Professional Level – Options Module

Advanced Taxation (United Kingdom)

Friday 9 December 2011

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 3–5

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

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The question paper begins on page 3.

SUPPLEMENTARY INSTRUCTIONS

1. You should assume that the tax rates and allowances for the tax year 2010/11 and for the financial year to 31 March 2011 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 – £37,400	20	10
Higher rate	£37,401 to £150,000	40	32·5
Additional rate	£150,001 and over	50	42·5

A starting rate of 10% applies to savings income where it falls within the first £2,440 of taxable income.

Personal allowances

		£
Personal allowance	Standard	6,475
	65 – 74	9,490
	75 and over	9,640
Income limit for age related allowances		22,900
Income limit for standard personal allowance		100,000

Car benefit percentage

The base level of CO_2 emissions is 130 grams per kilometre.

A rate of 5% applies to petrol cars with CO_2 emissions of 75 grams per kilometre or less, and a rate of 10% applies where emissions are between 76 and 120 grams per kilometre.

Car fuel benefit

The base figure for calculating the car fuel benefit is £18,000.

Pension scheme limits

Annual allowance	£255,000
Lifetime allowance	£1,800,000
The maximum contribution that can qualify for tax relief without evidence of earnings	£3,600

Authorised mileage allowances: cars

Up to 10,000 miles	40p
Over 10,000 miles	25p

Capital allowances: rates of allowance

	%
Plant and machinery	
Main pool	20
Special rate pool	10
Motor cars (purchases since 6 April 2009 (1 April 2009 for limited companies))	
CO_2 emissions up to 110 grams per kilometre	100
CO_2 emissions between 111 and 160 grams per kilometre	20
CO_2 emissions over 160 grams per kilometre	10
Annual investment allowance	
First £100,000 of expenditure	100
Industrial buildings	
Writing-down allowance	1

Corporation tax

Financial year	2008	2009	2010
Small profits rate	21%	21%	21%
Main rate	28%	28%	28%
	£	£	£
Lower limit	300,000	300,000	300,000
Upper limit	1,500,000	1,500,000	1,500,000
Standard fraction	7/400	7/400	7/400

Marginal Relief

Standard fraction x (U – A) x N/A

Value added tax (VAT)

Standard rate	– up to 3 January 2011	17·5%
	– from 4 January onwards	20%
Registration limit		£70,000
Deregistration limit		£68,000

Inheritance tax: tax rates

£1 – £325,000		Nil
Excess	– Death rate	40%
	– Lifetime rate	20%

Inheritance tax: taper relief

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

Capital gains tax

Rate of tax	– Lower rate	18%
	– Higher rate	28%
Annual exempt amount		£10,100
Entrepreneurs' relief	– Lifetime limit	£5,000,000
	– Rate of tax	10%

National insurance contributions
(not contracted out rates)

			%
Class 1	Employee	£1 – £5,715 per year	Nil
		£5,716 – £43,875 per year	11·0
		£43,876 and above per year	1·0
Class 1	Employer	£1 – £5,715 per year	Nil
		£5,716 and above per year	12·8
Class 1A			12·8
Class 2		£2·40 per week	
		Small earnings exception limit – £5,075	
Class 4		£1 – £5,715 per year	Nil
		£5,716 – £43,875 per year	8·0
		£43,876 and above per year	1·0

Rates of interest (assumed)

Official rate of interest	4%
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 (2)	1
£250,001 – £500,000	3
£500,001 or more	4

(1) For residential property the nil rate is restricted to £125,000.
(2) From 25 March 2010 to 24 March 2012 there is an exemption for first time buyers purchasing residential properties for no more than £250,000.

Stamp duty

Shares	0·5%

Section A – BOTH questions are compulsory and MUST be attempted

1 Your manager has sent you a schedule of information received from a client, named Drench, who is the managing director of Hail Ltd. Hail Ltd is a UK resident trading company with a year end of 30 June and Drench owns the whole of the company's ordinary share capital. The schedule is set out below together with an email from your manager.

Schedule of information from Drench

Acquisition of Rain Ltd

I intend to buy 100% of the ordinary share capital of Rain Ltd, a UK resident trading company, on 1 January 2012. I will either purchase the shares personally or Hail Ltd will acquire Rain Ltd as a 100% subsidiary.

Rain Ltd is one of two companies currently wholly-owned by Flake Ltd. All three of the companies in the Flake Ltd group are trading companies. Following its acquisition Rain Ltd will change its year end from 30 September to 30 June such that it will prepare accounts for the nine months ending 30 June 2012.

Budgeted results of Rain Ltd

The budgeted financial results of Rain Ltd for the nine months ending 30 June 2012 are set out below. The results depend on whether or not the company acquires new contracts in 2012. All of the company's sales are standard rated for the purposes of value added tax (VAT). The chargeable gain is in respect of the disposal of a 0·3% shareholding in a quoted company.

	Nine months ending 30 June 2012	
	Without the new contracts	With the new contracts
	£	£
Sales revenue (exclusive of VAT)	380,000	1,425,000
Tax adjusted (loss)/profit	(75,000)	285,000
Chargeable gain	16,000	16,000

Other relevant information

In the year ended 30 September 2011 Rain Ltd realised a tax adjusted trading loss of £27,000 and had no other income or chargeable gains. The trading loss was surrendered as group relief to companies within the Flake Ltd group.

Rain Ltd's main asset is a building which is currently worth £340,000. The building was purchased from Mist Ltd, the other 100% subsidiary of Flake Ltd, on 1 July 2008 for its book value of £248,000. The market value of the building at that time was £260,000. Mist Ltd had purchased the building on 1 January 1999 for £170,000.

Hail Ltd is budgeted to realise taxable total profits in the year ending 30 June 2012 of £240,000.

No elections will be entered into with any company in the Flake Ltd group.

Email from your manager

I want you to prepare the following:

(a) A memorandum for the client file that explains the following matters, providing supporting calculations where relevant:

(i) Acquisition of Rain Ltd

A comparison of the tax implications of:

– Drench acquiring Rain Ltd personally; and

– Hail Ltd acquiring Rain Ltd.

Drench is aware of the general implications of forming a group. Accordingly, your comparison should focus on the following specific issues.

On the assumption that Rain Ltd DOES NOT obtain the new contracts

- The manner in which the loss for the nine months ending 30 June 2012 should be relieved in order to maximise the tax relief obtained; the tax relief should be quantified where possible. Take care when identifying the rates of corporation tax payable by Rain Ltd and Hail Ltd as I suspect that the situation is not totally straightforward.

  Drench wants the loss to be used as soon as possible and only to be carried forward as a last resort.

- The tax implications of Hail Ltd making a payment to Rain Ltd in respect of any group relief losses surrendered.

On the assumption that Rain Ltd DOES obtain the new contracts

- The corporation tax liability of Rain Ltd for the nine months ending 30 June 2012.
- The date by when Rain Ltd will need to pay its corporation tax liability for the period in order to avoid interest charges.

(ii) Loan from Hail Ltd to Drench and VAT cash accounting scheme

- The tax implications for Hail Ltd of Drench borrowing £18,000 from the company on 1 February 2012. The loan will be interest-free and will be repaid by Drench on 1 February 2018.
- The advantages of the VAT cash accounting scheme and whether it will be possible for Rain Ltd to operate the scheme.

(b) A briefing note to me

Our firm will be assisting Rain Ltd to obtain the new contracts. We have experience in this area as we used to have a client that successfully applied for government building contracts. The client moved to a rival firm at the end of 2009.

To what extent is it acceptable for us to use the knowledge we gained in respect of our ex-client to assist Rain Ltd?

Tax manager

Required:

(a) Prepare the memorandum including supporting calculations requested in the email from your manager. The following marks are available.

(i) Acquisition of Rain Ltd; (15 marks)

(ii) Loan from Hail Ltd to Drench and VAT cash accounting scheme. (8 marks)

Professional marks will be awarded in part (a) for the extent to which the calculations are approached in a logical manner and the effectiveness with which the information is communicated. (2 marks)

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

January 1999	163·4
July 2008	216·5
January 2012	230·0 (assumed)

(b) Prepare the briefing note requested in the email from your manager. (5 marks)

(30 marks)

2 Your manager has sent you an email, together with an attachment, in respect of a client called Mirtoon. The email and the attachment are set out below.

Email from your manager

Mirtoon intends to leave the UK in January 2012 in order to live in the country of Koro. He has entered into a full-time contract of employment for a fixed term of four years but he may stay in Koro for as long as ten years. He will buy a house in Koro and will not make any return trips to the UK whilst he is living in Koro.

Mirtoon will sell his house in the UK and cease his business prior to his departure. Details of these proposals, together with information regarding agricultural land owned by Mirtoon, are set out in the attached extract from his email.

Background information

Mirtoon is 52 years old and divorced. He has always been resident, ordinarily resident and domiciled in the UK. He will continue to be UK domiciled whilst living in the country of Koro.

He does not own any buildings other than his home. He receives bank interest in respect of UK bank deposits of £22,600 per year. He will continue to hold these bank deposits whilst living in the country of Koro.

Mirtoon has not made any disposals for the purposes of capital gains tax in the tax year 2011/12. He has capital losses brought forward as at 5 April 2011 of £4,100.

Mirtoon is self employed. He has overlap profits brought forward in respect of his business of £7,600. He is registered for value added tax (VAT) and makes standard rated supplies only. He has never made any claims in respect of entrepreneurs' relief.

I want you to prepare the following:

(a) Mirtoon's financial position

Mirtoon wants to know how his plans to dispose of assets and his departure from the UK will affect his financial position. The details of his plans are in the following attachment. He has asked us to prepare a calculation of **the total** of the following amounts:

– The after tax proceeds from the sale of his home and business assets.

– The tax saving in respect of the offset of his trading losses.

  The trading losses should be offset against the total income of the tax year 2010/11; there is no need to consider any other loss reliefs.

  In order to accurately determine the tax effect of the relief available, you should prepare calculations of Mirtoon's income tax liability for 2010/11 both before and after the offset of the losses.

– Any other tax liabilities arising as a result of Mirtoon's plans to leave the UK.

You should include explanatory notes where this is necessary to assist Mirtoon's understanding of the calculations. This may be particularly useful in relation to the availability of any reliefs and allowances and the tax relief available in respect of the offset of the trading losses.

(b) A letter to be sent from me to Mirtoon that addresses the following matters

(i) VAT: The VAT implications of the cessation of the business and the sale of the business assets.

(ii) Income tax and capital gains tax: Whether or not Mirtoon will be liable to UK income tax and capital gains tax whilst he is living in the country of Koro by reference to his residence, ordinary residence and domicile status. You should include specific reference to the capital gains tax implications of the proposed sale of the agricultural land in June 2013.

There is no double tax treaty between the UK and the country of Koro.

(iii) Inheritance tax: Mirtoon has asked me to discuss some ideas he has had in relation to reducing the potential inheritance tax liability on his death. To help me with this, please include a summary of the rules relating to associated operations and gifts with reservation in the letter.

Tax manager

Attachment – Extract from an email from Mirtoon

> **Sale of house**
>
> I will sell my house on 31 December 2011 for £850,000. I purchased the house for £540,000 on 1 July 2001 and I have lived there ever since that date. Two rooms, representing 20% of the property, have always been used exclusively for the purposes of my business.
>
> **Sale of business assets**
>
> My business made a tax adjusted profit in the year ended 30 June 2010 of £90,000. However, in the year ended 30 June 2011 it made a tax adjusted loss of £20,000. I have not been able to find a buyer for the business and will therefore cease trading on 31 December 2011. I will then sell any remaining business assets.
>
> I expect to be able to sell the business assets, consisting of machinery and inventory, for £14,000, with no asset being sold for more than cost. The business will make a tax adjusted loss of £17,000 in the six months ending 31 December 2011 after taking account of the sale of the business assets.
>
> **Agricultural land**
>
> In May 2007 my father gave me 230 acres of agricultural land situated in the UK. A capital gain of £72,000 arose in respect of this gift and my father and I submitted a joint claim for gift relief. I expect the value of the land to increase considerably in 2012 and I intend to sell it in 2013.

Required:

(a) The calculations showing how Mirtoon's disposal of assets and subsequent departure from the UK will affect his financial position as requested in the email from your manager.

Note: Ignore national insurance contributions. (17 marks)

(b) Prepare the letter to Mirtoon requested in the email from your manager. The following marks are available.

(i) Value added tax (VAT); (3 marks)

(ii) Income tax and capital gains tax; (7 marks)

(iii) Inheritance tax. (6 marks)

Professional marks will be awarded in question 2 for the extent to which the calculations are approached in a logical manner in part (a) and the effectiveness with which the information is communicated in part (b). (3 marks)

(36 marks)

Section B – TWO questions ONLY to be attempted

3 Morice is the finance director of Babeen plc. Babeen plc is a non-close quoted trading company. Morice wants to provide information to the company's employees on a proposed approved Save As You Earn (SAYE) share option scheme, a medical care scheme and payments to employees for driving their own cars on business journeys.

The following information has been obtained from a telephone conversation with Morice.

Proposed approved SAYE scheme rules:

– Employees will invest in the scheme for five years.
– The scheme will permit monthly investments of between £5 and £500.
– The scheme will be open to all employees and directors who are at least 21 years old and have worked full-time for the company for at least three years.
– The share options granted under the scheme will enable employees to purchase shares for £2·48 each.

Detailed explanations, with supporting calculations, requested by Morice:

– Whether or not **each** of the proposed rules will be acceptable for an approved SAYE scheme.
– The tax and national insurance liabilities for the employee in the illustrative example below in respect of the grant and exercise of the share options, the receipt of the bonus and the sale of the shares on the assumption that the scheme referred to meets all of the conditions for approval.

Illustrative example – SAYE scheme that has been approved by HMRC:

– The share options will be granted on 1 January 2012 to purchase shares at £2·48 each.
– The employee will invest £250 each month for five years.
– A bonus equal to 90% of a single monthly payment will be paid at the end of the five-year period.
– The amount invested, together with the bonus, will be used to exercise share options.
– The share options will be exercised on 31 December 2016 and the shares will be sold on the same day.
– The employee's interest in the employing company will be less than 1%.
– A share in the employing company will be worth: £3·00 on 1 January 2012
  £4·00 on 31 December 2016

Medical care scheme:

– Babeen plc is to offer free private health insurance to its employees.
– The health insurance will cost the company £470 annually per employee.
– The insurance would cost each employee £590 if they were to purchase it personally.
– Employees who decline the offer will be able to borrow up to £7,500 from Babeen plc to pay for medical treatment.
– The loans will be interest-free and repayable over four years.

Payments to employees for driving their own cars on business journeys:

– For each mile driven – 36 pence.
– For each mile driven whilst carrying a passenger – an additional 3 pence.

Required:

(a) Prepare the DETAILED explanations, with supporting calculations, as requested by Morice in respect of the proposed SAYE scheme. (10 marks)

(b) Explain the income tax and national insurance implications for the employees of Babeen plc of:

(i) the medical care scheme;

(ii) the payments for driving their own cars on business journeys.

The following mark allocation is provided as guidance for this requirement:

(i) 3 marks
(ii) 4 marks

(7 marks)

(17 marks)

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Question 4 begins on page 12.

4 Surfe has requested advice on the tax implications of the creation of a discretionary trust and a calculation of the estimated inheritance tax liability on her death. The following information was obtained at a meeting with Surfe.

Surfe:

– Is a 63-year-old widow who has two adult nephews.
– Intends to create a trust on 1 January 2012.

Death of Surfe's husband:

– Surfe's husband, Flud, died on 1 February 2007. He had made no gifts during his lifetime.
– In his will, Flud left £140,000 in cash to his sister and the remainder of his estate to Surfe.

The trust:

– The trust will be a discretionary (relevant property) trust for the benefit of Surfe's nephews.
– Surfe will give 200 of her ordinary shares in Leat Ltd and £100,000 in cash to the trustees of the trust on 1 January 2012.
– The inheritance tax due on the gift will be paid by Surfe.
– The trustees will invest the cash in quoted shares.

Leat Ltd:

– Leat Ltd has an issued share capital of 1,000 ordinary shares.
– Surfe owns 650 of the company's ordinary shares.
– The remaining 350 of its ordinary shares are owned by 'Kanal', a UK registered charity.
– Leat Ltd is a property investment company such that business property relief is not available.

Leat Ltd – Value of an ordinary share:

– As at	1 January 2012	1 July 2014
	£	£
As part of a holding of 75% or more	2,000	2,400
As part of a holding of more than 50% but less than 75%	1,000	1,200
As part of a holding of 50% or less	800	1,000

Surfe – Lifetime gifts:

– 1 February 2000 Surfe gave 350 ordinary shares in Leat Ltd to 'Kanal', a UK registered charity.
– 1 October 2011 Surfe gave £85,000 in cash to each of her two nephews.

Surfe's death:

– It should be assumed that Surfe will die on 1 July 2014.
– Her death estate will consist of the house in which she lives, worth £1,400,000, quoted shares worth £600,000 and her remaining shares in Leat Ltd.
– Her will divides her entire estate between her two nephews and their children.

Required:

(a) Outline BRIEFLY:

(i) The capital gains tax implications of:

(1) the proposed gift of shares to the trustees of the discretionary trust;
(2) any future sale of the quoted shares by the trustees; and
(3) the future transfer of trust assets to Surfe's nephews.

(ii) The inheritance tax charges that may be payable in the future by the trustees of the discretionary trust.

Note: You are not required to prepare calculations for part (a) of this question.

The following mark allocation is provided as guidance for this requirement:

(i) 4 marks
(ii) 2 marks

(6 marks)

(b) Calculate the inheritance tax liabilities arising as a result of Surfe's death on 1 July 2014.

Note: The following nil rate bands may be relevant

6 April 1999 to 5 April 2000	£231,000.
6 April 2006 to 5 April 2007	£285,000.

(11 marks)

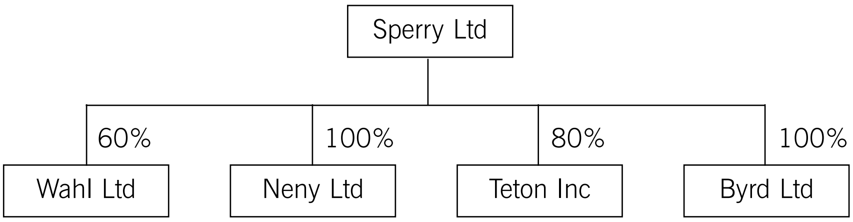
(17 marks)

5 The management of the Sperry Ltd group require advice on minimising the corporation tax liability in respect of a chargeable gain, the tax relief available in respect of loan interest payable and group registration for the purposes of value added tax (VAT).

The following information has been obtained from the management of the Sperry Ltd group.

The Sperry Ltd group:

– The structure of the group, which has not changed for many years, is:



– All of the companies, with the exception of Teton Inc, are UK resident manufacturing companies.
– Teton Inc is resident and trades in the country of Glaciera.

The budgeted results of each of the group companies for the year ended 31 March 2012 are:

–	Sperry Ltd	Wahl Ltd	Neny Ltd	Teton Inc	Byrd Ltd
	£	£	£	£	£
Taxable trading profit	540,000	20,000	35,000	480,000	180,000
Chargeable gain	–	–	–	–	50,000

– None of the companies has any other source of income.
– There are no trading losses or capital losses brought forward as at 1 April 2011.
– Byrd Ltd's gain arose on the disposal of a building; rollover relief is not available.

Proposed acquisition of a building:

– Sperry Ltd intends to purchase a building.
– The building will not be used in Sperry Ltd's trade but will be rented to a third party for £8,000 per month.
– Sperry Ltd intends to borrow £1,300,000 from a UK bank in order to purchase the building.
– Sperry Ltd will opt to tax the building for the purposes of VAT.

Proposed group registration for the purposes of VAT:

– It is intended that Sperry Ltd and Byrd Ltd will register as a group for VAT purposes.
– Sperry Ltd makes only standard rated supplies.
– Byrd Ltd makes only exempt supplies.
– Byrd Ltd's supplies will represent 30% of the value of the total supplies of the proposed VAT group.
– Sperry Ltd levies a monthly management charge on Byrd Ltd.

Required:

(a) Explain IN DETAIL the strategy that should be adopted by the Sperry Ltd group in order to minimise the corporation tax charge in respect of the chargeable gain of Byrd Ltd and state the date by which the necessary election(s) should be submitted. (7 marks)

(b) Explain how tax relief may be obtained for the interest charged to Sperry Ltd on the loan to acquire the building. (4 marks)

(c) Explain BRIEFLY the possible effects of registering Sperry Ltd and Byrd Ltd as a value added tax (VAT) group in relation to both the total input tax recovered by the Sperry Ltd group and the monthly management charge. (6 marks)

(17 marks)

End of Question Paper