Answers

Section C *Marks*

31 (a) Kagan's revised income tax liability for 2018–19 will be £170,667 (165,600 + ((15,300 – 2,000) at 38·1%)). 1

(b) (i) The base cost of the shares will be their value at the time of the aunt's death (£510,000), so the minimal increase in value is likely to be covered by Kagan's annual exempt amount of £11,700. 1

(ii) Kagan – Income tax liability 2018–19

	£	Marks
Employment income	400,000	½
Pension lump sum	0	½
Premium bond prizes	0	½
Interest from ISA	0	½
Property income	9,600	½
Dividend income	1,950	½
	411,550	
Personal allowance	0	½
Taxable income	411,550	

Income tax

£		£	Marks
34,500	at 20%	6,900	½
100,000	at 20%	20,000	½
115,500	at 40%	46,200	½
159,600	(411,550 – 1,950 – 100,000 – 150,000) at 45%	71,820	½
1,950	at 0%	0	½
411,550			
Income tax liability		144,920	
			6

(c) (1) The amount invested in the pension fund (and not withdrawn) will be outside of Kagan's estate, reducing the potential IHT liability. ½

(2) The investments in premium bonds, the ISA and the freehold property will not affect Kagan's potential IHT liability because one asset is simply being replaced with another of equivalent value. 1½

2

10

Marks

32 (a) Robinette – Taxable income 2018–19

	£	
Employment income		
Salary (10,600 x 6)	63,600	½
Living accommodation – Rent paid (690 x 6)	4,140	1
Running costs	1,440	½
Workplace nursery	0	½
Mileage allowance (5,200 at 10p (45p – 35p))	(520)	1
	68,660	
Trading profit – Old business (working 1)	75,350	W1
– New business (working 2)	11,800	W2
	155,810	
Property income (working 3)	6,288	W3
	162,098	
Personal allowance	(0)	½
Taxable income	162,098	

Tutorial notes:

(1) The provision of a workplace nursery is an exempt benefit regardless of the cost to the employer.

(2) No personal allowance is available because Robinette's adjusted net income of £162,098 exceeds £123,700.

Working 1 – Trading profit (old business)

	£	
14-month period ended 30 June 2018	106,900	½
Balancing allowance		
(15,300 + 2,600 – 1,750 – 7,300)	(8,850)	2½
	98,050	
Relief for overlap profits	(22,700)	½
	75,350	

Working 2 – Trading profit (new business)

		£	
Five-month period ended 30 June 2019		55,700	½
Capital allowances (26,200 x 100%)		(26,200)	1
		29,500	
Assessed in 2018–19	29,500 x 2/5 =	11,800	1

Working 3 – Property income

	£	
Rent receivable (1,100 x 6)	6,600	1
Insurance (624 x 6/12)	(312)	1
Property income	6,288	
		12

(b) (i) (1) If HMRC intend to carry out a compliance check into Robinette's self-assessment tax return for 2018–19, then they will have to notify her by 14 August 2020 (12 months after they received her tax return). 1

(2) If Robinette is confident that her return is complete and accurate, then the likely reason for HMRC carrying out a compliance check is because the return has been selected on a random basis. 1

2

(ii) Robinette was in business during 2018–19, so all of her records (both business and non-business) must be retained until five years after 31 January following the tax year, which is 31 January 2025. 1

15

		Marks

33 Maison Ltd – Corporation tax computation for the year ended 31 March 2019

	£	
Operating profit	892,900*	
Non-deductible expenditure	22,340*	
Deduction for lease premium (working 1)	(715)	W1
Capital allowances (working 2)	(70,500)	W2
Trading profit	844,025	
Property business income (working 3)	28,685	W3
Loan interest receivable	1,460*	
Chargeable gains (working 4)	77,985	W4
Taxable total profits	952,155	
Corporation tax (952,155 at 19%)	180,909	½
*Figures provided in question		1

Working 1 – Deduction for lease premium

	£	
Premium paid	44,000	½
Less: 44,000 x 2% x (12 – 1)	(9,680)	1
Amount assessed on the landlord as income	34,320	
Deduction (34,320/12 years x 3/12)	715	1

Working 2 – Capital allowances

	£	£	
Main pool		23,800	½
Annual investment allowance			
Building costs	0		½
Ventilation system	6,700		½
Heating system	3,900		½
Furniture and furnishings	33,500		½
Refrigerator and microwave cooker	2,600		½
	46,700		
	x 100%	46,700	½
Total allowances		70,500	

Working 3 – Property business income

	£	
Rent receivable (18,300 + (18,300 x 2/3))	30,500	1
Security deposit	0	½
Insurance	(1,035)	1
Initial repairs	0	1
Advertising	(780)	½
Property business income	28,685	

Tutorial notes:

(1) *A security deposit, less the cost of making good any damage, is returned to the tenant on the cessation of a letting. It is therefore initially not treated as income.*

(2) *The cost of insurance for the period 1 July to 1 November 2018 is deductible as pre-trading expenditure.*

(3) *The cost of the initial repairs to the warehouse are disallowable capital expenditure as the warehouse could not be let out in its original state and this was reflected in the purchase price paid.*

Marks

Working 4 – Chargeable gains

	£	
First property		
Gain	109,800	½
Indexation allowance		
Cost (101,000 x 0·315)	(31,815)	1
Enhancement expenditure	0	½
Chargeable gain	77,985	
Second property		
Gain	26,000	½
Indexation allowance		
Cost (117,000 x 0·315) – Restricted	(26,000)	1
Chargeable gain	0	
		15

Tutorial notes:

(1) There is no indexation allowance for the first property's enhancement expenditure of £26,200 because this was incurred after December 2017.

(2) For the second property, the indexation allowance cannot create a capital loss.

Additional marking guide for section C				*Marks available*	*Marks awarded*
31	Kagan				
	(a)	Retain		1	
	(b)	**(i)**	CGT	1	
		(ii)	Income	3·5	
			Income tax	2·5	
				6	
	(c)	IHT		2	
	Total marks			**10**	
32	Robinette				
	(a)	Employment		3·5	
		Old business		3·5	
		New business		2·5	
		Property		2	
		PA		0·5	
				12	
	(b)	**(i)**	Check	2	
		(ii)	Records	1	
	Total marks			**15**	
33	Maison Ltd				
	C/tax			0·5	
	Other items			1	
	Premium			2·5	
	C/As			3·5	
	Property			4	
	Gains			3·5	
	Total marks			**15**	

TX-UK Examiner's commentary on September/December 2019 sample questions

This commentary has been written to accompany the published sample questions and answers and is written based on the observations of markers. The aim is to provide constructive guidance for future candidates and their tutors, giving insight into what the marking team is looking for, and flagging pitfalls encountered by candidates who sat these questions.

Question 31

This question involved Kagan who had inherited quoted ordinary shares valued at £510,000. Kagan was unsure whether to retain the shares or sell some of them in order to make four alternative investments.

Retain the inherited shares: Kagan would have received dividend income of £15,300 in addition to his employment income of £400,000 (for which the income tax liability was given) for the tax year 2018-19.

Four alternative investments: These consisted of:

(1) A personal pension contribution of £100,000, with Kagan having sufficient unused annual allowances to cover the pension contribution. He would immediately have withdrawn £25,000 of the pension fund tax-free.

(2) Investing £50,000 in premium bonds.

(3) Investing £20,000 in a cash individual savings account (ISA).

(4) Purchasing a freehold property for £295,000, with the property then let out unfurnished.

After making the four investments, Kagan would have been left with £65,000 of inherited shares, on which he would have received dividend income of £1,950 for the tax year 2018-19.

Part (a) for 1 mark required candidates to calculate Kagan's revised income tax liability for the tax year 2018-19 if he retained the inherited shares. Although fairly well answered, many candidates used valuable time doing full before and after tax computations. Kagan was clearly an additional rate taxpayer, so all that was required was to calculate the additional rate tax due on the dividend income and then add it to the provided figure of tax on the employment income.

Part (b)(i) for 1 mark required an explanation as to why little or no capital gains tax would have been payable if Kagan had sold some of his inherited shares. This was because assets are inherited at the value at the time of the deceased's death. If these assets are sold soon after being inherited, there will generally be a minimal increase in value (this fact was stated in the question), so any gain is likely to be covered by the annual exempt amount. It was pleasing to see that this part was well answered by those candidates who appreciated the tax treatment.

Part (b)(ii) for 6 marks required a calculation of Kagan's revised income tax liability for the tax year 2018-19 if he sold some of his inherited shares and made the four alternative investments. This section was reasonably well answered, but several points should be noted:

- The question stated that a full tax computation was required, so exempt items (pension lump sum, premium bond prizes and the interest from the ISA) should simply have been listed within the main computation and indicated as such by the use of zero (0) – not by an explanation.
- The non-availability of the personal allowance should have been indicated in the same manner. There was no need to justify the non-availability given the level of Kagan's income.
- Although there might only be a ½ mark available for recognising an exemption, it is important to know the various exemptions so that time is not spent producing unnecessary, and more complicated workings – such as applying the savings income nil rate band where the interest from the ISA was included as savings income.

Part (c) for 2 marks required candidates to state for each of the four alternative investments whether the investment would reduce Kagan's potential inheritance tax liability compared to him retaining the inherited shares. Unfortunately, this section was not well answered. Candidates need to remember, that unlike other taxes, there are few exemptions from inheritance tax. Therefore, the replacement of the quoted shares with either premium bonds, an ISA or freehold property would not have changed the value of Kagan's chargeable estate. However, the investment in the pension fund (which is not withdrawn) would have been outside of Kagan's estate, thereby reducing his potential IHT liability.

Question 32

The income tax question involved Robinette.

- She had ceased self-employment on 30 June 2018, preparing accounts for the 14-month period from 1 May 2017 to 30 June 2018. The trading profit figure was given (before taking account of capital allowances).
- From 1 August 2018 to 31 January 2019, Robinette was employed by Bird plc, who provided her with living accommodation and a place in the company's workplace nursery for Robinette's son. Robinette used her private motor car for business purposes.
- Robinette commenced self-employment again, in a new business, on 1 February 2019. She prepared accounts for the five-month period from 1 February to 30 June 2019. The trading profit figure was again given (before taking account of capital allowances).
- In addition, Robinette received property income from letting out her main residence during the period she was employed by Bird plc.

Part (a) for 12 marks required candidates to calculate Robinette's taxable income for the tax year 2018-19. This section was generally very well answered.

However, candidates should always read the question carefully to ensure they understand what needs to be done before starting their answers. Where only taxable income is required, as in this part, candidates should never spend valuable time in also calculating the income tax liability. However, taxable income is after deducting the personal allowance, and this should have been shown by the use of zero (0) (Robinette's level of income meant that the personal allowance was reduced to nil).

Given that the question involved various changes in Robinette's sources of income, candidates needed to be very careful in regard to time-apportionment and basis periods. Common problems included:

- Time-apportioning profits for the period of cessation.

- Not appreciating that WDAs, the AIA and FYAs are not given for the period of cessation.

- Time-apportioning the trading profits on commencement before capital allowances have been deducted.

With this type of question, candidates should think carefully about which workings can be included as one-line calculations within the main computation, and which need their own separate working. For example, the mileage allowance working of 5,200 at 10p (45p – 35p) = £520 should have been included within the main computation.

Part (b) for 3 marks required candidates to (1) state the period during which HM Revenue and Customs (HMRC) would have to notify Robinette if they intended to carry out a compliance check in respect of her self-assessment tax return for the tax year 2018-19, and the likely reason why such a check would be made, and (2) to advise Robinette as to how long she must retain the records used in preparing her self-assessment tax return for the tax year 2018-19. Although there were a number of good answers, in general this section was not so well answered as part (a). Candidates should note:

- The fact that the requirement was for a total of just three marks should have been a good indication that only a few brief points needed to be made, and not a much longer discussion.

- Where a question asks for dates, then these dates need to be precise – including the year relevant to the question.

- Answers should always be related to the information provided. The question made it clear that Robinette's self-assessment tax return was complete and accurate, so the likely reason for HMRC carrying out a compliance check was because her tax return was selected on a random basis.

Question 33

The corporation tax question involved Maison Ltd, for which a partly completed draft corporation tax computation had been prepared for the year ended 31 March 2019. The figures provided were correct, but there were four uncompleted sections, all related to property. These were:

- A deduction for the payment of a lease premium.

- Capital allowances in respect of the construction of an extension adjacent to the company's existing freehold office building.

- Property business income from the letting of a warehouse which was purchased in a dilapidated state.

- Chargeable gains on the disposal of two investment properties.

The sole requirement for 15 marks was to prepare a completed version of Maison Ltd's corporation tax computation for the year ended 31 March 2019 after dealing with the uncompleted sections. The question was generally very well answered.

As regards layout, candidates should again include as many workings as possible within the main computation. Given that a draft layout was provided, then this layout should have been followed by candidates in their answers, thereby allowing candidates to achieve as many of the available marks as possible.

Lease premium: A number of candidates did not appreciate that this was a deduction rather than an addition.

Capital allowances: Candidates often did not appreciate that the construction cost of the building itself did not qualify as plant and machinery. The other costs (ventilation system, heating system, furniture and furnishings, and a refrigerator and microwave cooker) all qualified for the 100% annual investment allowance because the annual limit was not exceeded. It was therefore unnecessary to differentiate between those items integral to the building, and those which were not.

Property business income: Many candidates were not aware that the cost of initial repairs was disallowable capital expenditure because the property could not have been let out in its original state and this was reflected in the purchase price paid.

Chargeable gains: Figures for the two chargeable gains were given, so candidates should not have recalculated them. The reason for giving more information (proceeds and expenditure) was so that the indexation allowance could be calculated. Candidates should always deal with each gain separately, and not combine the figures. Common mistakes with the indexation allowance were giving indexation for expenditure incurred after December 2017, and using the allowance to create a capital loss.