Strategic Professional – Options

Advanced Taxation – United Kingdom (ATX – UK)

March/June 2019 – Sample Questions

ATX UK ACCA

Time allowed: 3 hours 15 minutes

This question paper is divided into two sections:

Section A – BOTH questions are compulsory and MUST be attempted

Section B – BOTH questions are compulsory and MUST 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.

ATX – 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 2018/19 and for the financial year to 31 March 2019 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 – £34,500	20%	7·5%
Higher rate	£34,501 – £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	£2,000

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

Personal allowance

Personal allowance	£11,850
Transferable amount	£1,190
Income limit	£100,000

Where adjusted net income is £123,700 or more, the personal allowance is reduced to zero.

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

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	13%
51 grams to 75 grams per kilometre	16%
76 grams to 94 grams per kilometre	19%
95 grams per kilometre	20%

Car fuel benefit

The base figure for calculating the car fuel benefit is £23,400.

Individual savings accounts (ISAs)

The overall investment limit is £20,000.

Property income

Basic rate restriction applies to 50% of finance costs relating to residential properties.

Pension scheme limits

Annual allowance	£40,000
Minimum allowance	£10,000
Threshold income limit	£110,000
Income limit	£150,000
Lifetime allowance	£1,030,000

The maximum contribution that can qualify for tax relief without any earnings is £3,600.

Approved 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 50 grams per kilometre	100%
CO_2 emissions between 51 and 110 grams per kilometre	18%
CO_2 emissions over 110 grams per kilometre	8%

Annual investment allowance

Rate of allowance	100%
Expenditure limit	£200,000

Cash basis accounting

Revenue limit	£150,000

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	– Financial year 2018	19%
	– Financial year 2017	19%
	– Financial year 2016	20%
Profit threshold		£1,500,000

Value added tax (VAT)

Standard rate	20%
Registration limit	£85,000
Deregistration limit	£83,000

Inheritance tax: nil rate bands and tax rates

Nil rate band

	£
6 April 2018 to 5 April 2019	325,000
6 April 2017 to 5 April 2018	325,000
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

Residence nil rate band		£125,000
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	£11,700
Entrepreneurs' relief and investors' relief	
– Lifetime limit	£10,000,000
– Rate of tax	10%

National insurance contributions

Class 1	Employee	£1 – £8,424 per year	Nil
		£8,425 – £46,350 per year	12%
		£46,351 and above per year	2%
Class 1	Employer	£1 – £8,424 per year	Nil
		£8,425 and above per year	13·8%
		Employment allowance	£3,000
Class 1A			13·8%
Class 2		£2·95 per week	
		Small profits threshold	£6,205
Class 4		£1 – £8,424 per year	Nil
		£8,425 – £46,350 per year	9%
		£46,351 and above per year	2%

Rates of interest (assumed)

Official rate of interest	2·5%
Rate of interest on underpaid tax	3·00%
Rate of interest on overpaid tax	0·5%

Standard penalties for errors

Taxpayer behaviour	Maximum penalty	Minimum penalty – unprompted disclosure	Minimum penalty – prompted disclosure
Deliberate and concealed	100%	30%	50%
Deliberate but not concealed	70%	20%	35%
Careless	30%	0%	15%

Stamp duty land tax on non-residential properties

Up to £150,000	0%
£150,001 – £250,000	2%
£250,001 and above	5%

Stamp duty

Shares	0·5%

Section A – BOTH questions are compulsory and MUST be attempted

1 Your manager has had a meeting with Maia, a client of your firm. Extracts from the memorandum prepared by your manager following the meeting and an email from her detailing the work she requires you to do are set out below.

Extracts from the memorandum prepared by your manager – dated 3 June 2019

Maia

Maia is 63 years old and has significant personal wealth. She has taxable income of approximately £120,000 each year, much of which she is able to save. She uses her capital gains tax annual exempt amount and her inheritance tax annual exemption every year. She is resident and domiciled in the UK.

Maia has agreed to provide financial assistance to her nephew, Josh.

Josh – financial position

Josh recently left university and, on 6 April 2019, he started working for NL Ltd, an unquoted company. He earns an annual gross salary of £25,200. Since 6 April 2019, NL Ltd has provided Josh with the use of a mobile telephone (market value of £650) and a home cinema system (market value of £1,700).

On 1 June 2019, NL Ltd issued 200 £1 ordinary shares to Josh. This share issue was not made as part of an approved share scheme. Josh paid £300 for these shares, which had a market value of £2,100 at that time. The shares are not readily convertible assets and Josh is not permitted to sell them until 1 April 2023.

Josh currently receives dividend income of £420 each year. He is resident and domiciled in the UK.

Josh estimates that from 6 April 2019 he needs £2,500 per month to pay his rent and living expenses. Maia has asked us to calculate how much cash Josh will need for the tax years 2019/20 and 2020/21, over and above his post-tax income from all sources.

Providing financial assistance to Josh – alternative strategies

Maia is considering three alternative strategies to provide financial assistance to Josh.

(i) Gift of investment property on 1 July 2019

This investment property is currently worth £370,000.

Maia purchased the property for £130,000 on 1 July 2008. Since its acquisition, this property has been rented out for taxable net rental income of £1,100 per month. It is a residential building, but I do not know whether or not it has been rented out as furnished holiday accommodation.

Under this strategy, Josh would continue to rent out the property on the same basis from 1 July 2019 onwards.

(ii) Gift of shares in Far Ltd on 1 July 2019

These shares are worth £420,000. They represent the whole of Maia's shareholding in the company and constitute 14% of the company's issued ordinary share capital.

Maia's father gave the shares to Maia on 1 November 2018 when they were worth £375,000. That gift resulted in a chargeable gain of £225,000 of which £140,000 was held over via a gift relief claim.

Far Ltd is an unquoted trading company. It owns chargeable non-business assets which represent 16% of its total chargeable assets.

(iii) Monthly cash gifts commencing on 1 July 2019

Maia would simply make a cash gift to Josh of £1,000 each month commencing on 1 July 2019.

Extract from the email from your manager – dated 4 June 2019

> **Please prepare a memorandum for the client files consisting of the work set out below.**
>
> **(a) Josh – additional cash requirement**
>
> Calculate the total additional cash required by Josh, over and above his income from all sources, for the tax years 2019/20 and 2020/21, after deducting tax and national insurance contributions (NIC).
>
> In order to prepare the calculations efficiently, you should think about how Josh's taxable income in 2020/21 will differ from that in 2019/20. There is no need to provide any narrative explanation of your calculations.
>
> **(b) Providing financial assistance to Josh – alternative strategies**
>
> In respect of each of the three alternative strategies set out in my memorandum, explain:
>
> – The increase in Josh's post-tax income for the 21-month period ending 5 April 2021.
>
>   You should ONLY consider the post-tax income to be received by Josh in relation to strategies (i) and (iii) and NOT strategy (ii).
>
>   There is no need to consider the capital values of any of the strategies as, in the short term, Josh will not realise any of this value.
>
> – The capital gains tax liabilities FOR MAIA ONLY on the assumption that those reliefs which are available will be claimed.
>
> – The inheritance tax implications for Maia and Josh including consideration of the availability of business property relief.
>
> As I noted in my memorandum, I do not know whether the investment property qualifies as furnished holiday accommodation or not. You should explain the liabilities for both possibilities regarding this property. You SHOULD NOT provide a definition of furnished holiday accommodation.
>
> Tax manager

Required:

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

(a) Josh – additional cash requirement. (9 marks)

(b) Providing financial assistance to Josh – alternative strategies.

(i) Gift of investment property. (12 marks)

(ii) Gift of shares in Far Ltd. (7 marks)

(iii) Monthly cash gifts. (3 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)

2 Your manager has sent you a schedule prepared by Claire Falkner concerning her company, Plad Ltd, and a new company, Quil Ltd, which she intends to incorporate on 1 July 2019. The covering email from your manager details the work he requires you to do. The two documents are set out below.

Attachment: Schedule from Claire Falkner – dated 3 June 2019

Plad Ltd

I have owned the whole of the ordinary share capital of Plad Ltd since 2004. Plad Ltd trades mainly in the UK and is a UK resident company. It purchases components from third parties to be assembled into finished products. It also has a permanent establishment in the country of Chekka. The profits realised in Chekka are subject to 14% Chekkan business tax. There is no double tax treaty between the UK and the country of Chekka.

The budgeted taxable profits of Plad Ltd for the year ending 30 June 2020 are set out below. Plad Ltd's profitability is very stable, so please assume that the figures for the following year will be the same.

	£
Trading profit in the UK	48,000
Trading profit in the country of Chekka (before deduction of 14% Chekkan tax)	7,000
Taxable total profits	55,000

Quil Ltd

Quil Ltd will be incorporated, registered for value added tax (VAT) and commence trading on 1 July 2019. It will trade in the UK and be a UK resident company.

From a commercial standpoint, my intention was to own Quil Ltd personally. However, if there is a sufficient tax advantage, I will consider establishing the company as a wholly-owned subsidiary of Plad Ltd.

The first two years of budgeted results of Quil Ltd are set out below. The trading profit/(loss) figures are before the deduction of capital allowances, but have otherwise been adjusted for the purposes of corporation tax. The chargeable gain will not qualify for rollover relief.

Year ending 30 June 2020 – trading loss	£(15,000)		
Year ending 30 June 2021 – trading profit	£162,000	chargeable gain	£16,000

On 1 July 2019, Quil Ltd will purchase the following capital assets:

Machinery and equipment	£160,000 (excluding VAT)
Building used for manufacturing and storage	£600,000 (excluding VAT)

The cost of the building includes £230,000 in respect of thermal insulation and air cooling equipment in order to create the appropriate conditions for manufacturing.

Value added tax (VAT)

I would like the two companies to register as a group for VAT purposes (to avoid the need to charge VAT on intra group supplies and to generally reduce administration) and for the group to continue to use the annual accounting scheme currently used by Plad Ltd. I appreciate this would mean that the two companies would be jointly and severally liable for the group's VAT liability.

Plad Ltd – unreported chargeable gain

I have just discovered that a chargeable gain of £21,600 realised by Plad Ltd in the year ended 30 June 2015 was omitted from its corporation tax return. However, because the gain arose in respect of the sale of land, it was reported for the purposes of stamp duty land tax. Accordingly, I assume we do not need to do anything and that HM Revenue and Customs (HMRC) will contact us about this at some point.

Extract from the email from your manager – dated 4 June 2019

> Please carry out the following work:
>
> **(a)** Group relief
>
> In order to help Claire make her decision on the ownership of Quil Ltd, advise her of the tax advantage of Quil Ltd being a wholly-owned subsidiary of Plad Ltd, such that the two companies form a group relief group. You should carry out this work in three stages:
>
> **(i)** Explain, with supporting calculations, the maximum amount of group relief which Plad Ltd would need to receive for the year ending 30 June 2020 such that none of its double tax relief in respect of the Chekkan tax would be wasted and its UK corporation tax payable would be £nil. You should assume the rate of corporation tax is 19% for all accounting periods.
>
> **(ii)** Prepare calculations of the corporation tax liabilities of the two companies for the two years ending 30 June 2021. Your calculations should be on the basis that the trading loss of Quil Ltd will be used as soon as possible whilst restricting the amount of group relief in an accounting period to the maximum figure you calculated in part (i).
>
> You SHOULD NOT provide any explanations of these calculations.
>
> **(iii)** Conclude by explaining the tax advantage of Quil Ltd becoming a wholly-owned subsidiary of Plad Ltd, as opposed to being owned personally by Claire.
>
> When carrying out this work, you should be aware of the following:
>
> – in the year ending 30 June 2020, the whole of the annual investment allowance will be available to Quil Ltd, and Quil Ltd will claim the maximum capital allowances available;
>
> – neither of the two companies will be required to pay corporation tax in quarterly instalments. This will be true regardless of who owns Quil Ltd.
>
> **(b)** Group registration for value added tax (VAT) purposes
>
> Explain any additional matters of which Claire should be aware in relation to group registration for VAT purposes.
>
> **(c)** Plad Ltd – unreported chargeable gain
>
> Explain the implications for Plad Ltd, and our firm, of the failure to report the chargeable gain to HM Revenue and Customs (HMRC). You SHOULD NOT address money laundering or the possibility of penalties, as I have already spoken to Claire about these matters.
>
> Tax manager

Required:

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

(a) Group relief. (17 marks)

(b) Group registration for value added tax (VAT) purposes. (3 marks)

(c) Plad Ltd – unreported chargeable gain. (5 marks)

(25 marks)

Section B – BOTH questions are compulsory and MUST be attempted

3 Dent Ltd requires advice on registering for value added tax (VAT), the corporation tax treatment of its expenditure on research and development (R&D) activities, and the after-tax cost of remuneration to be provided to a key employee.

Dent Ltd:

- Will be incorporated and start trading on 1 July 2019.
- Will undertake a research project to develop an innovative new process related to its trade.
- Will be a small enterprise for the purposes of R&D expenditure.
- Will prepare its first set of accounts to 30 June 2020.
- Will make wholly taxable supplies for VAT purposes.

Dent Ltd – budgeted income for the year ending 30 June 2020:

- The value of trading receipts in the first few months will be low, such that Dent Ltd will not be required to be compulsorily registered for VAT until 1 April 2020.
- Dent Ltd expects, however, to receive substantial fees in April to June 2020, such that it anticipates generating an overall taxable trading profit for the year ending 30 June 2020.
- All of Dent Ltd's customers will be registered for VAT.

Dent Ltd – budgeted R&D expenditure for the year ending 30 June 2020:

	£
Specialist equipment	110,000
Property costs	46,000
Consumables	12,000
Staff costs	185,000
	353,000

- The above figures are all exclusive of VAT, where applicable.
- The property costs entirely comprise heat, light and water expenses.
- The staff costs include a fee of £25,000 to an agency (which is VAT registered) for the provision of an unconnected external contractor's services for the year.
- The remainder of the staff costs wholly relate to amounts payable to, or on behalf of, Dent Ltd's employees, including pension contributions totalling £14,000.
- The property costs, consumables and agency fees are incurred evenly throughout the year.

Alina – design engineer:

- Alina will commence employment with Dent Ltd on 1 July 2019 to lead the R&D project.
- Alina's annual salary of £80,000 is included in the budgeted staff costs figure above.
- On 1 July 2019, Dent Ltd will additionally provide Alina with the following, none of which are included in the budgeted staff costs figure above:
  - a lump sum payment of £10,000 in recognition of her forthcoming employment;
  - a new computer costing £1,000, of which Alina will have use, including significant private use, for the first nine months of her employment; and
  - temporary living accommodation for the first six months of her employment (as detailed below).

Alina – provision of temporary living accommodation:

- Dent Ltd will rent a flat for Alina's use from 1 July 2019 to 31 December 2019.
- Dent Ltd will pay the rental cost of £660 per month.
- The market value of the flat is currently £225,000, and its annual value is £2,800.

Required:

(a) **Advise Dent Ltd on the implications for the recovery of input value added tax (VAT) of registering for VAT with effect from 1 April 2020, when it will be compulsory to do so, and explain why it is beneficial for the company instead to register voluntarily with effect from 1 July 2019.**

Note: Calculations are NOT required for this part (a). (6 marks)

(b) **Explain the corporation tax treatment of the research and development (R&D) expenditure of £353,000 to be incurred by Dent Ltd in the year ending 30 June 2020, and, on the assumption that Dent Ltd registers voluntarily for VAT with effect from 1 July 2019, calculate the amount of the deduction which will be available in respect of this R&D expenditure for corporation tax purposes.** (6 marks)

(c) **State the income tax implications of the receipt of the lump sum payment for Alina, and calculate the after-tax cost for Dent Ltd in respect of the lump sum payment and provision of the computer and the temporary living accommodation to Alina in its year ending 30 June 2020.**

Note: You should ignore VAT in this part (c). (8 marks)

(20 marks)

4 Rod has requested advice in relation to the capital gains tax implications of selling shares he obtained through his employer's enterprise management incentive (EMI) scheme, and the potential income tax relief available in respect of his share of a trading loss of a partnership which he has recently joined.

Rod:

– Is resident and domiciled in the UK.
– Was employed for many years by Lumba plc, before taking early retirement on 30 June 2018.
– Joined the Thora Partnership on 1 December 2018.
– Made no disposals for capital gains tax in the tax year 2018/19, other than the sale of his shares in Lumba plc (as detailed below).

Sale of Lumba plc shares:

– In May 2014, Lumba plc granted Rod options to purchase 20,000 shares under its EMI scheme.
– The market value of a share at the date of the grant was £2·60 and the option price was £2·30 per share.
– Rod exercised all of the options on 1 June 2018, when the market value was £3·90 per share.
– Rod sold all the shares on 1 December 2018, when the market value was £4·00 per share.
– The gain is eligible for entrepreneurs' relief.

The Thora Partnership:

– Has been carried on for many years by two partners, Abe and Bob.
– Prepares accounts to 30 November annually.
– Admitted Rod into the partnership on 1 December 2018.
– Is expected to make a tax-adjusted trading loss of £47,000 in the year ending 30 November 2019.

The Thora Partnership – profit/loss sharing arrangements:

– The partnership's profit/loss sharing arrangements from 1 December 2018 are as follows:

	Abe	Bob	Rod
Annual salary	£20,000	£20,000	£0
Profit/loss sharing ratio	1	1	1

Rod's income in the tax years 2015/16 to 2018/19:

Tax year	Employment income	Dividends
	£	£
2015/16	82,000	0
2016/17	90,000	16,000
2017/18	86,000	12,000
2018/19	26,000	8,000

Required:

(a) Calculate Rod's after-tax proceeds from the sale of his shares in Lumba plc and explain your calculation of the base cost for the shares. (6 marks)

(b) (i) Calculate Rod's share of the tax-adjusted trading loss in the Thora Partnership for the tax years 2018/19 and 2019/20.

Note: Your answer to this part (b)(i) should clearly show the relevant basis periods. (6 marks)

(ii) State how Rod is able to relieve the trading loss(es) calculated in (b)(i) above as early as possible, and explain, with supporting calculations, the total amount of income tax saved if Rod follows this strategy.

Note: You should assume the tax rates and allowances for the tax year 2018/19 apply to all tax years. (8 marks)

(20 marks)

End of Question Paper