Answers

1 Maia

Memorandum

Client	Maia
Subject	Provision of financial assistance for Josh
Prepared by	Tax senior
Date	4 June 2019

(a) **Josh – additional cash requirement**

	£	£
2019/20		
Salary	25,200	25,200
Shares in NL Ltd (£2,100 – £300)	1,800	
Home cinema (£1,700 x 20%)	340	
Mobile telephone (exempt)	0	
Employment income	27,340	
Dividend income	420	420
	27,760	
Less: personal allowance	(11,850)	
	15,910	
		25,620
Income tax		
£15,490 (£27,340 – £11,850) x 20%	3,098	
£420 x 0% (nil rate band)	0	
		(3,098)
Class 1 national insurance contributions (NIC)		
(£25,200 – £8,424) x 12%	2,013	(2,013)
Income after tax and NIC		20,509
2020/21		
As for 2019/20		20,509
Add: tax in respect of shares in NL Ltd (£1,800 x 20%)		360
Income after tax and NIC		20,869
Cash required (24 x £2,500)		60,000
Anticipated income (£20,509 + £20,869)		(41,378)
Additional cash required		18,622

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

(i) **Gift of investment property**

Increase in Josh's post-tax income

Josh would receive net rental income of £13,200 (£1,100 x 12) in a full tax year, such that he would continue to be a basic rate taxpayer. Accordingly, his additional post-tax income in the 21-month period from 1 July 2019 to 5 April 2021 would be £18,480 (£1,100 x 21 x 80%).

Capital gains tax (CGT) liabilities for Maia

Maia's gift of the building would be treated as a sale at market value for the purposes of calculating the chargeable gain. This gives rise to a gain of £240,000 (£370,000 – £130,000).

If the building IS NOT furnished holiday accommodation:

– The building would not be a business asset, such that neither gift relief nor entrepreneurs' relief would be available.

– Maia is a higher rate taxpayer who uses her annual exempt amount every year. Accordingly, her CGT liability on the gift of the building will be £67,200 (£240,000 x 28%).

If the building IS furnished holiday accommodation:

– Gift relief would be available because furnished holiday accommodation is included within the definition of business assets used in the trade. Accordingly, no CGT would be payable by Maia in respect of the gift.

Tutorial note: *A claim for gift relief would need to be signed by both Maia and Josh as it is a joint election. Those candidates who did not recognise the availability of gift relief were given credit for explaining that entrepreneur's relief would be available, such that the CGT rate applied to the gain would be 10%.*

Inheritance tax (IHT) implications for Maia and Josh

If the building IS NOT furnished holiday accommodation:

– The gift would be a potentially exempt transfer, such that there would be no inheritance tax due unless Maia were to die within seven years of the gift.

– If Maia were to die within seven years of the gift, the excess of the market value of the property at the time of the gift (i.e. £370,000) over Maia's available nil rate band would be subject to IHT at 40%. This tax would be payable by Josh.

– Maia's available nil rate band would be the nil rate band for the year of death (assumed to be £325,000) less her chargeable transfers in the seven years prior to 1 July 2019.

– Taper relief would be available if Maia were to survive the gift by more than three years. This would reduce the IHT by 20% for each additional full year for which she survived the gift.

If the building IS furnished holiday accommodation:

– Since Maia will have owned the building for more than two years prior to the transfer, the gift could qualify for 100% business property relief (BPR). However, the building will only qualify as relevant business property if Maia is able to demonstrate to HM Revenue and Customs (HMRC) that it is operated as a business with substantial involvement by her (and subsequently by Josh) and additional services are provided. It should be anticipated that this treatment will be resisted by HMRC.

– Even if it does qualify for BPR, it will be necessary for Josh to still own the building (or replacement business property) and for it to still be qualifying business property at the time of Maia's death.

(ii) Gift of shares in Far Ltd

CGT liabilities for Maia

Maia's gift of the shares would be treated as a sale at market value for the purpose of calculating the chargeable gain. Gift relief would be available because Far Ltd is an unquoted trading company.

	£	£
Proceeds at market value		420,000
Less: cost		
Market value on 1 November 2018	375,000	
Less: gift relief in respect of earlier gift	(140,000)	
		(235,000)
		185,000
Less: gift relief (£185,000 x 84% (100% – 16%))		(155,400)
Chargeable gain		29,600

Entrepreneurs' relief would not be available, regardless of whether or not Maia works for Far Ltd, because Maia will not have owned the shares for one year on 1 July 2019. Accordingly, as Maia is a higher rate taxpayer, her CGT liability would be £5,920 (£29,600 x 20%).

IHT implications for Maia and Josh

Business property relief would not be available because Maia will not have owned the shares for two years on 1 July 2019. Accordingly, the IHT implications would be the same as for the gift of the investment property, where it is not furnished holiday accommodation, as set out above.

(iii) Monthly cash gifts

Increase in Josh's post-tax income

There would be no income tax implications for Josh. He would therefore receive £21,000 over the 21-month period.

CGT liabilities for Maia

There would be no CGT implications for Maia because cash is an exempt asset.

IHT implications for Maia and Josh

These gifts are likely to be exempt from IHT as they would satisfy the following conditions:

– They would be part of Maia's expenditure out of her income.
– There would be a regular pattern of giving.
– They would not affect Maia's standard of living.

2 Plad Ltd and Quil Ltd

(a) Group relief

(i) Maximum group relief

– The whole of Plad Ltd's UK trading profit of £48,000 should be covered by group relief. However, in order not to waste double tax relief (DTR), an amount of Plad Ltd's Chekkan profits should remain subject to corporation tax.

– The amount of Chekkan profits which should remain subject to corporation tax is £5,158 (£7,000 x 14%/19%), being the amount on which the UK corporation tax (£5,158 x 19% = £980) equals the whole of the Chekkan tax paid by Plad Ltd (£7,000 x 14% = £980).

– In this situation, the Chekkan tax suffered will be fully relieved as DTR (being the lower of the UK tax on the Chekkan income and the Chekkan tax suffered).

– Accordingly, the group relief should be the UK profits of £48,000 plus the balance of the Chekkan profits of £1,842 (£7,000 – £5,158), i.e. £49,842. With group relief of this amount, Plad Ltd's UK corporation tax liability will be fully covered by DTR, such that there will be no UK corporation tax payable.

Tutorial note: *The following calculation demonstrates that where the group relief is £49,842, as calculated above, none of the DTR will be wasted and the corporation tax liability will be zero.*

	£	£
Taxable total profits before group relief		*55,000*
Group relief		*(49,842)*
Taxable total profits		*5,158*
Corporation tax at 19%		*980*
Double tax relief – the lower of:		
UK tax on overseas profits (£5,158 x 19%)	*980*	
Overseas tax (£7,000 x 14%)	*980*	
		(980)
Corporation tax liability		*0*

(ii) Corporation tax liabilities

Plad Ltd

Year ending 30 June 2020

The corporation tax liability of Plad Ltd for the first year will be £nil, as explained above.

Year ending 30 June 2021

	£
Taxable total profit pre group relief	55,000
Less: group relief (W2)	(44,182)
Taxable total profit	10,818
Corporation tax at 19%	2,055
Less: DTR	
The lower of:	
UK tax on the Chekkan profits of £1,330 (£7,000 x 19%)	
Chekkan tax of £980	(980)
Corporation tax liability	1,075

Quil Ltd

	Year ending 30 June	
	2020	2021
	£	£
Trading profit/(loss) before capital allowances	(15,000)	162,000
Capital allowances (W1)	(231,200)	(25,824)
Trading loss	(246,200)	
Trading profit	Nil	136,176
Chargeable gain	–	16,000
	Nil	152,176
Loss brought forward (W2)	–	(152,176)
Taxable total profit	Nil	Nil
Corporation tax liability at 19%	Nil	Nil

(iii) Conclusion

- Where the two companies are in a group relief group (as opposed to being owned personally by Claire) trading losses of £94,024 (£49,842 + £44,182) would be relieved by group relief in the two-year period rather than being carried forward.
- At the least, this is advantageous from the point of view of cash flow, as it delays total tax payments of £17,865 (£94,024 x 19%).
- In addition, if group relief were not available, such that Quil Ltd had to carry forward unused losses, there is no certainty that the losses would ever be relieved.

Tutorial note: *Quil Ltd is required to use its losses brought forward against its own taxable total profits before it can surrender losses to Plad Ltd as group relief.*

Workings

1. Capital allowances

	Main pool	Special rate pool	Allowances
	£	£	£
Year ending 30 June 2020			
Additions qualifying for AIA	160,000	230,000	
AIA	–	(200,000)	200,000
	160,000	30,000	
WDA at 18%/8%	(28,800)	(2,400)	31,200
			231,200
TWDV carried forward	131,200	27,600	
Year ending 30 June 2021			
WDA at 18%/8%	(23,616)	(2,208)	25,824
TWDV carried forward	107,584	25,392	

2. Quil Ltd – loss memorandum

	Year ending 30 June	
	2020	2021
	£	£
Trading loss brought forward	0	196,358
Trading loss for the current year	246,200	
Offset against total profits of Quil Ltd	–	(152,176)
Surrender to Plad Ltd	(49,842)	(44,182)
Trading loss carried forward	196,358	0

(b) Group registration for value added tax (VAT) purposes

Two companies can register as a group for the purposes of VAT provided they are established in the UK and one controls the other or they are both controlled by the same person. Accordingly, Plad Ltd and Quil Ltd will be able to register as a group regardless of whether Plad Ltd owns Quil Ltd or they are both owned personally by Claire.

Claire should be aware that the annual accounting scheme will not be available if the two companies are registered as a group.

(c) Plad Ltd – unreported chargeable gain

Plad Ltd

– The company has a responsibility to report this omission to HM Revenue and Customs (HMRC) and to pay the outstanding corporation tax. It will be committing tax evasion, a criminal offence, if it fails to do so.

– HMRC will charge Plad Ltd interest on any tax which becomes payable.

Our firm

– We should investigate how this error arose and consider whether or not there are likely to be further errors.

– We will not retain a client which is engaged in deliberate tax evasion, as this poses a threat to the fundamental principles of integrity and professional behaviour. Accordingly, we could not continue to act for Plad Ltd unless the chargeable gain is disclosed to HMRC.

– If we were to cease to act for Plad Ltd, we would notify HMRC, although we would not provide them with any reason for our action.

3 (a) Compulsory registration for value added tax (VAT) and why voluntary registration is beneficial

If Dent Ltd registers for VAT on 1 April 2020, it can make a claim to recover input tax suffered on goods and services purchased prior to registration as follows:

Input tax may be recovered on assets which have been purchased for the purpose of the business in the four years prior to registration, provided they are still held by Dent Ltd on 1 April 2020. Thus, Dent Ltd will be able to recover the VAT paid on the purchase of the specialist equipment. However, VAT will not be recoverable on the cost of the consumables which have been consumed prior to 1 April 2020.

Input tax may be recovered on the supply of services for the purpose of the business, which were supplied within the six months prior to registration. Accordingly, Dent Ltd will not be able to recover input VAT on a proportion of the property costs and the agency fees which relate to the period from 1 July 2019 to 30 September 2019.

If Dent Ltd registers for VAT on 1 July 2019, all the VAT suffered on the goods and services supplied from commencement of the business will be recoverable. Additionally, there will be a cash flow advantage for Dent Ltd as it is likely to be in a repayment position in at least the first of its VAT returns.

Although Dent Ltd will have to charge VAT on its taxable supplies from 1 July 2019, this will not be a problem for its customers, as they will all be VAT registered and therefore able to reclaim any VAT charged.

(b) Corporation tax relief available in respect of the research and development (R&D) expenditure

The expenditure on the specialist equipment qualifies for a 100% capital allowance as it is capital expenditure on an asset to be used for R&D purposes.

As Dent Ltd is a small enterprise for the purposes of R&D expenditure, an additional 130% deduction is available in calculating the company's taxable trading income in respect of qualifying revenue expenditure which is directly related to the R&D activities. In this case, this will apply to the property costs (as they comprise only heat, light and water charges), consumables and the staff costs (including the pension contributions). However, this additional relief is restricted in respect of the contractor supplied by the agency (as an unconnected third party) to 65% of the cost, i.e. £16,250 (65% x £25,000).

Therefore the total deduction available to Dent Ltd in the year ending 30 June 2020 is £657,525 (£353,000 + (130% x (£46,000 + £12,000 + (£185,000 – £25,000 + £16,250)))).

(c) Lump sum payment and provision of computer and temporary living accommodation to Alina

Income tax implications for Alina of receiving the lump sum payment

The lump sum payment is fully taxable on Alina in 2019/20 as it relates to future services to be performed by her.

After-tax cost to Dent Ltd

Lump sum payment

	£
Amount of payment	10,000
Class 1 employer national insurance contributions (NIC) (£10,000 x 13·8%)	1,380
Pre-tax cost of lump sum payment	11,380

This is eligible for the additional 130% deduction as it is qualifying R&D expenditure, so the tax-deductible amount for Dent Ltd is £26,174 (£11,380 x 230%).

Provision of computer and temporary living accommodation

	£
Cost of computer	1,000
Rent paid (£660 x 6)	3,960
Class 1A NICs (£4,110 (W) x 13·8%)	567
Pre-tax cost of the provision of computer and temporary living accommodation	5,527

The total tax-deductible amount is £31,701 (£26,174 + £5,527)

	£
Total pre-tax cost to Dent Ltd (£11,380 + £5,527)	16,907
Less: corporation tax relief: (£31,701 x 19%)	(6,023)
After-tax cost	10,884

Working

		£
Taxable benefits for Alina in 2019/20:		
Computer (£1,000 x 20% x 9/12)		150
Accommodation benefit: Higher of	(i) annual value = £2,800	
	(ii) rent paid by Dent Ltd = £3,960 (£660 x 6)	3,960
Taxable benefit		4,110

Tutorial notes:

1. *The provision of taxable benefits to an employee is not qualifying expenditure for the purpose of the additional 130% deduction for R&D expenditure.*
2. *Dent Ltd can claim an annual investment allowance (AIA) in respect of the cost of the computer.*

4 (a) After-tax proceeds from the sale of the Lumba plc shares

The capital gain on the sale of the Lumba plc shares is calculated as follows:

	£	£
Sale proceeds (£4·00 x 20,000)		80,000
Less: exercise price (£2·30 x 20,000)	46,000	
amount charged to income tax on exercise (see below)	6,000	
Base cost		(52,000)
Chargeable gain		28,000
Less: annual exempt amount		(11,700)
Taxable gain		16,300

The capital gains tax payable is £1,630 (£16,300 x 10%).

The after-tax proceeds are £78,370 (£80,000 – £1,630).

As the options were granted at a discount to the market value at the date of grant, a charge to income tax will have arisen on 1 June 2018, when Rod exercised the options, on an amount of £6,000 (£0·30 per share x 20,000 shares), being the difference between the market value of the shares at the date of grant and the exercise price of the options (£2·60 – £2·30). This is added to the price paid for the shares (£2·30 per share) in calculating the base cost of the shares.

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

	£
2018/19 (1 December 2018 to 5 April 2019)	
£29,000 (W) x 4/12	9,667
2019/20 (1 December 2018 to 30 November 2019)	
Loss 1 December 2018 to 30 November 2019 (W)	29,000
Less: used in 2018/19	(9,667)
	19,333

Working:

	£
Tax-adjusted trading loss year ending 30 November 2019	47,000
Add: salaries for Abe and Bob (£20,000 + £20,000)	40,000
Balance of loss to be allocated in the profit/loss sharing ratio	87,000

Rod's share of the loss is £29,000 (£87,000/3).

(ii) Tax saving available to Rod as a result of taking the earliest possible relief for his share of the trading losses of the Thora Partnership

Rod has a trading loss of £9,667 in 2018/19 and a trading loss of £19,333 in 2019/20.

The losses can be carried back and offset against Rod's total income of the three years prior to the tax year of the loss in each case, on a FIFO basis. This is the earliest possible relief available to Rod.

The loss of 2018/19 will be carried back and offset against Rod's total income of 2015/16 of £82,000, which will result in a tax saving of £3,867 (£9,667 x 40%).

The loss of 2019/20 will be carried back and offset against Rod's total income of 2016/17 of £106,000 (£90,000 + £16,000). This will result in a tax saving of £7,733 (£19,333 x 40%), as the relief will be taken against the employment income in priority to the dividends. Additionally, as Rod's total income originally exceeded £100,000, his personal allowance was restricted to £8,850 (£11,850 – ((£106,000 – £100,000)/2)). After taking loss relief, his full personal allowance will be available, generating a further tax saving of £1,200 ((£11,850 – £8,850) x 40%).

Therefore Rod's total tax saving as a result of taking loss relief is £12,800 (£3,867 + £7,733 + £1,200).

Tutorial notes:

1. *Rod is eligible to claim opening years' loss relief as the trading loss arose within the first four years of him joining the partnership.*
2. *In calculating an individual's income tax liability, losses are usually offset against non-savings income first, before savings income (if any), and then dividends. This will maximise the amount of tax relief obtained.*

				Available	*Maximum*
1	**(a)**	Tax year 2019/20			
			Employment income	3	
			PA and tax liability	2	
			National insurance contributions	1·5	
		Tax year 2020/21		1·5	
		Monthly cash required		2	
				10	9
	(b)	**(i)**	Income tax	2	
			Capital gains tax		
			Taxable gain	1	
			If the building is not furnished holiday accommodation (FHA)	1·5	
			If the building is FHA	2	
			Inheritance tax		
			If the building is not FHA	4	
			If the building is FHA	3	
				13·5	12
		(ii)	Capital gains tax		
			Chargeable gain	1·5	
			Gift relief	2·5	
			Tax payable	2·5	
			Inheritance tax	2	
				8·5	7
		(iii)	Income tax	1	
			Capital gains tax	1	
			Inheritance tax	2	
				4	3
	Problem solving			1	
	Clarity of explanations and calculations			1	
	Effectiveness of communication			1	
	Overall presentation and style			1	
				4	4
	Total				**35**
2	**(a)**	Tax-efficient group relief		5	
		Plad Ltd corporation tax liabilities			
			Year ending 30 June 2020	1	
			Year ending 30 June 2021	3·5	
		Quil Ltd corporation tax liabilities			
			Capital allowances	4	
			Two years ending 30 June 2021	3·5	
		Conclusion		2	
				19	17
	(b)	Conditions for group registration		2	
		Annual accounting scheme		1	
				3	3
	(c)	Plad Ltd		2·5	
		Our firm		4	
				6·5	5
	Total				**25**

				Available	Maximum
3	(a)	Pre-registration expenditure – goods		3	
		Pre-registration expenditure – services		1·5	
		Benefits of voluntary registration		2·5	
				7	6
	(b)	Capital expenditure – explanation		1	
		Additional deduction for revenue expenditure – explanation		3·5	
		Total deduction – calculation		2	
				6·5	6
	(c)	Income tax implications for Alina		1	
		Pre-tax cost of lump sum payment		2·5	
		Pre-tax cost of computer and living accommodation		4	
		Total pre-tax expenditure		0·5	
		Corporation tax saving		0·5	
				8·5	8
	Total				**20**
4	(a)	Calculation of chargeable gain		2	
		Calculation of after-tax proceeds		2	
		Explanations		3	
				7	6
	(b)	(i)	Calculation of Rod's share of the loss (working)	2	
			2018/19 loss	2	
			2019/20 loss	2·5	
				6·5	6
		(ii)	Identification of earliest relief	3	
			Calculation of tax saving – 2015/16	1·5	
			– 2016/17	4	
			Total saving	1	
				9·5	8
	Total				**20**