Professional Level – Options Module

Advanced Taxation (United Kingdom)

Friday 5 June 2015

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 2014/15 and for the financial year to 31 March 2015 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 – £31,865	20%	10%
Higher rate	£31,866 to £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 £2,880 of taxable income.

Personal allowances

Personal allowance	
Born on or after 6 April 1948	£10,000
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)	£27,000

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	11%
95 grams per kilometre	12%

Car fuel benefit

The base figure for calculating the car fuel benefit is £21,700.

New individual savings accounts (NISAs)

The overall investment limit is £15,000.

Pension scheme limits

Annual allowance – 2014/15	£40,000
– 2011/12 to 2013/14	£50,000
Lifetime allowance	£1,250,000
The 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

Rate of allowance	100%
Expenditure limit	£500,000

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	2012	2013	2014
Small profits rate	20%	20%	20%
Main rate	24%	23%	21%
Lower limit	£300,000	£300,000	£300,000
Upper limit	£1,500,000	£1,500,000	£1,500,000
Standard fraction	1/100	3/400	1/400

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	£81,000
Deregistration limit	£79,000

Inheritance tax: nil rate bands and tax rates

	£	
6 April 2014 to 5 April 2015	325,000	
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	
Rate of tax on excess over nil rate band	– Lifetime rate	20%
	– Death rate	40%

Inheritance tax: taper relief

Years before death	Percentage 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

Rates of tax – Lower rate	18%
– Higher rate	28%
Annual exempt amount	£11,000
Entrepreneurs' relief – Lifetime limit	£10,000,000
– Rate of tax	10%

National insurance contributions
(Not contracted out rates)

Class 1	Employee	£1 – £7,956 per year	Nil
		£7,957 – £41,865 per year	12%
		£41,866 and above per year	2%
Class 1	Employer	£1 – £7,956 per year	Nil
		£7,957 and above per year	13·8%
		Employment allowance	£2,000
Class 1A			13·8%
Class 2		£2·75 per week	
		Small earnings exception limit	£5,885
Class 4		£1 – £7,956 per year	Nil
		£7,957 – £41,865 per year	9%
		£41,866 and above per year	2%

Rates of interest (assumed)

Official rate of interest	3·25%
Rate of interest on underpaid tax	3%
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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Question 1 begins on page 7.

Section A – BOTH questions are compulsory and MUST be attempted

1 Your manager has received a letter from Jodie in connection with her proposed emigration from the UK. Extracts from the letter and from an email from your manager are set out below.

Extract from the letter from Jodie

I was born in 1975 and I have always lived in the UK. I plan to leave the UK and move to the country of Riviera on 5 April 2016. My intention is to move to Riviera permanently and acquire a new home there. However, if my children are not happy there after four years, we will return to the UK.

My husband died three years ago. My brother lives in Riviera and is the only close family I have apart from my children. I will not have any sources of income in the UK after 5 April 2016.

I intend to work part-time in Riviera so that I can look after my children. In the tax year 2016/17, I will return to the UK for a holiday and stay with friends for 60 days; for the rest of the tax year I will live in my new home in Riviera.

My unincorporated business

I prepared accounts to 31 December every year until 31 December 2014. I then ceased trading on 31 May 2015. I made a tax adjusted trading loss in my final period of trading of £18,000.

I was unable to sell my business as a going concern due to the decline in its profitability. Accordingly, on 31 May 2015 I sold my business premises for £190,000. I paid £135,000 for these premises on 1 June 2002. I also sold various items of computer equipment, which I had used in my business, for a total of £2,000. This equipment cost me a total of £5,000. I retained the remaining inventory, valued at £3,500, for my own personal use.

My taxable income for the last five tax years is set out below. There is no property income in the 2015/16 tax year because I sold my rental property in May 2014.

	2011/12	2012/13	2013/14	2014/15	2015/16
	£	£	£	£	£
Trading income	64,000	67,000	2,000	3,000	Nil
Property income	15,000	13,000	14,000	2,500	Nil
Bank interest	2,000	2,000	3,000	3,500	8,000 (est.)

Other matters

On 30 April 2015 I sold my house, which is built on a one hectare plot, for £400,000. I purchased the house for £140,000 in March 1994 and lived in it throughout my period of ownership. I have been living in a rented house in the UK since 1 May 2015. My tenancy of this rented house will end on 5 April 2016.

When we spoke, you mentioned that you wanted details of any gifts I have received. The only item of significance is 2,000 ordinary shares in Butterfly Ltd which my mother gave to me on 14 May 2013 when the shares were worth £60,000. Butterfly Ltd is a UK resident trading company.

My mother and I submitted a joint claim for capital gains tax holdover relief on the gift of these Butterfly Ltd shares, such that no capital gains tax was payable. I recently received an offer of £68,000 for these shares, but I decided not to sell them. My mother had inherited the shares from her brother on 18 December 2001 when they were worth £37,000. Neither I nor my mother have ever worked for Butterfly Ltd.

Extract from an email from your manager

Additional information

- Jodie's business has always been registered for the purposes of value added tax (VAT). The sales proceeds in respect of the business assets are stated net of VAT.
- Jodie has overlap profits from the commencement of her business of £6,500.

Please prepare paragraphs for inclusion in a letter from me to Jodie addressing the following issues.

(a) UK tax residence status and liability to UK income tax

- Assuming Jodie leaves the UK in accordance with her plans, explain how her residence status for the tax year 2016/17 will be determined and conclude on her likely residence status for that year. To help, I have already concluded that Jodie will **not** be regarded as non-UK resident using the automatic overseas tests so there is no need to consider these tests.
- State how becoming non-UK resident will affect Jodie's liability to UK income tax.

(b) Relief available in respect of the trading loss

- Calculate the income tax relief which Jodie would obtain if she were to claim terminal loss relief in respect of her trading loss. You should **not** consider any other ways in which the loss could be relieved.
- There is no need to calculate Jodie's tax liabilities for each of the years concerned; just calculate the tax which will be saved due to the offset of the loss and explain how you have determined this figure.

(c) Capital gains tax

Assuming that Jodie becomes non-UK resident from 6 April 2016 and does not return to the UK for at least four tax years:

- explain how this will affect her liability to UK capital gains tax in the tax year 2016/17 and future years, and in 2015/16 (the tax year prior to departure); and
- calculate her capital gains tax liability for the tax year 2015/16. You should include explanations of the chargeable gains which have arisen or may arise in that year and the tax rate(s) which will be charged.

(d) Other matters

- Explain how leaving the UK will affect the UK inheritance tax liability on any gifts Jodie may make in the future.
- Explain the matters which Jodie should be aware of in relation to VAT in respect of the cessation of her business. I have already checked that Jodie charged the correct amount of VAT when she sold the business premises and the computer equipment.

Tax manager

Required:

Prepare the paragraphs for inclusion in a letter from your manager to Jodie as requested in the email from your manager. The following marks are available:

(a) UK tax residence status and liability to UK income tax. (7 marks)

(b) Relief available in respect of the trading loss. (8 marks)

(c) Capital gains tax. (11 marks)

(d) Other matters. (5 marks)

Professional marks will be awarded for following the manager's instructions, the clarity of the explanations and calculations, the effectiveness with which the information is communicated, and the overall presentation.

(4 marks)

Notes
1. You should assume that the tax rates and allowances for the tax year 2014/15 apply to all tax years.
2. Ignore national insurance contributions throughout this question.

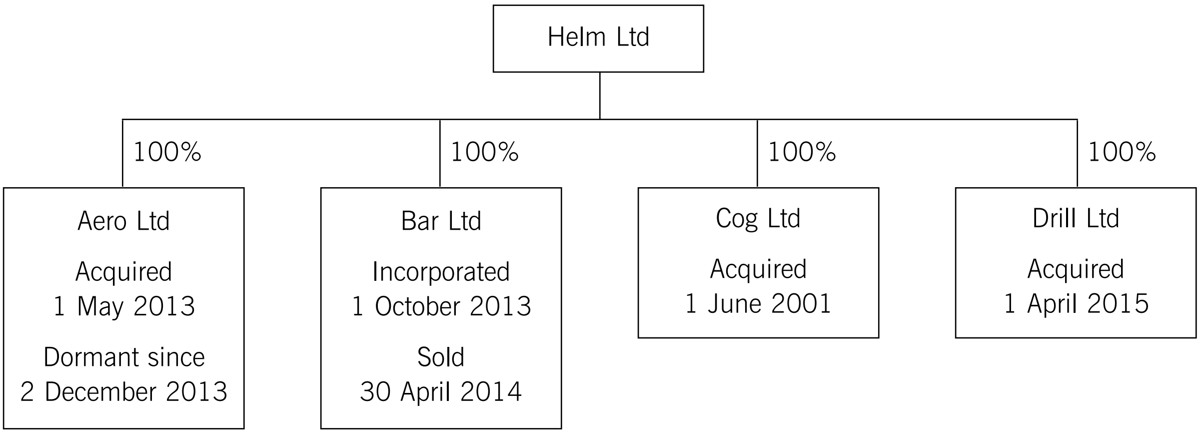
(35 marks)

2 Your manager has had a number of telephone conversations with Gomez, a potential new client. Gomez owns the whole of the ordinary share capital of Helm Ltd. Extracts from the memorandum prepared by your manager setting out the matters discussed and an email from your manager in connection with the Helm Ltd group are set out below.

Extracts from the memorandum

Helm Ltd

The past and present members of the Helm Ltd group are set out below.



Year ended 31 March 2015

Sale of Bar Ltd

The whole of the ordinary share capital of Bar Ltd was sold to an unconnected party on 30 April 2014 for £1,200,000. Bar Ltd was incorporated on 1 October 2013, when Helm Ltd subscribed £1,000,000 for 200,000 ordinary shares.

Bar Ltd was formed to purchase the entire trade and assets of Aero Ltd for £1,000,000. This purchase occurred on 1 December 2013. The assets consisted of a building valued at £830,000, inventory and receivables. The building had cost Aero Ltd £425,000 on 1 July 1994 and was valued at £880,000 on 30 April 2014 when it was still owned by Bar Ltd.

Year ending 31 March 2016

Purchase of Drill Ltd

Helm Ltd purchased the whole of the ordinary share capital of Drill Ltd on 1 April 2015. Drill Ltd has capital losses to carry forward as at 31 March 2015 of £74,000.

The business of Drill Ltd is to be expanded in the year ending 31 March 2016.

– Drill Ltd intends to borrow £1,350,000 in order to finance the purchase of a building and to provide additional working capital. Drill Ltd will be required to pay an arrangement fee of £35,000 in order to obtain this loan.
– The building will cost Drill Ltd £1,200,000. To begin with, this building will be larger than Drill Ltd requires. One quarter of the building will be rented out to a third party until Drill Ltd needs the additional space.

Cog Ltd

On 1 May 2015, Cog Ltd sold a warehouse for £470,000. Cog Ltd had owned the warehouse for almost two years and had rented it to a tenant throughout this period. Cog Ltd had always intended to bring the warehouse into use in its trade at some point in the future, but before this could happen, it sold the warehouse and realised a chargeable gain of £82,000.

Email from your manager

Additional information

1. All of the companies are UK resident trading companies.
2. All of the companies are profitable and prepare accounts to 31 March each year.

Please carry out the following work in preparation for a meeting with Gomez.

(a) Sale of Bar Ltd

- Calculate the chargeable gain resulting from the sale of the shareholding in Bar Ltd assuming the substantial shareholding exemption is not available. Explain any significant matter(s) which affect this calculation.
- Explain whether or not the substantial shareholding exemption will be available.
- Explain the implications of the sale in relation to stamp duty land tax.

(b) Drill Ltd

Explain how tax relief may be obtained in respect of the arrangement fee and the interest payable on the loan of £1,350,000 (you should be aware that Drill Ltd receives less than £50 of interest income each year).

(c) Cog Ltd – chargeable gain on the sale of the warehouse

Explain:

- whether or not the chargeable gain on the sale of the warehouse can be relieved by rollover relief; and
- how Drill Ltd's capital losses can be relieved; in particular, whether or not they can be offset against the chargeable gain made on the sale of the warehouse by Cog Ltd.

(d) Becoming tax advisers to Gomez and the Helm Ltd group of companies

Prepare a summary of the information we require, and any actions which we should take before we agree to become tax advisers to Gomez and the Helm Ltd group of companies.

Tax manager

Required:

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

(a) Sale of Bar Ltd. (11 marks)

Note: The following figures from the Retail Prices Index should be used, where necessary.

July 1994	144·0
October 2013	251·9
December 2013	253·4
April 2014	255·7

(b) Drill Ltd. (5 marks)

(c) Cog Ltd – chargeable gain on the sale of the warehouse. (4 marks)

(d) Becoming tax advisers to Gomez and the Helm Ltd group of companies. (5 marks)

(25 marks)

Section B – TWO questions ONLY to be attempted

3 Nocturne Ltd, a partially exempt company for the purposes of value added tax (VAT), requires advice on the corporation tax implications of providing an asset to one of its shareholders; the income tax implications for another shareholder of making a loan to the company; and simplifying the way in which it accounts for VAT.

Nocturne Ltd:

– Is a UK resident trading company.
– Prepares accounts to 31 March annually and expects to pay corporation tax at the rate of 20%.
– Has four shareholders, each of whom owns 25% of the company's ordinary share capital.
– Owns a laptop computer, which it purchased in October 2012 for £1,200, and which has a current market value of £150.
– Has purchased no other plant and machinery for several years and the tax written down value of its main pool at 31 March 2015 was £nil.

Provision of a laptop computer to one of Nocturne Ltd's shareholders:

– Nocturne Ltd is considering two alternative ways of providing a laptop computer in the year ending 31 March 2016 for the personal use of one of its shareholders, Jed.
– Jed is neither a director nor an employee of Nocturne Ltd.
– Option1: Nocturne Ltd will buy a new laptop computer for £1,800 and give it immediately to Jed.
– Option 2: Nocturne Ltd will gift its existing laptop to Jed and will purchase a replacement for use in the company for £1,800.

Loan from Siglio:

– Siglio will loan £60,000 to Nocturne Ltd on 1 October 2015 to facilitate the purchase of new equipment.
– Siglio is both a shareholder of Nocturne Ltd and the company's managing director.
– Nocturne Ltd will pay interest at a commercial rate on the loan from Siglio.
– Siglio will borrow the full amount of the loan from his bank on normal commercial terms.

VAT – partial exemption:

– Nocturne Ltd is partially exempt for the purposes of VAT.
– Nocturne Ltd's turnover for the year ended 31 March 2015 was £240,000 (VAT exclusive).
– Nocturne Ltd's turnover for the year as a whole for VAT purposes comprised 86% taxable supplies and 14% exempt supplies.
– The input VAT suffered by Nocturne Ltd on expenditure during the year ended 31 March 2015 was:

	£
Wholly attributable to taxable supplies	7,920
Wholly attributable to exempt supplies	1,062
Unattributable	4,150

– Nocturne Ltd expects its turnover and expenditure figures to increase by approximately 25% next year.
– Siglio has heard about an annual test for computing the amount of recoverable input VAT during an accounting period and would like more information about this.

Required:

(a) Explain, with the aid of supporting calculations, which of the two proposed methods of providing the laptop computer to Jed would result in the lower after-tax cost for Nocturne Ltd.

Note: You should ignore value added tax (VAT) for part (a) of this question. (7 marks)

(b) Explain the income tax implications for Siglio of providing the loan to Nocturne Ltd. (4 marks)

(c) (i) Determine, by reference to the *de minimis* tests 1 and 2, Nocturne Ltd's recoverable input VAT for the year ended 31 March 2015. (4 marks)

(ii) Advise Siglio of Nocturne Ltd's eligibility for the annual test for computing the amount of recoverable input VAT for the year ending 31 March 2016 and the potential benefits to be gained from its use. (5 marks)

(20 marks)

4 King, a wealthy client of your firm with a significant property portfolio, requires advice on the sale of some unquoted shares and on the capital gains tax and inheritance tax implications of transferring assets to a trust and to his two children.

King:
- Is resident and domiciled in the UK.
- Is an additional rate taxpayer.
- Has used his capital gains tax annual exempt amount for the tax year 2015/16.
- Has made one previous lifetime gift of £25,000 to his daughter, Florentyna, on 1 June 2014.
- It should be assumed that King will die on 1 May 2017.

King's family:
- King's daughter, Florentyna, is 34 years old and has two young children.
- Florentyna will have income from part-time employment of £10,000 in the tax year 2015/16. This is her only source of taxable income.
- King's son, Axel, is 40 years old and has an 18-year-old daughter, who is a university student.

King's plans:
- On 1 September 2015, King will sell some of his shares in Wye Ltd.
- On 1 October 2015, King will put a cottage he owns in Newtown and the after-tax cash proceeds from the sale of the shares in Wye Ltd into an interest in possession trust for Florentyna and her children.
- On 1 March 2016, King will gift his share of a flat in Unicity to Axel.

Sale of shares in Wye Ltd:
- Wye Ltd is an unquoted investment company.
- King acquired 5,000 shares in Wye Ltd on 1 June 2002 at a cost of £5 each.
- These shares will be worth £45 each on 1 September 2015.
- King will sell sufficient shares to generate after-tax proceeds of £30,000.

Cottage in Newtown:
- This property is wholly owned by King.
- It is expected to have a value of £315,000 on 1 October 2015.

Creation of the interest in possession trust:
- King will pay any inheritance tax arising as a result of the gifts made to the trust.
- Florentyna will be the life tenant and her two young children will be the remaindermen of the trust.
- Florentyna will live in the cottage in Newtown and the trustees will invest the cash in quoted shares which will generate annual dividends of £3,000.

Flat in Unicity:
- The flat in Unicity is jointly owned by King and his wife, Joy, in the proportions: King 75% and Joy 25%.
- King and Joy have recently signed a contract with Axel's daughter to rent the flat to her for three years starting on 1 September 2015.
- The rental agreement is on a commercial basis.
- King has obtained the following expected valuations for the flat as at 1 March 2016:

	With vacant possession £	Without vacant possession £
Value of a 25% share	60,000	40,000
Value of a 75% share	220,000	160,000
Value of the whole property	340,000	250,000

Required:

(a) Calculate the minimum number of shares in Wye Ltd which King must sell to generate after-tax proceeds of £30,000. (3 marks)

(b) (i) Advise King, with the aid of supporting calculations, of the capital gains tax and immediate inheritance tax implications of the proposed gift of assets into the interest in possession trust on 1 October 2015. (6 marks)

(ii) Explain how Florentyna will be taxed on the income arising in the trust and calculate the additional income tax, if any, payable by her in respect of this income for the tax year 2015/16. (4 marks)

(c) Explain, with the aid of supporting calculations, why the disposal of the flat in Unicity may be caught by the associated operations rules and the increase in the inheritance tax liability which would arise on King's death on 1 May 2017 if these rules were to apply. (7 marks)

(20 marks)

5 Cate requires advice on the after-tax cost of taking on a part-time employee and the tax implications of starting to sell items via the internet. Cate's husband, Ravi, requires advice in relation to capital gains tax on the disposal of an overseas asset.

Cate:

– Is resident and domiciled in the UK. She is aged 48.
– Is married to Ravi.
– Runs a successful unincorporated business, D-Designs.
– Receives dividends of £27,000 each year.
– Wants to sell some second-hand books online.

D-Designs business:

– Was set up by Cate in 2008.
– Is now making a taxable profit of £90,000 per annum.
– Operates a number of dress shops and already employs six full-time staff.
– Requires an additional part-time employee.

Part-time employee – proposed remuneration package:

– Salary of £12,000 per annum.
– Qualifying childcare vouchers of £25 per week for 52 weeks a year.
– Mileage allowance of 50 pence per mile for the 62-mile round trip required each week to redistribute stock between the shops. This will be for 48 weeks in the year.
– This employment will be the employee's only source of taxable income.

Sale of second-hand books:

– Cate inherited a collection of books from her mother in December 2013.
– Cate intends to sell these books via the internet.
– Some of the books are in a damaged state and Cate will get them rebound before selling them.

Ravi:

– Is domiciled in the country of Goland.
– Has been resident in the UK since his marriage to Cate in February 2007.
– Has UK taxable income of £125,000 in the tax year 2014/15.
– Realises chargeable gains each year from disposals of UK assets equal to the capital gains tax annual exempt amount.
– Sold an investment property in Goland in February 2015 for £130,000, realising a chargeable gain of £70,000. None of the proceeds from the sale of this property have been remitted to the UK.

Required:

(a) Calculate the annual cost for Cate, after income tax and national insurance contributions, of D-Designs employing the part-time employee. (9 marks)

(b) Discuss whether the profit from Cate's proposed sale of books via the internet will be liable to either income tax or capital gains tax. (5 marks)

(c) Advise Ravi on the options available to him for calculating his UK capital gains tax liability for the tax year 2014/15. Provide supporting calculations of the tax payable by him in each case. (6 marks)

(20 marks)

End of Question Paper