Professional Level – Options Module

Advanced Taxation (United Kingdom)

March/June 2017 – Sample Questions

Time allowed: 3 hours and 15 minutes

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.

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 2016/17 and for the financial year to 31 March 2017 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 – £32,000	20%	7·5%
Higher rate	£32,001 to £150,000	40%	32·5%
Additional rate	£150,001 and over	45%	38·1%

Savings income nil rate band – Basic rate taxpayers	£1,000
– Higher rate taxpayers	£500
Dividend nil rate band	£5,000

A starting rate of 0% applies to savings income where it falls within the first £5,000 of taxable income.

Personal allowance

Personal allowance	£11,000
Transferable amount	£1,100
Income limit	£100,000

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

Remittance basis charge

UK resident for	
Seven out of the last nine years	£30,000
12 out of the last 14 years	£60,000
17 out of the last 20 years	£90,000

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:

50 grams per kilometre or less	7%
51 grams to 75 grams per kilometre	11%
76 grams to 94 grams per kilometre	15%
95 grams per kilometre	16%

Car fuel benefit

The base figure for calculating the car fuel benefit is £22,200.

Individual savings accounts (ISAs)

The overall investment limit is £15,240.

Pension scheme limits

Annual allowance – 2014/15 to 2016/17	£40,000
– 2013/14	£50,000
Minimum allowance	£10,000
Threshold income limit	£110,000
Income limit	£150,000
Lifetime allowance	£1,000,000

The maximum contribution that can qualify for tax relief without any earnings is £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 75 grams per kilometre	100%
CO_2 emissions between 76 and 130 grams per kilometre	18%
CO_2 emissions over 130 grams per kilometre	8%

Annual investment allowance

Rate of allowance	100%
Expenditure limit	£200,000

Cap on income tax reliefs

Unless otherwise restricted, reliefs are capped at the higher of £50,000 or 25% of income.

Corporation tax

Rate of tax	20%
Profit threshold	£1,500,000

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	£83,000
Deregistration limit	£81,000

Inheritance tax: nil rate bands and tax rates

	£	
6 April 2016 to 5 April 2017	325,000	
6 April 2015 to 5 April 2016	325,000	
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	
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

	Normal rates	Residential property
Lower rate	10%	18%
Higher rate	20%	28%
Annual exempt amount		£11,100
Entrepreneurs' relief – Lifetime limit		£10,000,000
– Rate of tax		10%

National insurance contributions

Class 1	Employee	£1 – £8,060 per year	Nil
		£8,061 – £43,000 per year	12%
		£43,001 and above per year	2%
Class 1	Employer	£1 – £8,112 per year	Nil
		£8,113 and above per year	13·8%
		Employment allowance	£3,000
Class 1A			13·8%
Class 2		£2·80 per week	
		Small profits threshold	£5,965
Class 4		£1 – £8,060 per year	Nil
		£8,061 – £43,000 per year	9%
		£43,001 and above per year	2%

Rates of interest (assumed)

Official rate of interest	3%
Rate of interest on underpaid tax	3%
Rate of interest on overpaid tax	0·5%

Stamp duty land tax

Non-residential properties	
£150,000 or less	0%
£150,001 – £250,000	2%
£250,001 and above	5%
Residential properties (note)	
£125,000 or less	0%
£125,001 – £250,000	2%
£250,001 – £925,000	5%
£925,001 – £1,500,000	10%
£1,500,001 and above	12%

Note: These rates are increased by 3% in certain circumstances including the purchase of second homes and buy-to-let properties.

Stamp duty

Shares	0·5%

Section A – BOTH questions are compulsory and MUST be attempted

1 Your manager has sent you the notes she prepared following a meeting with Pippin, an established client of your firm who is resident and domiciled in the UK. The notes together with an email from your manager are set out below.

Meeting notes from your manager – dated 8 June 2017

Commencement of 'Pinova' business

Pippin intends to start a new unincorporated business, 'Pinova', on 1 August 2017. He has identified two alternative strategies: strategy A and strategy B.

The budgeted tax-adjusted profit/(loss) of the two strategies are set out below. These figures are before the adjustments necessary in respect of the equipment purchases and employment costs (see below).

	Strategy A		Strategy B	
	Period ending 31 March 2018	Year ending 31 March 2019 and future years	Period ending 31 March 2018	Year ending 31 March 2019 and future years
	£	£	£	£
Profit/(loss)	13,000	60,000	(10,000)	130,000

Equipment purchases and employment costs

The above profit/loss figures need to be adjusted in respect of the following:

– Both strategies will require Pippin to purchase equipment in August 2017 for £8,000.

– Strategy B will require two employees from 1 April 2018. Pippin will pay each of them a gross salary of £2,000 per month. He will also pay them £0·50 per business mile for driving their own cars. He expects each of them to drive 250 business miles per month.

– Strategy A will not require any employees.

Pippin will claim the maximum capital allowances available to him. He will also claim opening years loss relief in respect of the trading loss arising under strategy B.

Cessation of previous business

Pippin's previous unincorporated business ceased trading on 31 December 2016. The taxable profits of the business for its final three tax years were:

	£
2014/15	82,000
2015/16	78,000
2016/17	14,000

Pippin had no other taxable income during these three years.

Receipt of £75,000

Pippin's aunt, Esme, died on 31 January 2017.

On 1 September 2011, Esme's father (Pippin's grandfather) died leaving the whole of his estate to Esme. However, on 1 January 2012 Pippin received £75,000 but cannot remember whether the money came from Esme or from his grandfather's estate.

On 1 November 2011, Esme had transferred cash of £375,000 to a trust for the benefit of her children.

Shares in Akero Ltd

Pippin owns 16,000 shares in Akero Ltd which have a current market value of £4·50 per share. Pippin subscribed £16,000 for these shares on 4 January 2015. Pippin obtained income tax relief of £4,800 (£16,000 x 30%) under the enterprise investment scheme (EIS) in the tax year 2014/15. He also claimed EIS deferral relief in that year of £16,000 in relation to a chargeable gain on the sale of a painting.

Pippin is considering selling 5,000 of his Akero Ltd shares in order to fund his personal expenditure during the start-up phase of the Pinova business.

Extract from an email from your manager – dated 8 June 2017

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

(i) Additional funds required for the 20-month period from 1 August 2017 to 31 March 2019

Pippin's taxable income will consist of the profits of the Pinova business and, for the tax year 2018/19 onwards, he expects to receive dividend income of £1,500 per year. His personal expenditure is £4,000 per month.

I want you to complete the table below to calculate the additional funds which Pippin would require during the first 20 months of the business under each of the two strategies (A and B) after putting aside sufficient funds to settle his tax liabilities for the tax years 2017/18 and 2018/19. You should then evaluate the two strategies by reference to the results of your calculations.

Pippin and I calculated his total **pre-tax** cash receipts; you do not need to check them. The only adjustment required to these pre-tax cash receipts is the cost of employing the two employees.

	Strategy A	Strategy B
	£	£
Total pre-tax cash receipts for the 20-month period	61,000	109,500
Cost of employing the two employees	Nil	( )
Pippin's total income tax and national insurance contribution liabilities for the tax years 2017/18 and 2018/19	( )	( )
Personal expenditure (£4,000 x 20)	(80,000)	(80,000)
Additional funds required		

(ii) Receipt of £75,000

Explain, with supporting calculations, the inheritance tax implications for Pippin of the receipt of the £75,000.

(iii) Sale of shares in Akero Ltd

Explain the tax liabilities which would result if Pippin were to sell 5,000 of his Akero Ltd shares in the tax year 2017/18.

Tax manager

Required:

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

(i) Additional funds required for the 20-month period from 1 August 2017 to 31 March 2019. (20 marks)

(ii) Receipt of £75,000. (5 marks)

(iii) Sale of shares in Akero Ltd. (6 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 and style of the memorandum. (4 marks)

(35 marks)

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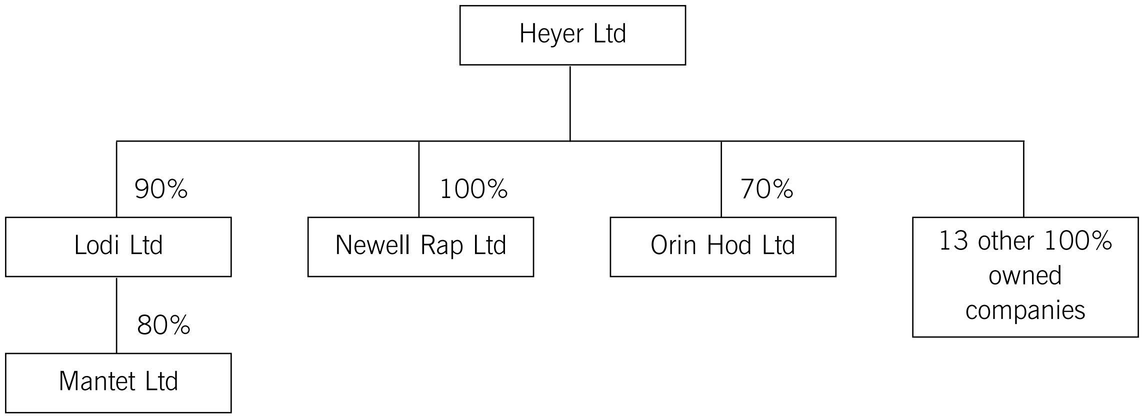
Question 2 begins on page 9.

2 Your manager has asked you to take charge of some work in connection with the Heyer Ltd group of companies. A schedule of information from the client files and an email from your manager detailing the work he requires you to do are set out below.

Heyer Ltd group – schedule of information from the client files

Group structure



General information

– All of the companies are resident in the UK and prepare accounts to 31 December each year.

– The figures given below of taxable total profits (TTP) take account of all possible rollover relief claims.

– None of the companies has received any dividend income from non-group companies.

Specific information

Mantet Ltd

– Mantet Ltd has TTP of between £40,000 and £50,000 every year.

Newell Rap Ltd

– Heyer Ltd acquired Newell Rap Ltd on 1 May 2016.

– Newell Rap Ltd has a capital loss brought forward as at 1 January 2017 of £94,000. This loss arose on a sale of land on 1 February 2014.

Orin Hod Ltd

– The TTP of Orin Hod Ltd exceed £200,000 every year.

– In the year ending 31 December 2017 Orin Hod Ltd will make chargeable gains of £86,000.

Other 100% owned companies

– Each of these companies has TTP of more than £130,000 every year.

– Four of them will have substantial chargeable gains in the year ending 31 December 2017.

– Five of them will have capital losses in the year ending 31 December 2017.

Heyer Ltd group – schedule of information from the client files (continued)

Group restructuring

- It is intended that the trade and assets of five group companies (Newell Rap Ltd and four of the other 100% owned companies) will be sold to Lodi Ltd at some point in January 2018.
- The assets of the five companies, including the business premises, machinery and equipment will be sold to Lodi Ltd for their market value.
- The tax written down value of the main pool of each of the five companies immediately prior to the sale will be zero.

Pink Time Ltd

Heyer Ltd intends to incorporate a new subsidiary, Pink Time Ltd, on 1 September 2017. Pink Time Ltd will have a monthly turnover of £35,000. All of its sales will be to members of the public and will be zero rated for the purposes of value added tax (VAT).

Email from your manager – dated 8 June 2017

Please carry out the following work:

(a) Group planning

The group's objective is to minimise the corporation tax payable in instalments by group companies in respect of the year ended 31 December 2017.

I have asked Cox, our tax assistant, to carry out this work and I have provided him with the details of the companies' budgeted results for 2017. There is no group relief available within the group.

Cox has not done this type of work before and he has had very little experience of capital gains groups, so I want you to prepare some guidance for him. The guidance should consist of explanations of:

- the circumstances in which a member of the Heyer Ltd group would be required to pay corporation tax in instalments, assuming that the profits threshold should be divided by 18;
- which companies are members of a capital gains group;
- how Cox should determine the amount of chargeable gains and capital losses to transfer between the group companies in order to achieve the group's objective; and
- the relevance to the group's objective of the **specific information** provided in the schedule of information.

(b) Group restructuring

Identify, with reasons, the implications of the proposed group restructuring in relation to chargeable gains, stamp duty land tax and capital allowances, and what will happen to any capital losses belonging to the five companies whose trade and assets are transferred.

(c) Pink Time Ltd

Explain whether it will be compulsory for Pink Time Ltd to register for value added tax (VAT) and why the company would benefit from registering.

(d) Disclosure of transfer pricing

It has been realised by the management of Heyer Ltd that transfer pricing adjustments should have been made in respect of the year ended 31 December 2013 for three of the companies in the group. The corporation tax liability of the group was understated as a result of this non-disclosure.

I have already explained the interest and penalties which may be charged in respect of this. I want you to list the other matters which need to be considered, by us, as tax advisers to the group, and by the management of the group, in relation to the disclosure or non-disclosure of this information to HM Revenue and Customs (HMRC).

Tax manager

Required:

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

(a) Group planning. (11 marks)

(b) Group restructuring. (4 marks)

(c) Pink Time Ltd. (5 marks)

(d) Disclosure of transfer pricing. (5 marks)

(25 marks)

Section B – TWO questions ONLY to be attempted

3 Your client, Dan, requires advice on the inheritance tax implications arising as a result of the recent death of his father, Noah, Dan's own UK residence status, and the potential chargeable gain arising on his proposed disposal of his UK house.

Noah:

- Was resident in the UK from 1 April 1998 until his death on 31 May 2017, following a short illness.
- Had a domicile of origin in the country of Skarta and did not acquire a domicile of choice in the UK.
- Has one child, Dan.

Noah – information for inheritance tax:

- Noah had not made any lifetime gifts.
- Noah left all the assets in his estate upon his death to Dan.

Noah – valuation of assets owned at death on 31 May 2017:

	£
House located in the country of Skarta	242,000
Chattels and cash in the UK	335,000

Inheritance tax and liabilities in the country of Skarta:

- Under the tax system in Skarta, the inheritance tax payable will be £56,080.
- Legal and administration fees of £12,400 will be payable in Skarta in respect of Noah's house.
- There is no double tax treaty between the UK and Skarta.

Dan:

- Is domiciled in the country of Skarta.
- Is unmarried, and has no children.
- First became resident in the UK on 1 July 2012.
- Left the UK on 1 January 2016 to go travelling.
- Returned to the UK for the first time on 15 May 2017, when his father was taken ill.
- Intends to work part time in the UK throughout the month of July 2017 only.
- Will remain in the UK until 5 August 2017, when he intends to move permanently to Skarta.

Dan – disposal of his UK house:

- Dan purchased a house in the UK on 1 October 2012 for £286,000, where he lived until 1 January 2016.
- He has not lived in the house since this date.
- He allowed his father, Noah, to live in the house, rent-free, until his father's death.
- He has agreed to sell the UK house on 1 August 2017 for £318,000.
- The house was valued at £297,000 on 5 April 2015.

Required:

(a) (i) State, giving reasons, whether or not the house in Skarta will be included in Noah's chargeable estate on death for the purposes of UK inheritance tax. (3 marks)

(ii) Assuming that the house in Skarta is subject to inheritance tax in the UK, calculate the value of Dan's inheritance from Noah after all taxes and liabilities have been paid. (6 marks)

(b) (i) On the assumption that Dan does not satisfy either of the automatic tests for determining his UK residence status, explain why Dan will NOT be resident in the UK for tax purposes in the tax year 2017/18. (5 marks)

(ii) Calculate the chargeable gain arising on the disposal of Dan's UK house on 1 August 2017 under the residential property rules applicable to non-UK residents. Dan will not elect to be taxed on the whole of the gain but will elect for the gain to be time-apportioned if it is beneficial to do so. (6 marks)

(20 marks)

4 Jordi is a director and shareholder of Traiste Ltd. He has asked for your advice in connection with the forthcoming redundancy of an employee, the sale of shares in Traiste Ltd by his sister, Kat, and the payment implications for Traiste Ltd of alternative ways for Jordi to extract profits from the company.

Traiste Ltd:
– Is a UK resident unquoted trading company.
– Has two shareholders, Jordi and Kat, who each own 50% of the 1,000 £1 shares in issue.

Traiste Ltd – proposed redundancy package for an employee:
– An employee, Esta, will be made redundant on 30 June 2017.
– Esta will receive statutory redundancy pay of £12,000 and an *ex-gratia* payment of £36,000 from Traiste Ltd.
– Traiste Ltd will continue to lease a motor car for Esta's personal use until 31 December 2017, although she has no contractual entitlement to this.
– The monthly lease payments are £420.
– The motor car has CO_2 emissions of 178 grams per kilometre and is petrol powered.
– The motor car is currently worth £10,300. Its list price when new was £18,400.

Kat:
– Is resident and domiciled in the UK.
– Is 58 years old.
– Is a director and shareholder of Traiste Ltd.
– Will receive employment income of £34,000 from Traiste Ltd and dividends from other UK companies of £4,000 in the tax year 2017/18.
– Has already used her annual exempt amount for capital gains tax purposes for the tax year 2017/18.

Kat – proposed sale of shares:
– Kat subscribed for her 500 shares in Traiste Ltd at par on the incorporation of the company on 1 March 2013.
– She wishes to sell all of her shares before the end of 2017, and retire from the company.
– Kat's brother, Jordi, has offered to buy these shares for £47 each. He is not prepared to sign any tax election in relation to this offer.
– Alternatively, Traiste Ltd will buy these shares for their market value of £52 each.

Jordi:
– Is resident and domiciled in the UK.
– Is 53 years old.
– Is a director and shareholder of Traiste Ltd.
– Is paid a gross annual salary of £50,000 by Traiste Ltd.
– Wishes to extract an additional cash sum of £30,000, net of all taxes, from Traiste Ltd, to be paid on 31 March 2018.
– The additional sum will be extracted as either a bonus or a dividend.
– Will not receive any other taxable income in the tax year 2017/18.

Required:

(a) (i) Explain briefly the income tax implications for Esta in respect of each of the three components of the proposed redundancy package.

Note: Calculations are NOT required for this part. (3 marks)

(ii) Calculate the corporation tax deductions available to Traiste Ltd in respect of the redundancy package provided to Esta. (4 marks)

(b) Explain, with reference to the after-tax proceeds in each case, why Kat should accept Jordi's offer to buy her shares in Traiste Ltd, rather than sell her shares back to Traiste Ltd. (8 marks)

(c) Explain, with supporting calculations, the amount of any payments to be made by Traiste Ltd to HM Revenue and Customs (HMRC) in respect of each of the two ways for Jordi to extract the additional £30,000 cash from the company, and state the due date of any such tax payments. (5 marks)

(20 marks)

5 The finance director of Achiote Ltd would like your advice on the tax implications of the acquisition of two intangible fixed assets, various transactions involving an overseas subsidiary, and opting to tax a commercial building.

Achiote Ltd:
- Owns 100% of the ordinary shares in Borage Ltd and 80% of the ordinary shares in Caraway Inc.
- Achiote Ltd and Borage Ltd are resident in the UK. Caraway Inc is resident in the country of Nuxabar.
- All three companies are trading companies and prepare accounts to 31 March annually.

Borage Ltd – purchase of intangible fixed assets:
- Borage Ltd purchased the goodwill of an unincorporated business for £62,000 on 1 September 2016.
- Borage Ltd will amortise this goodwill in its accounts on a straight-line basis over a five-year period.
- Borage Ltd also purchased a patent from Achiote Ltd for £45,000 on 1 January 2017.
- Achiote Ltd had purchased the patent for £38,000 on 1 January 2014.
- The patent was being amortised in Achiote Ltd's accounts on a straight-line basis over a ten-year period.
- Borage Ltd will continue to amortise the patent over the remainder of its ten-year life.

Achiote Ltd – loan to Caraway Inc:
- Achiote Ltd made a loan of £100,000 to Caraway Inc on 1 April 2016.
- The rate of interest on the loan is 6% per annum, which is 2% below the rate applicable to an equivalent loan from an unrelated party.
- There is no double tax treaty between the UK and Nuxabar.

Achiote Ltd – sale of equipment to, and proposed sale of shares in, Caraway Inc:
- Achiote Ltd acquired its 80% shareholding in Caraway Inc on 1 January 2017 for £258,000.
- Achiote Ltd is now proposing to sell an 8% shareholding in Caraway Inc to an unconnected company on 1 October 2017 for £66,000.
- An item of equipment owned by Achiote Ltd and used in its trade was sold to Caraway Inc on 1 March 2017 for its market value of £21,000.
- The item of equipment had cost Achiote Ltd £32,000 in May 2016.

Achiote Ltd – purchase and rental of a commercial building:
- Achiote Ltd has recently purchased a two-year-old commercial building from an unconnected vendor.
- The building will be rented to an unconnected company, Rye Ltd.
- Rye Ltd is a small local company, which supplies goods to Achiote Ltd but does not charge value added tax (VAT) on these sales.

Required:

(a) Explain, with supporting calculations where appropriate, the corporation tax treatment in the year ended 31 March 2017, of the goodwill and the patent acquired by Borage Ltd. (4 marks)

(b) Explain the implications of the rate of interest charged by Achiote Ltd on the loan to Caraway Inc by reference to the transfer pricing legislation, and any action which should be taken by Achiote Ltd. (5 marks)

(c) Advise Achiote Ltd of the chargeable gains implications arising from (1) the sale of the item of equipment to Caraway Inc; and (2) its proposed sale of the shares in Caraway Inc. (5 marks)

(d) (i) On the assumption that Rye Ltd makes only taxable supplies, state TWO legitimate reasons why it might not charge value added tax (VAT) on its sales to Achiote Ltd. (2 marks)

(ii) Explain whether or not it would be financially beneficial for Achiote Ltd to opt to tax the commercial building, and the implications for Rye Ltd if it chooses to do so. (4 marks)

Note: The following indexation factors should be used for this question, where applicable:

January 2014 to January 2017	0·067
May 2016 to March 2017	0·038
January 2017 to October 2017	0·033
March 2017 to October 2017	0·026

(20 marks)

End of Question Paper