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# Answers

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1 (a) Report to Mr Daube

Prepared by A. N. Taxadviser  
Date 6 December 2010  
Subject Various corporate matters as requested

(i) Sale of Shank Ltd

Use of trading losses

Losses carried forward as at 31 March 2010

The losses carried forward as at 31 March 2010 of £35,000 can only be carried forward for offset against future trading profits of the same trade of Shank Ltd. However, it will not be possible to relieve the losses after 1 February 2011 (the date on which the company is to be sold) if there is a major change in the nature or conduct of the company's trade in the three years after the change of ownership. Such a change would include a major change to the property dealt in, the services provided, customers or markets. Mr Daube would appear to be of the opinion that such changes will be necessary in order for the company to become profitable.

Current period losses

Part of the trading loss for the year ending 31 March 2011 can be surrendered to the other members of the Hock Ltd group (but not to Knuckle Ltd as, although it is owned by Mr Daube, it is not a member of the Hock Ltd group relief group). The loss that can be surrendered is restricted to the amount accruing during the period in which Shank Ltd and the recipient company are members of the same group relief group.

For the purposes of group relief, Shank Ltd will be regarded as having left the group on the day on which arrangements were entered into for it to leave. Such arrangements will be regarded as existing once an offer for sale has been accepted even if it remains subject to contract. Accordingly, Shank Ltd will be treated as leaving the group on 1 November 2010 at the latest.

Shank Ltd will be in the same group as Hock Ltd and Rump Ltd for the period from 1 April 2010 until 31 October 2010 (at the latest). Accordingly, £31,500 ( $7/12 \times £54,000$ ) of the loss is available for group relief to Hock Ltd and Rump Ltd.

Shank Ltd will be in the same group as Brisket Ltd for the period from 1 May 2010 until 31 October 2010 (at the latest). Accordingly, £27,000 ( $6/12 \times £54,000$ ) of the loss is available for group relief to Brisket Ltd.

The maximum loss that can be surrendered to any company is that company's profits chargeable to corporation tax for the corresponding period. Any loss not surrendered as group relief will be carried forward by Shank Ltd for offset against future trading profits of the same trade subject to the same restrictions as set out above.

Loss arising on the sale of Shank Ltd

The substantial shareholding exemption will apply to the sale of Shank Ltd such that the loss will not give rise to any tax relief. The substantial shareholding exemption will apply because both Hock Ltd and Shank Ltd are trading companies and Hock Ltd has owned at least 10% of Shank Ltd for the 12 months prior to the date of sale.

Upper and lower limits when calculating corporation tax

The companies in the Hock Ltd group and Knuckle Ltd are all associated with each other because they are all controlled by the same person, i.e. Mr Daube. For the year ending 31 March 2011 Shank Ltd and Brisket Ltd will be included because they will have been associated with the other companies at some time in the accounting period. Accordingly, the upper and lower limits for Hock Ltd, Rump Ltd and Knuckle Ltd, for the purposes of calculating the rate of corporation tax will be £300,000 and £60,000 respectively (i.e. the full limits of £1,500,000 and £300,000 divided by 5).

Shank Ltd may also be associated with additional companies relating to its new owner.

Brisket Ltd may also be associated with additional companies relating to its previous owner.

The upper and lower limits will be compared to the companies' 'profits' in order to determine the rates of corporation tax payable.

(ii) Sales of buildings

Gar building

On 1 January 2011 Shank Ltd and Hock Ltd will still be members of a capital gains group. Accordingly, the Gar building will be automatically transferred at no gain, no loss such that no chargeable gain will arise on the sale.

*Tutorial note*

*The rules concerning capital gains groups do not include anything equivalent to the arrangements rule that applies in respect of group relief.*

### Cray building – chargeable gain

	£
Proceeds	420,000
Less: Cost	(240,000)
Indexation allowance (£240,000 x 0.250)	(60,000)
Chargeable gain	<u>120,000</u>

### Monk building

	£
Proceeds	290,000
Less: Cost	(380,000)
Allowable loss	<u>(90,000)</u>

The allowable loss on the sale of the Monk building cannot be increased by indexation allowance.

There are restrictions on the use of the proportion of the loss that accrued prior to Brisket Ltd joining the Hock Ltd group. This 'pre-entry' element of the loss can only be offset against chargeable gains arising on assets:

- sold by Brisket Ltd in the year ending 31 March 2011 before it joined the Hock Ltd group; or
- acquired by Brisket Ltd before it joined the Hock Ltd group; or
- acquired by Brisket Ltd for use in its trade after it joined the Hock Ltd group from persons other than members of the Hock Ltd group.

The whole or part of the remainder of the loss, the 'post-entry' element, can be transferred to other members of the Hock Ltd capital gains group (i.e. not Knuckle Ltd). The amount transferred can then be offset against the recipient company's chargeable gains in the year ending 31 March 2011 or future years. Alternatively, it can be carried forward for offset against any future chargeable gains of Brisket Ltd.

The pre-entry element of the loss is calculated on a time-apportionment basis. Brisket Ltd will have owned the building for 40 months before it joined the Hock Ltd group (1 January 2007 to 1 May 2010) out of a total period of ownership of 50 months (1 January 2007 to 1 March 2011).

	£
Pre-entry element (£90,000 x 40/50)	72,000
Post-entry element (balance)	18,000
Allowable loss	<u>90,000</u>

The pre-entry element of the loss can also be calculated as if the building had been sold for its market value on 1 May 2010, the day Brisket Ltd joined the Hock Ltd group, if this is more beneficial. Bearing in mind that it is advantageous for the pre-entry element to be as low as possible, the company would only elect to calculate the pre-entry loss in this manner if the market value of the building as at 1 May 2010 was more than £308,000 (£380,000 – £72,000).

### Sword building

The gain on the sale of the Sword building will be calculated as follows:

	£
Proceeds	460,000
Less: Cost (note 1)	(210,000)
	250,000
Indexation allowance from January 2001 to February 2011 (£210,000 x 0.480)	(100,800)
Chargeable gain	<u>149,200</u>

#### Notes

##### 1. Cost

	£
Original cost	255,000
Less: Rollover relief (note 2)	(45,000)
	<u>210,000</u>

##### 2. Rollover relief

	£
Gain on sale of the Pilot building	60,000
Sales proceeds not reinvested in the Sword building (£270,000 – £255,000)	(15,000)
Rollover relief claimed	<u>45,000</u>

### Value added tax (VAT)

VAT should only be charged on commercial buildings that are less than three years old or where an option to tax election has been made in respect of the building. No VAT should be charged on the sale of the Gar building if Shank Ltd and Hock Ltd are members of a VAT group.

### Stamp duty land tax

No stamp duty land tax will be payable in respect of the sale of the Gar building because Shank Ltd is a 75% subsidiary of Hock Ltd. The sales prices of the other buildings are all between £250,000 and £500,000. Accordingly, the purchasers will be required to pay stamp duty land tax at the rate of 3%.

#### *Tutorial note*

*Relief from stamp duty land tax is not available if there are arrangements in place for a non-associated person to acquire control of the transferee. In this case Shank Ltd is the transferor, not the transferee, therefore the relief will be available.*

### (iii) Potential sales by Knuckle Ltd to overseas customers – VAT implications

#### Customers situated outside the European Union (EU)

Supplies of goods to customers situated in countries outside the EU will be zero rated. Knuckle Ltd will need to retain documentary evidence of the export.

#### Customers situated within the EU

Supplies of goods to customers within the EU will be zero rated provided:

- The customer is registered for the purposes of VAT.
- Knuckle Ltd includes the customer's VAT number on the invoice.
- Knuckle Ltd retains evidence that the goods have been delivered to another EU member state.

Supplies of goods to customers within the EU who are not VAT registered will be subject to VAT in the same way as supplies to UK customers.

If Knuckle Ltd's supplies to non-VAT registered customers in a particular EU country exceed the relevant limit for that country, it will have to register for VAT in that country.

Knuckle Ltd will not charge any VAT on its zero rated supplies but, because the supplies are taxable supplies, it will still be able to recover all of its input tax.

### (b) Becoming tax advisers to Mr Daube and his companies

Information needed:

- Evidence of Mr Daube's identity (passport for example) and address.
- Proof of incorporation and primary business address and registered office of each company.
- The structure, directors and shareholders of the companies.
- The identities of those persons instructing the firm on behalf of the companies and those persons that are authorised to do so.

Action to take:

- Consider whether becoming tax advisers to Mr Daube and the companies would create any threats to compliance with the fundamental principles of professional ethics, for example integrity and professional competence. Where such threats exist the appointment should not be accepted unless the threats can be reduced to an acceptable level via the implementation of safeguards.
- Contact the existing tax adviser(s) in order to ensure that there has been no action by Mr Daube or the companies that would, on ethical grounds, preclude the acceptance of the appointment.

## 2 Sushi

Firm's address

Sushi's address  
6 December 2010

Dear Sushi

### Personal taxation

I set out below my advice in connection with the assets you have inherited from your mother.

#### (i) UK inheritance tax and the statute

UK inheritance tax is charged on assets situated in the UK. It is also charged on assets situated overseas where the owner is domiciled or deemed domiciled in the UK. A person's domicile is the country in which they have their permanent home.

### **On the death of your mother**

Your mother was domiciled in Zakuskia and did not own any UK assets. Accordingly, there will be no UK inheritance tax liability on her estate.

### **On your death**

You now own both UK and Zakuskian assets. On your death, UK inheritance tax will, inevitably, be charged in respect of the UK assets but the treatment of the assets in Zakuskia will depend on your domicile position.

When you were born you would have acquired a domicile of origin in Zakuskia as your father was domiciled there. You will have retained this domicile unless you have acquired a domicile of choice in the UK. You will have acquired a domicile of choice in the UK if it can be seen that you have severed all of your ties with Zakuskia with the intention of making the UK your permanent home. You will continue to be domiciled in Zakuskia if we can show that you have retained ties there with the intention of returning there one day.

However, even if you continue to be domiciled in Zakuskia, you will be deemed domiciled in the UK (for the purposes of inheritance tax only) once you have been resident here for 17 of the 20 tax years ending with the year in which any assets are transferred. At the end of the tax year 2010–11 you will have been resident here for 15 years. Accordingly, 2012–13 will be your 17th year of UK residence and you will be deemed domiciled in the UK from that year onwards such that your Zakuskian assets, in addition to your UK assets, will then be subject to inheritance tax. Until 2012–13, provided you have not acquired a domicile of choice in the UK, your Zakuskian assets will not be subject to inheritance tax.

### **UK inheritance tax on land and buildings situated in Zakuskia**

Land and buildings situated in Zakuskia but subject to UK inheritance tax will be included in your death estate at the market value in Zakuskia converted into sterling at the UK buying rate. Expenses incurred in Zakuskia in connection with administering and realising the property will be deductible up to a maximum of 5% of the value of the property.

Any available nil rate band will be deducted from your death estate and the balance will be subject to UK inheritance tax at 40%. The amount payable in respect of the land and buildings in Zakuskia is calculated by determining the percentage, by reference to market values, of your assets held at death represented by the land and buildings and applying that percentage to the total UK inheritance tax due. The inheritance tax due in Zakuskia will be deductible from the UK liability but cannot result in a repayment.

### **The statue**

Once you bring the statue into the UK it will become a UK asset and the gift will be a potentially exempt transfer regardless of your country of domicile. However, the gift of the statue will not be a potentially exempt transfer if we are able to demonstrate that you are currently domiciled in Zakuskia (i.e. you have not acquired a domicile of choice in the UK), and you give the statue to your son whilst it is in Zakuskia. Such a gift would be outside UK inheritance tax as the asset would be overseas and you, the donor, would not be UK domiciled.

If you have already acquired a UK domicile of choice the gift of the statue will be a potentially exempt transfer regardless of where it is situated.

#### *Tutorial note*

*Candidates were not expected to consider the possibility of varying Sushi's mother's will because the will would, presumably, have been governed by the law of Zakuskia. However, credit was given to those candidates who explained how such a variation could avoid the gift of the statue being a potentially exempt transfer.*

### **(ii) The Zakuskian income**

If you are domiciled in Zakuskia you can choose to be taxed on the remittance basis such that you will only be taxed on remittances to the UK. If you have acquired a domicile of choice in the UK you will be taxed on all of the Zakuskian income regardless of whether or not it is remitted to the UK.

The most obvious example of a remittance occurs where the overseas income is brought into the UK. However, the definition of remittance is much wider than this. For example, it includes the situation where the overseas income is used to repay an overseas debt where the funds borrowed have been brought into the UK. A remittance would also occur where the overseas income is used to purchase items which are themselves brought into the UK. There are exceptions to this latter rule in respect of: items costing less than £1,000, items for personal use (clothes, watches etc), and items brought into the UK for repair or for no more than 275 days.

My calculations are included in the appendix to this letter.

You can see that if you remit £100,000 per annum, it will not be beneficial for you to claim the remittance basis due to the remittance basis charge and the loss of tax reliefs. The additional UK tax payable in respect of the Zakuskian income will be £60,000 per year.

Please do not hesitate to contact me if I can be of any further assistance.

**Yours sincerely**

**Tax manager**

## Appendix

### Sushi – increase in UK tax liability due to the Zakusian income

#### A. Remittance basis not available

	£
Zakusian income gross of Zakusian tax	200,000
UK income tax at 40%	80,000
Relief for Zakusian tax at 10% (lower than UK tax)	(20,000)
Annual increase in UK tax payable	<u>60,000</u>

#### B. Remittance basis available and claimed – Remit £100,000 (gross) per annum

	£
Remittance basis charge (note 1)	30,000
Loss of income tax personal allowance (£6,475 at 40%) (note 2)	2,590
Loss of capital gains tax annual exemption (£10,100 x 18%) (note 2)	1,818
Cost of claiming the remittance basis	<u>34,408</u>
Zakusian income remitted to the UK gross of Zakusian tax	100,000
UK income tax at 40% (note 3)	40,000
Relief for Zakusian tax at 10% (lower than UK tax)	(10,000)
UK income tax on remitted income	<u>30,000</u>
Annual increase in UK tax payable (£34,408 + £30,000)	<u>64,408</u>

#### Notes

1. The remittance basis will not be available to you automatically because you will have unremitted income of more than £2,000. The remittance basis charge will be payable because you are claiming the remittance basis and you have been resident in the UK for seven of the nine preceding tax years.
2. On claiming the remittance basis you will no longer be entitled to the income tax personal allowance and the capital gains tax annual exemption.
3. Income taxed under the remittance basis is taxed as non-savings income regardless of its true nature. Accordingly, the amount remitted will be taxed at 40%.

#### Tutorial notes

*A claim to be taxed on the remittance basis must include a nomination of the unremitted overseas income resulting in the remittance basis charge of £30,000. Sushi would need to nominate £100,000 of overseas income as the effective rate of UK tax after double tax relief is 30%. The nominated income can subsequently be remitted to the UK without giving rise to a further UK tax liability.*

*Under the remittance basis rules, nominated income cannot be regarded as having been remitted until all other income has been remitted. Accordingly, it would not be possible for Sushi to claim that some or all of the income remitted in one year is the nominated income from the previous year (such that it is not taxable) because she will have other income that has not been remitted.*

### 3 Trifles Ltd, Victoria and Melba

#### (a) Purchase of own shares – conditions relating to period of ownership and reduction in level of shareholding

##### Victoria

Victoria inherited the shares from her husband, Brownie. Accordingly, the required period of ownership in order for the capital treatment to apply is three years rather than the usual five years. Victoria is permitted to extend her period of ownership to include that of Brownie. Accordingly, her qualifying period is from 1 February 2007 until 28 February 2011 such that she satisfies the condition.

Victoria is selling all of her shares and will therefore satisfy the condition relating to the reduction in the level of her shareholding.

##### Melba

Melba acquired the shares on 1 February 2003. Accordingly, she has owned them for more than five years such that she satisfies the condition for capital treatment.

After the purchase of Victoria's shares, Melba's 1,700 shares will represent 20% (1,700/(10,000 – 1,500)) of Trifles Ltd issued share capital. In order to satisfy the condition for capital treatment, her interest in the company after the purchase of

her shares must be no more than 15% (20% x 75%). However, after the purchase of her shares she will own 1,250 shares (1,700 – 450) out of a total issued share capital of 8,050 shares (10,000 – 1,500 (Victoria) – 450 (Melba)) representing a 15.53% holding such that the condition is not satisfied.

**(b) Victoria – after tax proceeds from the purchase of own shares**

**Capital receipt**

	£
Proceeds (1,500 x £30)	45,000
Less: Cost (probate value)	<u>(16,000)</u>
	29,000
Less: Entrepreneurs' relief (£29,000 x 4/9)	(12,889)
Capital loss brought forward	<u>(4,300)</u>
	11,811
Less: Annual exemption	<u>(10,100)</u>
	1,711
Capital gains tax at 18%	<u>308</u>
After tax proceeds (£45,000 – £308)	<u>44,692</u>

**Income receipt**

	£
Amount received (1,500 x £30)	45,000
Less: Original subscription price (1,500 x £2)	<u>(3,000)</u>
Distribution	42,000
Income tax at 25% (note)	<u>10,500</u>
After tax proceeds (£45,000 – £10,500)	<u>34,500</u>

**Note**

This is the effective rate of income tax suffered by a higher rate taxpayer on a distribution, i.e.  $100/90 \times (32.5\% - 10\%)$ .

*Tutorial note: If the amount received is treated as income, Victoria will also realise a capital loss of £13,000. This is the excess of her cost (£16,000) over the original subscription price of the shares (£3,000).*

**(c) Tax implications of the loan of the motorcycle**

Trifles Ltd is a close company as it is controlled by five or fewer shareholders.

**Melba**

The loan of the motorcycle cannot give rise to an employment income benefit because Melba will not be a director or employee of Trifles Ltd. However, the provision of a benefit by a close company to a shareholder who is not a director or an employee is treated as a distribution. Melba will be treated as having received a distribution equal to the amount that would have been taxable as employment income had she been an employee, i.e. £1,440 (£9,000 x 20% – (12 x £30)). Income tax will be charged at 25% (note) on the £1,440, resulting in income tax payable of £360.

**Note**

This is the effective rate of income tax suffered by a higher rate taxpayer on a distribution, i.e.  $100/90 \times (32.5\% - 10\%)$ .

**Trifles Ltd**

Trifles Ltd will not be able to claim capital allowances in respect of the motorcycle or a tax deduction in respect of its running costs.

## 4 Sakura

### (a) Capital gains tax and inheritance tax implications for Sakura

#### Capital gains tax

The receipt of the insurance proceeds in respect of the destruction of the figurine represents a disposal for the purposes of capital gains tax. The capital gain will be £39,000 (£67,000 – £28,000). The disposal is deemed to have taken place on 1 June 2010, the date on which the insurance proceeds were received, and therefore relates to the tax year 2010/11 and not 2009/10.

Sakura intends to sell the painting for consideration worth £25,000. However, because he and Cashel are connected persons, he will be deemed to have received proceeds equal to the market value of the painting. This will result in a capital gain of £26,000 (£48,000 – £22,000).

#### Inheritance tax

The insurance proceeds received by Sakura are less than the value of the antique figurine such that there has been a fall in the value of his estate. However, there are no inheritance tax implications as there was no gratuitous intent on the part of Sakura.

Sakura is exchanging an asset worth £48,000 for one worth £25,000. Accordingly, there will be a fall in the value of his estate of £23,000. This will result in a potentially exempt transfer of £17,000 after deducting the annual exemptions for 2010/11 and 2009/10. If Sakura were to die within seven years of the exchange the transfer would become chargeable but would be covered by his nil rate band such that no inheritance tax would be due.

#### Minimisation of Sakura's capital gains tax liability

Where insurance proceeds are received on the destruction of an asset a form of rollover relief is available. In order to obtain the relief, Sakura will need to acquire a replacement asset by 31 May 2011 (i.e. within 12 months of receiving the insurance proceeds) and submit a claim to HM Revenue and Customs. It will need to be considered whether or not HM Revenue and Customs will accept that a 'modern glass figurine' can be a replacement for an 'antique china figurine' for the purposes of this relief.

Because the new figurine will cost less than the insurance proceeds, there will be a capital gain equal to the amount of the proceeds not spent. Accordingly, the capital gain after relief will be £8,000 (£67,000 – £59,000). This is on the assumption that the glass figurine is accepted as a suitable replacement and that it is purchased prior to 1 June 2011. The balance of the gain will not be charged but will be deducted from the base cost of the glass figurine.

Sakura has an annual exemption of £10,100 to deduct from his capital gains in each tax year. He can minimise his capital gains tax liability by delaying the exchange of the painting for the boat until the tax year 2011/12 such that the gain on the insurance proceeds will be covered by his 2010/11 annual exemption and the whole of the 2011/12 annual exemption will be available to deduct from the gain on the painting.

This strategy will result in a capital gains tax liability for the tax year 2011/12 of £2,862 ((£26,000 – £10,100) x 18%). The tax will be due on 31 January 2013 (31 January following the end of the tax year in which the exchange takes place).

### (b) Cashel – The disposal of the boat

#### Capital gains tax

A boat is a chattel with a useful life of less than 50 years. Accordingly, it is an exempt asset for the purposes of capital gains tax.

#### Inheritance tax

Cashel has received an asset worth £48,000 as consideration for the disposal of a boat that was worth only £25,000. Accordingly, there has been no fall in the value of his estate and therefore there will be no inheritance tax implications.

### (c) The calculation of the penalty due in respect of an honest error in a tax return

A penalty may be payable where there is an error in Sakura's tax return or any other document submitted to HM Revenue and Customs. The penalty will be a percentage of the potential lost revenue. The potential lost revenue is the additional tax and national insurance contributions due following the correction of the error. The percentage payable depends on the circumstances.

No penalty will be charged if Sakura has taken reasonable care when preparing his tax return. Reasonable care is demonstrated by, for example, keeping accurate records and checking the correct position where something is not understood.

Where an error is careless but honest, as opposed to deliberate, the maximum penalty is 30% of the potential lost revenue. This percentage will be reduced if Sakura discloses the error to HM Revenue and Customs, provides them with assistance in quantifying the error, and allows them access to his records.

Where the disclosure is unprompted, i.e. Sakura discloses the error whilst he has no reason to believe that HM Revenue and Customs has discovered or is about to discover the error, the percentage may be reduced to 0%. Otherwise, the minimum penalty following disclosure is 15% of the potential lost revenue.



## 5 Robusto Ltd

### (a) Market analysis services

#### Cheapest provider

Robusto Ltd is partially exempt for the purposes of value added tax (VAT) and can only recover 75% (W1) of its input VAT. Accordingly, purchasing the services from Cognac Ltd would result in irrecoverable VAT that would increase the overall cost of the services.

	<b>£</b>
Fee excluding VAT	28,500
Irrecoverable VAT (£28,500 x 17.5% x 25%)	1,247
Total cost	<u>29,747</u>

Purchasing the services from Fonseca Inc would cause a similar problem. International services provided by one business to another are treated as supplied in the country where the customer carries on its business. Accordingly, the services would be treated as supplied in the UK. Robusto Ltd would have to apply the reverse charge procedure and account for output tax at the rate of 17.5%. It could then recover 75% of the VAT as input tax in the normal way. Fonseca Inc has quoted a higher fee than Cognac Ltd and therefore the total cost including irrecoverable VAT would also be higher.

Pisco is not registered for VAT and therefore the total cost would be the fee of £29,500, which would appear to be the cheapest option.

However, it should be borne in mind that Pisco will need to register for VAT if, as a result of the supply of the market analysis services to Robusto Ltd, its total supplies in a 12-month period exceed the registration limit of £68,000. If this were to occur, it would then become more expensive than Cognac Ltd.

#### Tutorial note

Robusto will obtain a tax deduction for the cost incurred but, since this will be the case in each situation, this will not affect the decision as to which is the cheapest supplier of the services.

#### Maximum salary

The cost of taking on an employee to carry out the analysis will include the employer's class 1 national insurance contributions. The salary (y) that would result in a total cost of £29,500 is calculated below.

$$\begin{aligned}
 y + ((y - £5,715) \times 12.8\%) &= £29,500 \\
 y + 12.8\% y - (£5,715 \times 12.8\%) &= £29,500 \\
 1.128 y - £731 &= £29,500 \\
 1.128 y &= £29,500 + £731 = £30,231 \\
 y &= £30,231 / 1.128 \\
 y &= £26,801
 \end{aligned}$$

#### Tutorial note

##### Proof of maximum salary

	<b>£</b>
Salary	26,801
Class 1 national insurance contributions ((£26,801 - £5,715) x 12.8%)	2,699
Total cost	<u>29,500</u>

#### Working

##### 1. Proportion of recoverable input tax

	<b>£</b>
Standard rated supplies	850,000
Zero rated supplies	120,000
	<u>970,000</u>
Exempt supplies	330,000
Total supplies	<u>1,300,000</u>
Recoverable input tax - £970,000/£1,300,000 rounded up	<u>75%</u>

### (b) Contractual arrangements that would indicate an employer/employee relationship

Any THREE of the following:

- Any necessary equipment or tools to be provided by Robusto Ltd.
- Robusto Ltd to have control over when and how the work is to be carried out by Pisco.
- Pisco is not permitted to provide a substitute to carry out the work.
- No obligation for Pisco to correct any unsatisfactory work at his own expense.

- The right to dismiss Pisco before the contract has been completed.

*Tutorial note*

*Other contractual arrangements that would indicate an employer/employee relationship would include rewarding Pisco by reference to time spent rather than work done or provision for payments to be made in respect of illness or holidays. However, it is clear from the question that Pisco would charge a fixed fee for the work so it would not be possible for the contract to include such terms.*

**(c) Employer/employee relationship between Robusto Ltd and the individual carrying out the services**

**Tax implications for Robusto Ltd and Cognac Ltd**

The fee, including the irrecoverable VAT, will be tax deductible for Robusto Ltd.

The fee, net of VAT, will be taxable trading income for Cognac Ltd.

The contract between Robusto Ltd and Cognac Ltd would be a relevant engagement for the purposes of the personal service company rules and thus:

- Cognac Ltd will be deemed to have made a salary payment to Offley on 5 April each year based on the amounts it has received in respect of all such relevant engagements less certain allowable deductions.
- Cognac Ltd will have to pay employers' class 1 national insurance contributions in respect of the payment and deduct PAYE and employees' class 1 national insurance contributions from the payment.
- The deemed salary payment, together with the employers' national insurance contributions, will be deductible when calculating Cognac Ltd's taxable trading profits.

**Robusto Ltd's preference**

If HM Revenue and Customs could successfully argue that the relationship between Robusto Ltd and Pisco is one of employer and employee, Robusto Ltd would be required to pay employers' class 1 national insurance contributions on behalf of Pisco. This would increase the cost of the services to Robusto Ltd.

If the services are purchased from Cognac Ltd there is no effect on Robusto Ltd because the national insurance contributions are borne by Cognac Ltd under the personal service companies rules as set out above.

Accordingly, Robusto Ltd might prefer to offer the contract to Cognac Ltd rather than to Pisco.

**Professional Level – Options Module, Paper P6 (UK)  
Advanced Taxation (United Kingdom)**

**December 2010 Marking Scheme**

	<i>Available</i>	<i>Maximum</i>
<b>1 (a) (i)</b> Use of trading losses		
Losses carried forward	3.5	
Current year loss	5.5	
Loss on sale of Shank Ltd	2	
Associates	3.5	
	<u>14.5</u>	12
<b>(ii)</b> Gar building	2	
Cray building	1	
Monk building		
Capital loss	1	
Use of pre-entry element	2	
Use of post-entry element	1.5	
Calculation of pre-entry element	4	
Sword building	2.5	
VAT	3	
Stamp duty land tax	2	
	<u>19</u>	16
<b>(iii)</b> Customers situated outside the EU	1	
Customers situated within the EU	2.5	
Possibility of need to register in other countries	1	
Recoverability of input tax	1	
	<u>5.5</u>	4
Appropriate style and presentation	1	
Effectiveness of communication	1	
	<u>2</u>	2
<b>(b)</b> Information needed	3	
Action to take	3	
	<u>6</u>	5
<b>Total</b>		<u><b>39</b></u>

	<i>Available</i>	<i>Maximum</i>
<b>2 (i)</b> Assets subject to inheritance tax	1.5	
Mother's death	1	
Sushi's death		
UK assets	0.5	
Foreign assets	0.5	
Domicile of origin	1	
Domicile of choice	1	
Deemed domicile	2.5	
UK IHT on land and buildings in Zakuska		
Valuation	1.5	
UK IHT and double tax relief	2	
The statue	2.5	
	<u>14</u>	12
<b>(ii)</b> Meaning and availability of remittance basis	1.5	
Meaning of remittance	3	
Calculations		
Remittance basis not available	2	
Remittance basis available		
Remittance basis charge	1	
Loss of personal allowance and annual exemption	2	
Tax on remitted income	1	
Explanatory notes (1 mark per sensible point) – maximum	3	
Conclusion	1	
	<u>14.5</u>	12
Appropriate style and presentation	1	
Effectiveness of communication	1	
Approach to problem solving	1	
	<u>3</u>	3
<b>Total</b>		<u><b>27</b></u>
<b>3 (a)</b> Victoria		
Period of ownership	2.5	
Reduction in level of shareholding	0.5	
Melba		
Period of ownership	1	
Reduction in level of shareholding	2.5	
	<u>6.5</u>	6
<b>(b)</b> Capital receipt	4	
Income receipt	2.5	
	<u>6.5</u>	6
<b>(c)</b> Close company	1.5	
Melba		
Recognition of distribution	1.5	
Supporting calculations	1.5	
Trifles Ltd	1	
	<u>5.5</u>	5
<b>Total</b>		<u><b>17</b></u>

	<i>Available</i>	<i>Maximum</i>
<b>4 (a)</b> Capital gains tax		
Insurance proceeds	2	
Painting	2	
Inheritance tax		
Figurine	1	
Painting	2	
Minimisation of liability		
Availability of relief and conditions	2.5	
Quantification of relief	1.5	
Use of annual exemptions	1.5	
Liability and due date	1	
	<u>13.5</u>	<b>11</b>
<b>(b)</b> Capital gains tax	1	
Inheritance tax	1	
	<u>2</u>	<b>2</b>
<b>(c)</b> The penalty	2	
Reasonable care	0.5	
Maximum percentage	0.5	
Disclosure	2	
	<u>5</u>	<b>4</b>
<b>Total</b>		<u><b>17</b></u>
<b>5 (a)</b> Partial exemption position	2	
Cognac Ltd	1	
Fonseca Inc	3	
Pisco	2	
Maximum salary	2.5	
	<u>10.5</u>	<b>9</b>
<b>(b)</b> One mark for each contractual arrangement	3	
	<u>3</u>	<b>3</b>
<b>(c)</b> Implications for Robusto Ltd and Cognac Ltd		
Tax treatment of the fee	1	
Additional implications for Cognac Ltd		
Personal service company rules apply	0.5	
Deemed salary payment	2.5	
Robusto Ltd's preference		
Employer's class 1 NIC	1	
Comparison with Cognac Ltd	1	
	<u>6</u>	<b>5</b>
<b>Total</b>		<u><b>17</b></u>