incentive plan with an approved company share option plan in relation to:

- **the flexibility desired by Klubb plc regarding the employees included in the plan and the number or value of shares which can be acquired by each plan member; and**
- **the income tax and capital gains tax implications of acquiring and selling the shares under each plan.**

(9 marks)

(c) (i) Explain whether or not Hartz Co will be regarded as a controlled foreign company (CFC) for the year ending 31 March 2015 and the availability or otherwise of the low profits exemption. (4 marks)

(ii) On the assumption that Hartz Co is a CFC, and that no CFC exemptions are available, calculate the budgeted CFC charge for Klubb plc based on the budgeted results of Hartz Co for the year ending 31 March 2015. (3 marks)

(20 marks)

End of Question Paper