

Professional Level – Options Module

# Advanced Taxation (United Kingdom)

Friday 6 June 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

	£
<b>Personal allowance</b>	
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
<b>Income limit</b>	
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<sub>2</sub> emissions is 95 grams per kilometre.

The percentage rates applying to petrol cars with CO<sub>2</sub> 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**

	%
<b>Plant and machinery</b>	
Main pool	18
Special rate pool	8
<b>Motor cars</b>	
New cars with CO <sub>2</sub> emissions up to 95 grams per kilometre	100
CO <sub>2</sub> emissions between 96 and 130 grams per kilometre	18
CO <sub>2</sub> emissions over 130 grams per kilometre	8
<b>Annual investment allowance</b>	
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%
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**Section A – BOTH questions are compulsory and MUST be attempted**

- 1 Your manager has received a letter from Ziti. Ziti owns and runs an unincorporated business which was given to him by his father, Ravi. Extracts from the letter and from an email from your manager are set out below.

**Extract from the letter from Ziti**

I have decided that, due to my father's serious illness, I want to be able to look after him on a full-time basis. Accordingly, I am going to sell my business and use the proceeds to buy a house nearer to where he lives.

My father started the business in 1999 when he purchased the building referred to in the business assets below. He gave the business (consisting of the goodwill, the building and the equipment) to me on 1 July 2010 and we submitted a joint claim for gift relief, such that no capital gains tax was payable. I have no sources of income other than this business.

I have identified two possible methods of disposal.

- (i) My preferred approach would be to close the business down. I would do this by selling the building and the equipment on 31 January 2015 at which point I would cease trading.
- (ii) My father would like to see the business carry on after I sell it. For this to occur, I would have to continue trading until 30 April 2015 and then sell the business to someone who would continue to operate it.

In each case I would prepare accounts for the year ending 30 April 2014 and then to the date of cessation or disposal.

I attach an appendix setting out the information you requested in relation to the business.

Sadly, I have been told that my father is unlikely to live for more than three years. Please let me know whether his death could result in an inheritance tax liability for me in respect of the gift of the business.

My father's only lifetime gift, apart from the business given to me, was of quoted shares to a discretionary (relevant property) trust on 1 May 2006. The shares had a market value of £190,000 at the date of the gift and did not qualify for business property relief.

**Appendix**

**Business assets (all figures exclude value added tax (VAT))**

	<b>Goodwill</b>	<b>Building</b>	<b>Equipment</b>
	<b>£</b>	<b>£</b>	<b>£</b>
Original cost of the business assets	Nil	60,000	18,000
Market value at the time of my father's gift on 1 July 2010	40,000	300,000	9,000
Expected market value as at 31 January 2015 and 30 April 2015	40,000	330,000	10,000

**Financial position of the business**

The tax adjusted trading profits for the year ended 30 April 2013 were £55,000.

From 1 May 2013, it can be assumed that the business generates trading profits of £5,000 per month. The only tax adjustment required to this figure is in respect of capital allowances.

The tax written down value of the main pool as at 30 April 2013 was nil. I purchased business equipment for £6,000 on 1 August 2013. There have been no disposals of equipment since 30 April 2013.

Extract from an email from your manager

**Additional background information**

- Ziti was born in 1967.
- Ziti and Ravi are both resident and domiciled in the UK.
- Ziti has overlap profits from when he took over the business of £9,000.
- All of the equipment is moveable and no item has a cost or market value of more than £6,000.
- The business is registered for the purposes of VAT.
- No election has been made in respect of the building in relation to VAT.

Please prepare notes, which we can use in a meeting with Ziti, which address the following issues:

**(a) Sale of the business**

- (i)** Calculations to enable Ziti to compare the financial implications of the two possible methods of disposal.

You will need to calculate:

- Ziti's taxable trading profits from 1 May 2013 onwards and the income tax thereon; and
- any capital gains tax (CGT) payable.

You should include:

- explanations of the availability of any CGT reliefs;
- a summary of the post-tax cash position; and
- any necessary assumptions.

- (ii)** Explanations of whether or not VAT would need to be charged on either or both of the alternative disposals.

**(b) Inheritance tax**

Calculations of the amount of inheritance tax which would be payable by Ziti for all possible dates of his father's death between 7 June 2014 and 30 June 2017. You should include an explanation of the availability of any inheritance tax reliefs.

When calculating these potential inheritance tax liabilities you should assume that Ziti will sell the business on 30 April 2015.

The best way for you to approach this is to identify the particular dates on which the inheritance tax liability will change.

Tax manager

**Required:**

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

**(a) Sale of the business.**

- (i) Comparison of the financial implications of the alternative methods for disposing of the business.**

Note: Ignore national insurance contributions. (17 marks)

- (ii) Value added tax (VAT).** (5 marks)

**(b) Inheritance tax.** (9 marks)

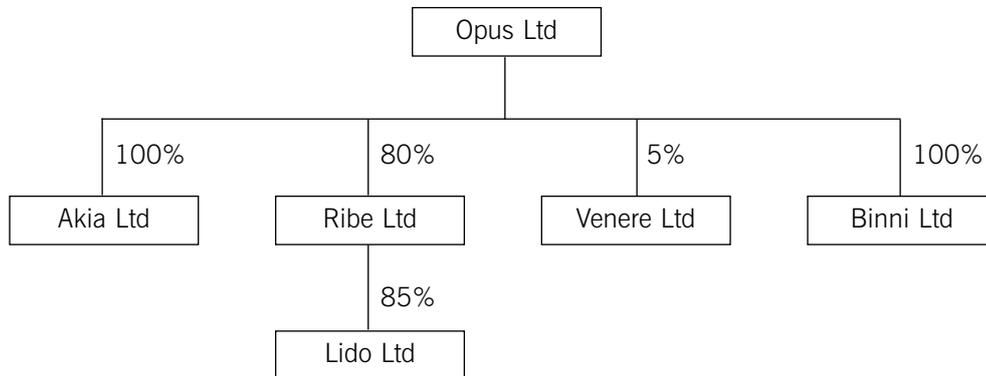
Professional marks will be awarded for adopting a logical approach to problem solving, the clarity of the calculations, the effectiveness with which the information is communicated, and the overall presentation of the notes. (4 marks)

**(35 marks)**

- 2 Your manager is due to attend a meeting with the finance director of Opus Ltd. A schedule of information obtained from the client files and an email from your manager in connection with the Opus Ltd group are set out below.

**Schedule of information**

**Opus Ltd – holdings in other companies as at 31 March 2014**



**Results for the period ended 31 March 2014**

	Opus Ltd £	Akia Ltd £	Ribe Ltd £	Lido Ltd £	Venere Ltd £	Binni Ltd £
Trading profit/(loss)	10,000	(93,000)	41,000	75,000	160,000	78,000
Property income	8,000	–	–	–	–	–
Chargeable gain	Note 3	6,000	–	21,000	–	–

**Notes**

**Holdings in other companies**

- All of the companies are UK resident trading companies.
- All of the companies, including Binni Ltd, have always paid corporation tax at the main rate due to a large number of overseas associated companies.
- Opus Ltd – acquisition of the holdings in other companies
  - Opus Ltd acquired Akia Ltd and the shareholding in Ribe Ltd (together with its subsidiary Lido Ltd) on 1 January 1999.
  - Venere Ltd has an issued share capital of 1,000,000 ordinary shares. Opus Ltd acquired 170,000 ordinary shares in Venere Ltd on 1 July 2004 for £65,000. It sold 120,000 of these shares on 1 October 2013 for £150,000. The indexation factor from July 2004 to October 2013 is 0.216.
  - Opus Ltd acquired Binni Ltd on 1 December 2013.
- The minority interests in Ribe Ltd and Lido Ltd are owned by individuals.
- Venere Ltd is a 75% subsidiary of Jarrah Ltd, a company with no connections to the Opus Ltd group.

**Results for the period ended 31 March 2014**

- All of the companies, with the exception of Binni Ltd, have prepared accounts for the year ended 31 March 2014. Binni Ltd has prepared accounts for the ten months ended 31 March 2014.
- Where necessary, the results shown above have been adjusted for tax purposes.
- Akia Ltd's trading loss includes writing down allowances in the main pool of £35,000.
- Akia Ltd is not expected to return to profitability for a number of years.
- Ribe Ltd has trading losses brought forward of £68,000 as at 1 April 2013.

## Email from your manager

Please carry out the following work in preparation for the Opus Ltd meeting.

### (a) Relieving the trading losses of Akia Ltd and Ribe Ltd

The objective of the group is to relieve all losses as soon as possible.

Prepare calculations, together with supporting explanations, to show how the group's objective can best be achieved, clearly identifying any losses to be carried forward as at 31 March 2014 and any further information which may need to be obtained.

There may be some interesting planning possibilities here; you should think carefully about the tax position of each company.

### (b) Sale of the shares in Venere Ltd

Opus Ltd has received an offer of £80,000 for its remaining 50,000 ordinary shares in Venere Ltd. If the sale were to go ahead, it would take place on 30 June 2014. However, the management of Opus Ltd are of the opinion that the results of Venere Ltd for the year ending 31 March 2015 will be such that the shares could be worth as much as £100,000 if the sale were to be delayed until 30 April 2015.

Set out the matters which the management of Opus Ltd should consider in order to decide on which of the two dates it would be more financially advantageous to sell the shares in Venere Ltd. When calculating the indexation allowance, use an approximate indexation factor of 0.400 for the period from 1 July 2004 until the date of sale.

### (c) Error in the corporation tax return of Binni Ltd

A detailed review of the results of Binni Ltd for the year ended 31 May 2012 has revealed that no adjustment was made in respect of an amount of disallowable expenditure. As a result of this, the company's corporation tax liability for the year was understated by £8,660. I have told the company that there may be interest and penalties in respect of this error.

Explain how the interest on the underpaid tax will be calculated and state the matters which would need to be considered if the company were unwilling to disclose the error to HM Revenue and Customs.

Tax manager

## Required:

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

(a) Relieving the trading losses of Akia Ltd and Ribe Ltd. (14 marks)

(b) Sale of the shares in Venere Ltd. (5 marks)

(c) Error in the corporation tax return of Binni Ltd.

Note: You are not required to calculate the amount of interest payable or to consider any penalty which may be charged. (6 marks)

**(25 marks)**

## Section B – TWO questions ONLY to be attempted

- 3 Your firm has been asked to provide advice to Pita plc in respect of providing employees with financial assistance with childcare and encouraging them to work from home, the establishment of an enterprise management incentive scheme, and a redundancy package provided to an employee.

### Pita plc:

- Is a UK resident company which trades in the UK and is quoted on the UK Stock Exchange.
- Has an issued share capital of 10,000,000 irredeemable £1 ordinary shares.
- Has gross assets of £24,000,000 and 180 employees.

### Issues – Pita plc:

- Intends to provide assistance with childcare to employees and to encourage them to work from home.
- Intends to establish an enterprise management incentive (EMI) scheme for nine key employees.
- Has provided a redundancy package to Narn, an employee.

### Financial assistance with childcare and encouraging working from home:

- Pita plc will provide employees with vouchers to purchase £42 of childcare per child per week.
- The vouchers will cost Pita plc 95 pence for each £1 of childcare purchased.
- Pita plc will pay employees an extra £3 per day when they work from home.
- The payments are intended to cover the additional household costs of working from home.

### The EMI scheme:

- The scheme would reward seven full-time and two part-time key employees.
- Each key employee will be granted an option to acquire 10,000 shares at £1.75 per share.
- The options will be exercised in six years' time when the shares are expected to be worth £5 each.
- An ordinary share in Pita plc is expected to be worth £2 when the options are granted.

### Redundancy package provided to Narn on 31 March 2014:

- Statutory redundancy of £8,100 paid on 31 March 2014.
- An additional payment of £26,000 made on 31 March 2014.
- Continued use of her company car until 30 September 2014.
- Pita plc paid £18,400 for Narn's diesel powered car; it had a list price of £19,500.
- The car has CO<sub>2</sub> emissions of 134 grams per kilometre.

### Required:

- (a) Explain whether or not the planned financial assistance with childcare and encouragement to work from home will give rise to taxable employment income for the employees. (6 marks)
- (b) (i) Explain, with reference to the information provided, whether or not Pita plc is a qualifying company for the purpose of the enterprise management incentive (EMI) scheme and if it is able to make the scheme available to just the nine key employees. (4 marks)
- (ii) On the assumption that an EMI scheme is established, explain the income tax and capital gains tax implications for the employees in respect of the grant and exercise of the options and the sale of the shares, including the availability of entrepreneurs' relief. (5 marks)
- (c) Explain, with supporting calculations, the taxable amounts arising in respect of the redundancy package provided to Narn. (5 marks)

**(20 marks)**

- 4 Kesme and Soba, a married couple, require advice on Kesme's taxable income and rent-a-room relief, the capital gain on a future sale of the family home, and the assets which will be received by Soba under Kesme's will.

**Kesme:**

- Was born on 1 June 1940.
- Is UK resident and UK domiciled.
- Is married to Soba.
- Has not made any lifetime gifts for the purposes of inheritance tax.

**Soba:**

- Is UK resident but non-UK domiciled.
- Has elected to be treated as UK domiciled for the purposes of inheritance tax.

**Kesme's income for the tax year 2013/14:**

- State retirement pension of £7,900 (gross).
- A pension from a former employer of £24,100 (gross).
- Rental income in respect of furnished rooms in the family home.
- Interest in respect of 8% loan stock in Ramen plc.

**Rental income in respect of furnished rooms in the family home:**

- Kesme and Soba purchased the family home on 1 July 1990 and have lived there since that date.
- Three furnished rooms have been rented out to an individual tenant since 6 April 2013.
- The tenant does not share Kesme and Soba's living accommodation or take meals with them.
- The three rooms represent 30% of the property.
- The annual rent is £14,400 and there are allowable expenses of £1,600 per year.

**8% loan stock in Ramen plc:**

- Kesme purchased £18,000 of 8% loan stock on 1 May 2007.
- Interest is payable on 31 May and 30 November annually.
- Kesme sold the 8% loan stock on 30 September 2013 cum interest.

**Kesme's estate and his will:**

- Kesme's share of the family home, a plot of land and chattels are worth £1,280,000 in total.
- The plot of land is worth £370,000 and is situated in the UK.
- Kesme has left the plot of land to his daughter.
- Kesme has left the residue of his estate to his wife, Soba.

**Required:**

- (a) Explain the availability and operation of rent-a-room relief in relation to Kesme and calculate his taxable income for the tax year 2013/14 on the assumption that the relief is claimed. (8 marks)
- (b) Explain the effect of renting out the furnished rooms on the amount of the taxable capital gain on a future sale of the family home. (6 marks)
- (c) Explain the implications of the election made by Soba to be treated as UK domiciled for the purposes of inheritance tax, and calculate the value of the residue of the estate which she would receive under Kesme's will if he were to die on 6 June 2014. (6 marks)

**(20 marks)**

- 5 Charlotte is the owner of Bamburg Ltd. She requires advice on the value added tax (VAT) flat rate scheme, the sale of a substantial item of machinery, and the alternative methods by which she can extract additional funds from the company.

**Charlotte:**

- Is UK resident and UK domiciled.
- Owns 100% of the ordinary share capital of Bamburg Ltd.
- Earns an annual salary from Bamburg Ltd of £46,000 and has no other income.
- Has two ideas to generate additional cash in Bamburg Ltd.
- Wants to receive an additional £14,000 (after the payment of all personal taxes) from Bamburg Ltd on 30 June 2014.

**Bamburg Ltd:**

- Is a UK resident trading company which pays corporation tax at the small profits rate.
- Is registered for VAT.
- Has budgeted sales revenue for the year ending 31 March 2015 of £120,000 excluding VAT.
- Makes wholly standard rated supplies apart from £6,000 of exempt supplies.
- Has a nil tax written down value on its main pool as at 31 March 2014.
- Will not purchase any plant and machinery in the year ending 31 March 2015.

**Charlotte's ideas to generate additional cash in Bamburg Ltd:**

- 'Bamburg Ltd should join the VAT flat rate scheme in order to save money.'
- 'Bamburg Ltd should sell the 'Cara' machine and offset the resulting loss against its profits.'

**The 'Cara' machine:**

- Was purchased on 1 January 2012 for £94,000.
- Rollover relief was claimed in respect of this purchase to defer a chargeable gain of £13,000.
- The 'Cara' machine is currently worth £80,000.
- Following the sale of the 'Cara' machine, Bamburg Ltd will rent a replacement machine.

**Alternative methods of extracting an additional £14,000 from Bamburg Ltd:**

- Bamburg Ltd to pay Charlotte a bonus.
- Bamburg Ltd to pay Charlotte a dividend.
- Bamburg Ltd to make an interest-free loan of £14,000 to Charlotte.

**Required:**

- (a) Explain, with reference to the information provided, whether or not Bamburg Ltd would be permitted to join the value added tax (VAT) flat rate scheme and set out the matters which would need to be considered in order to determine whether or not it would be financially beneficial for the company to do so. (5 marks)
- (b) Explain the tax and financial implications of Bamburg Ltd selling the 'Cara' machine during the year ending 31 March 2015. (5 marks)
- (c) (i) Prepare calculations to determine whether it would be cheaper for Bamburg Ltd to pay Charlotte a bonus or a dividend, such that she would receive £14,000 after the payment of all personal taxes. (5 marks)
- (ii) Explain the immediate tax implications for Bamburg Ltd and Charlotte of Bamburg Ltd making an interest-free loan of £14,000 to Charlotte. (5 marks)

**(20 marks)**

**End of Question Paper**