Professional Level – Options Module

Advanced Taxation (United Kingdom)

March/June 2016 – Sample Questions

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

This question 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 question 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.

Paper P6 (UK)

Think Ahead ACCA

The Association of Chartered Certified Accountants

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
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
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

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%

This is a blank page.
Question 1 begins on page 7.

Section A – BOTH questions are compulsory and MUST be attempted

1 Your manager has received schedules of information from Ray and Shanira in connection with their personal tax affairs. These schedules and an extract from an email from your manager are set out below.

Schedule of information from Ray – dated 8 June 2016

I was born in 1958. I am resident and domiciled in the UK.

Shanira and I are getting married on 17 September 2016.

Ray – unincorporated business

I was employed part-time until 31 March 2016. The annual salary in respect of my part-time job was £15,000. I receive bank interest (net) of £3,000 and cash dividends of £3,420 each year. The whole of my income tax liability has always been settled via tax deducted at source.

I began trading on 1 June 2016. I purchased a computer on 3 June 2016, which is used both in the business and personally. I am not registered for the purposes of value added tax (VAT).

You have advised me that my taxable trading profits have been calculated using the accruals basis, rather than the cash basis, and the budgeted taxable trading profits of the business are:

Eight months ending 31 January 2017	£35,000
Year ending 31 January 2018	£66,000

You have already informed me that my taxable trading profit based on these budgeted profits, and my income tax liability in respect of **all** of my income will be:

Tax year	Taxable trading profit	Income tax liability
2016/17	£46,000	£10,762
2017/18	£66,000	£18,762

What tax payments will I be required to make between 1 July 2016 and 30 September 2018?

Schedule of information from Shanira – dated 8 June 2016

I was born in 1960. I am resident and domiciled in the UK.

Ray and I are getting married on 17 September 2016.

Gifts from Shanira to Ray

On 1 February 2016, I gave Ray a house situated in the country of Heliosa. We have only ever used this house for our holidays. The house was valued at £360,000 at the time of this gift. I purchased the house on 1 September 1999 for £280,000.

I will make the following further gifts to Ray between now and the end of the calendar year 2016:

– Painting

  I purchased this painting at auction for £15,000 on 1 March 2012. It is a painting which we both love and would never sell. However, I obviously paid too much for it, as its current market value is only £7,000.

– Shares in Solaris plc

  I will give Ray the whole of my holding of 7,400 ordinary shares in Solaris plc. The current market value is £9·20 per share.

  I acquired these shares on 1 October 2014 when Solaris plc purchased the whole of the ordinary share capital of Beem plc. This takeover was a genuine commercial transaction.

  At the time of the takeover:

  – I owned 3,700 ordinary shares in Beem plc, which I had purchased on 1 June 2008 for £12,960.
  – In addition to the shares in Solaris plc, I also received £14,800 in cash from Solaris plc.
  – An ordinary share in Solaris plc was worth £8·40 on 1 October 2014.

Extract from an email from your manager – dated 9 June 2016

Additional information in relation to Shanira

- Shanira is a higher rate taxpayer.
- The gift of the house to Ray on 1 February 2016 was Shanira's first lifetime gift.
- You should use the current market values of the painting and the shares in Solaris plc in order to calculate the chargeable gains arising on these gifts.
- Neither gift relief nor entrepreneurs' relief will be available in respect of the proposed gift of the shares in Solaris plc.
- Shanira has not made any other chargeable disposals since 5 April 2015.
- There is capital gains tax in the country of Heliosa but no inheritance tax.
- There is no double tax treaty between Heliosa and the UK.

Please prepare a memorandum for the client files which addresses the following issues:

(a) Ray – unincorporated business

(i) – Calculations of the income tax and national insurance contribution payments to be made between 1 July 2016 and 30 September 2018 and the dates on which they will be payable.

– Ray has told me that he does not intend to withdraw all of the profits of the business. Instead, he will either increase his inventory levels or acquire additional equipment, and he has asked how this will affect his taxable income.

(ii) – Ray is incurring input tax and is considering registering voluntarily for VAT. Set out the information we need in order to advise him on whether or not voluntary registration is possible and/or financially beneficial and explain why the information is needed.

– An explanation of whether or not Ray can recover the input tax in respect of the computer purchased on 3 June 2016 if he registers for VAT.

(b) Gifts from Shanira to Ray

(i) – A calculation of the capital gains tax payable in respect of the gift of the house in Heliosa based on the currently available information, together with any further information required to finalise the liability, and the due date of payment.

– An explanation, with supporting calculations, of when the further gifts should be made to Ray. The objective here is to maximise Ray's capital gains tax base cost without creating a capital gains tax liability for Shanira. In order to achieve this objective, you should consider dividing the proposed gift of the shares into two gifts to be given on different days.

(ii) – The maximum possible inheritance tax liability which could arise in respect of the proposed gifts to Ray of the painting and the shares, if Shanira were to follow our advice in respect of their timing, together with the circumstances in which this liability would occur.

Tax manager

Required:

Prepare the memorandum as requested in the email from your manager. The following marks are available:

(a) Ray – unincorporated business.

(i) Income tax and national insurance contribution payments, and the level of his taxable income. (11 marks)

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

(b) Gifts from Shanira to Ray.

(i) Capital gains tax. (10 marks)

(ii) Inheritance tax. (5 marks)

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

(35 marks)

2 Your manager has had a meeting with Gail. Gail owns the whole of the ordinary share capital of Aero Ltd. An email from your manager setting out the matters discussed in the meeting and a schedule prepared by Mill, a junior member of your firm's tax department, are set out below.

Email from your manager – dated 9 June 2016

Gail

Gail was born in 1969 and is resident and domiciled in the UK. She owns the whole of the ordinary share capital of Aero Ltd (A Ltd) and works full-time as a director of the company. A Ltd owns the whole of the ordinary share capital of Zephyr Ltd (Z Ltd). A Ltd and Z Ltd are both UK resident companies paying corporation tax at the main rate.

Historical transactions in respect of A Ltd and Z Ltd – all transactions took place at market value

1 January 2008	A Ltd acquired the whole of the ordinary share capital of Z Ltd for £180,000.
1 October 2012	A Ltd sold a building (the Simpson Building) to Z Ltd for £110,000. A Ltd had purchased this building for £75,000 on 1 December 2004.
1 March 2014	Z Ltd sold a building (the Torro Building) to A Ltd for £170,000. Z Ltd had purchased this building for £115,000 on 1 June 2010.

Proposed transactions – all transactions will take place at market value

Gail intends to raise a substantial sum of money by carrying out the following transactions:

(1) 24 June 2016	Z Ltd will sell the Simpson Building to an unrelated purchaser for £140,000. Rollover relief will not be claimed in respect of this disposal. Z Ltd will pay a dividend to A Ltd equal to the post-tax proceeds of this sale.
(2) 1 July 2016	A Ltd will sell the whole of the ordinary share capital of Z Ltd for £250,000.
(3) 15 July 2016	All of the cash realised by A Ltd as a result of transactions (1) and (2) will be paid to Gail in the form of either a dividend or a bonus.

Please carry out the following work:

(a) Schedule prepared by Mill

I can confirm that there are no computational errors in the schedule but I suspect that Mill will have made a few technical errors.

Please identify and explain any errors in the schedule, explain whether or not the notes to the schedule are or are not correct, and calculate the correct amount of total cash available to pay to Gail.

(b) Payment to Gail

Calculate the additional tax and national insurance contributions due, as reduced by any corporation tax savings, if all of the cash realised by A Ltd as a result of the proposed transactions (1) and (2) is paid to Gail in the form of:

(i) a bonus
(ii) a dividend.

Gail's annual income tax liability in respect of her annual salary of £85,000 from A Ltd is £23,627. This will be her only source of income in the tax year 2016/17 other than any payments received from A Ltd as outlined above.

(c) Non-disclosure of income

Gail has realised that she has not declared some of her income in respect of the tax year 2011/12. As a result of this, her income tax liability for that tax year was understated. I have already explained the interest and penalties which may be charged in respect of this error.

State the other matters which need to be considered, by us and by Gail, in relation to the disclosure of this error to HM Revenue and Customs (HMRC).

Tax manager

Schedule prepared by Mill

Cash which will be available to pay to Gail as a result of the proposed transactions (1) and (2)

	£
Sale of the Simpson Building by Zephyr Ltd	
Sale proceeds	140,000
Less: cost	(110,000)
indexation allowance (October 2012 to June 2016) £110,000 x 0·080	(8,800)
Chargeable gain	21,200
Less: corporation tax payable by Zephyr Ltd at 21%	(4,452)
Dividend of post-tax proceeds paid to Aero Ltd	16,748
Less: corporation tax payable by Aero Ltd at 21%	(3,517)
Cash available in respect of the sale of the Simpson Building	13,231
Sale proceeds in respect of Zephyr Ltd	250,000
Total cash available for Gail	263,231

Notes

1. I do not think there will be a chargeable gain on the sale of Zephyr Ltd due to the substantial shareholding exemption.
2. I think there will be a degrouping charge in respect of the Torro Building but I do not know how to compute it.

Mill

Required:

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

(a) Schedule prepared by Mill. (11 marks)

Note: The following movements in the Retail Prices Index should be used, where necessary.

December 2004 to October 2012	0·293
December 2004 to June 2016 (est.)	0·400
January 2008 to July 2016 (est.)	0·250
June 2010 to March 2014	0·137
October 2012 to June 2016 (est.)	0·080

(b) Payment to Gail. (9 marks)

(c) Non-disclosure of income. (5 marks)

(25 marks)

Section B – TWO questions ONLY to be attempted

3 Your client, Eric, requires advice on the capital gains tax implications arising from the receipt of insurance proceeds and the disposal of some shares, and the inheritance tax reliefs available in respect of assets in his estate at death. His son Zak requires advice regarding the application of the personal service company (IR35) legislation.

Eric:

– Is UK resident and domiciled.
– Is a higher rate taxpayer.
– Is in ill health and is expected to die within the next few months.

Capital transactions in the tax year 2014/15:

– Eric made no disposals for capital gains tax purposes in the tax year 2014/15 other than those detailed below.
– Eric received insurance proceeds of £10,000 following damage to a valuable painting.
– Eric sold half of his shareholding in Malaga plc for £11·50 per share.

Damaged painting:

– Eric purchased the painting for £46,000 in July 2012.
– The painting was damaged in October 2014 such that immediately afterwards its value fell to £38,000.
– The insurance proceeds of £10,000 were received by Eric on 1 December 2014.
– Eric has not had the painting repaired.

Malaga plc shares:

– Malaga plc is a quoted trading company with 200,000 issued shares.
– 80% of Malaga plc's chargeable assets have always been chargeable business assets.
– Eric was given 12,000 shares in Malaga plc by his sister on 1 April 2010, when they were valued at £126,000.
– Eric's sister had purchased the shares for £96,000 on 1 March 2009.
– Gift relief was claimed in respect of the gift of the shares to Eric on 1 April 2010.
– Eric paid the inheritance tax arising in respect of this gift following his sister's death on 1 September 2011.
– Eric has never worked for Malaga plc.
– Eric sold 6,000 shares in Malaga plc on 1 March 2015.

Assets owned by Eric and a previous lifetime gift:

– Eric owns farmland in the UK, which has been leased to a tenant farmer for the last ten years.
– The farmland has a market value of £420,000 and an agricultural value of £340,000.
– Eric's other assets, excluding the remaining Malaga plc shares, are valued at £408,000.
– Eric has made only one previous lifetime gift, of £60,000 cash to his son Zak on 1 July 2009.

Zak:

– Is the sole shareholder, director and employee of Yoyo Ltd, a company which provides consultancy services.
– In the year ended 31 March 2016, Yoyo Ltd's gross fee income from relevant engagements performed by Zak will be £110,000.
– In the tax year 2015/16, Zak will draw a salary of £24,000 and dividends of £50,000 from Yoyo Ltd.
– Neither Yoyo Ltd nor Zak has any other source of income.

Required:

(a) Calculate Eric's total after-tax proceeds in respect of the two capital gains tax disposals in the tax year 2014/15. (6 marks)

(b) (i) On the assumption that Eric dies on 31 March 2016, advise on the availability and effect (if any), of agricultural property relief, business property relief and quick succession relief in respect of the farmland and the retained shares in Malaga plc.

Note: You are not required to prepare calculations for this part of the question. (6 marks)

(ii) Explain, with the aid of calculations, the impact on the inheritance tax liability arising on Eric's death if Eric does not die until 1 August 2016. (3 marks)

(c) Calculate Zak's taxable income for the tax year 2015/16 if the personal service company (IR35) legislation were to apply to the fee income received by Yoyo Ltd. (5 marks)

(20 marks)

4 Your firm has been asked to provide advice to Granada Ltd, and one of its shareholders, Maria. Maria wants advice on the tax consequences of selling some of her shares back to Granada Ltd. Granada Ltd wants advice on the corporation tax and value added tax (VAT) implications of the recent acquisition of an unincorporated business.

Maria:
– Is resident and domiciled in the UK.
– Is a higher rate taxpayer and will remain so in the future.
– Has already realised chargeable gains of £15,000 in the tax year 2015/16.

Shares in Granada Ltd:
– Maria subscribed for 10,000 £1 ordinary shares in Granada Ltd at par in June 2006.
– Maria is one of four equal shareholders and directors of Granada Ltd.
– Maria intends to sell either 2,700 or 3,200 shares back to the company on 31 March 2016 at their current market value of £12·80 per share.
– All of the conditions for capital treatment are satisfied, except for, potentially, the condition relating to the reduction in the level of shareholding.

Granada Ltd:
– Is a UK resident trading company which manufactures knitwear.
– Prepares accounts to 31 December each year.
– Is registered for VAT.
– Acquired the trade and assets of an unincorporated business, Starling Partners, on 1 January 2016.

Starling Partners:
– Had been trading as a partnership for many years as a wholesaler of handbags within the UK.
– Starling Partners' main assets comprise a freehold commercial building and its 'Starling' brand, which were valued on acquisition by Granada Ltd at £105,000 and £40,000 respectively.
– Is registered for VAT.
– The transfer of its trade and assets to Granada Ltd qualified as a transfer of a going concern (TOGC) for VAT purposes.
– The business is forecast to make a trading loss of £130,000 in the year ended 31 December 2016.

Granada Ltd – results and proposed expansion:
– The knitwear business is expected to continue making a taxable trading profit of around £100,000 each year.
– Granada Ltd has no non-trading income but realised a chargeable gain of £10,000 on 1 March 2016.
– Granada Ltd is considering expanding the wholesale handbag trade acquired from Starling Partners into the export market from 1 January 2017.
– Granada Ltd anticipates that this expansion will result in the wholesale handbag trade returning a profit of £15,000 in the year ended 31 December 2017.

Required:

(a) (i) Explain, with the aid of calculations, why the capital treatment WILL NOT apply if Maria sells 2,700 of her shares back to Granada Ltd, but WILL apply if, alternatively, she sells back 3,200 shares. (4 marks)

(ii) Calculate Maria's after-tax proceeds per share if she sells:

(1) 2,700 shares back to Granada Ltd; and alternatively
(2) 3,200 shares back to Granada Ltd. (4 marks)

(b) (i) Describe the corporation tax treatment of the acquisition of the 'Starling' brand by Granada Ltd, if no charge for amortisation was required in its statement of profit or loss. (3 marks)

(ii) Discuss how Granada Ltd could obtain relief for the trading loss expected to be incurred by the trade acquired from Starling Partners, if it does not wish to carry any of the loss back. (5 marks)

(c) Explain the value added tax (VAT) implications for Granada Ltd in respect of the acquisition of the business of Starling Partners, and the additional information needed in relation to the building to fully clarify the VAT position. (4 marks)

(20 marks)

5 Bex has recently left employment and entered into a business partnership with Amy. Bex requires advice in respect of a loan to the partnership, the calculation of her share of profits and the tax treatment of her redundancy payment.

Bex:
– Is resident and domiciled in the UK.
– Received an annual salary of £120,000 from her former employer, Cape Ltd.
– Was made redundant by Cape Ltd on 30 September 2015.
– Joined Amy, a sole trader, to form a partnership on 1 January 2016.
– Has no other source of income.

Amy and Bex partnership:
– Will prepare its first set of accounts for the 16-month period to 30 April 2017.
– Is expected to make a tax-adjusted profit of £255,000 (before deducting interest and capital allowances) for the period ending 30 April 2017.
– The tax written down value on its main pool at 1 January 2016 is £nil.
– Except for the computer referred to below, no further assets will be purchased by either Amy or Bex for use in the partnership in the period ending 30 April 2017.

Profit sharing arrangements:
– The partnership's profit sharing agreement is as follows:

	Amy		Bex
Annual salary	£nil		£30,000
Profit sharing ratio	3	:	1

Bex – loans:
– In addition to her capital contribution, Bex will make a £20,000 loan to the partnership on 1 August 2016. The partnership will use this money wholly for business purposes.
– This loan will be financed by a £25,000 personal loan from Bex's bank, taken out on the same date.
– The remaining £5,000 of the bank loan will be used to purchase a computer for use in the partnership. Bex will have 20% private use of this computer.
– Both the loan from Bex to the partnership and the personal bank loan to Bex will carry interest at the rate of 5% per annum.

Bex – redundancy package from Cape Ltd:
– The package comprised a £22,000 statutory redundancy payment and an additional *ex-gratia* payment of £48,000.
– Bex also received three months' salary in lieu of notice, as specified in her contract of employment.

Required:

(a) (i) Explain, with the aid of calculations, the tax deductions which will be available in respect of the loan interest payable on both the loan from Bex to the partnership and the personal bank loan to Bex. (7 marks)

(ii) In respect of the period ending 30 April 2017, show the allocation between the partners of the taxable trading profit of the partnership. (4 marks)

(iii) Calculate Bex's taxable trading income in respect of her share of the partnership profits for all relevant tax years.

Note: Your answer to (a)(iii) should clearly state the tax years and basis periods involved. (3 marks)

(b) Explain the income tax implications for Bex of the receipt of the redundancy package from Cape Ltd and calculate her total income tax liability for the tax year 2015/16. (6 marks)

(20 marks)

End of Question Paper