
Answers

1 Snowdon

Memorandum

Client Snowdon
Subject Personal tax matters
Prepared by Tax senior
Date 7 June 2018

(i) Purchase of the cottage from Coleen

Errors in Snowdon's computation

- The value of the gift for the purpose of inheritance tax (IHT) is the fall in value of Coleen's estate, i.e. £35,000 (£260,000 – £225,000) being the value of the cottage less the amount paid by Snowdon.
- The cottage was a lifetime gift and not a gift on death. Accordingly, the annual exemption for both the year of the gift and the previous year are available: a total of £6,000 (2 x £3,000).
- The 40% rate of taper relief is correct. However, the relief should be 40% of the inheritance tax due as opposed to 40% of the gift.
- The nil rate band of £325,000 should be reduced by chargeable transfers in the seven years prior to 1 May 2014. Accordingly, it will be reduced by the chargeable lifetime transfer made by Coleen on 1 March 2010.

Inheritance tax due in respect of the gift of the cottage

	£
Value of the gift	35,000
Less: annual exemptions (£3,000 x 2)	<u>(6,000)</u>
	29,000
Nil rate band	325,000
Less: chargeable transfer in the seven years prior to 1 May 2014	<u>(318,000)</u>
Available nil rate band	7,000
Inheritance tax ((£29,000 – £7,000) x 40%)	8,800
Less: taper relief (£8,800 x 40%) (between four and five years)	<u>(3,520)</u>
	5,280

Base cost of the cottage for the purposes of a future disposal

	£	£
Value of the cottage as at 1 May 2014		260,000
Less: gift relief		
Proceeds (market value)	260,000	
Less: cost	<u>(165,000)</u>	
	95,000	
Less: £225,000 – £165,000	<u>(60,000)</u>	
Gift relief		<u>(35,000)</u>
Base cost of cottage		225,000

(ii) Expansion of the Siabod business

Strategy A

	£
Additional turnover (£435,000 – £255,000)	<u>180,000</u>
Salary	48,000
Employer's class 1 NIC ((£48,000 – £8,164) x 13.8%)	5,497
Overheads and advertising (£38,000 + £2,000)	40,000
Irrecoverable VAT (W1)	nil
	<u>93,497</u>
Additional tax adjusted trading profit (£180,000 – £93,497)	<u>86,503</u>

Strategy B

	£
Additional turnover (as for strategy A)	180,000
Fee paid to Tor Ltd	90,000
Advertising	2,000
Irrecoverable VAT (W2)	8,736
	<u>100,736</u>
Additional tax adjusted trading profit (£180,000 – £100,736)	<u>79,264</u>

The most financially advantageous strategy would be strategy A.

Additional post-tax income in respect of strategy A

	£
Tax adjusted trading profit prior to expansion	85,000
Tax adjusted trading profit in respect of expansion (above)	<u>86,503</u>
	171,503
Interest income	<u>740</u>
	172,243
Personal allowance	Nil
	<u>172,243</u>

	£
Income tax on trading income	
£33,500 x 20%	6,700
(£150,000 – £33,500) x 40%	46,600
(£171,503 – £150,000) x 45%	<u>9,676</u>
	62,976
Income tax on interest income	
£740 x 45%	333
Class 4 NIC	
(£45,000 – £8,164) x 9%	3,315
(£171,503 – £45,000) x 2%	<u>2,530</u>
Total income tax and NIC	69,154
Less: income tax and class 4 NIC on profit of £85,000 (£22,700 + £4,115)	(26,815)
Less: income tax on interest income prior to expansion of business ((£740 – £500) x 40%)	<u>(96)</u>
Additional income tax and class 4 NIC in respect of expansion	<u>42,243</u>
Additional post-tax income (£86,503 – £42,243)	<u>44,260</u>

Tutorial note: Prior to expanding the business, Snowdon was a higher rate taxpayer and was therefore entitled to a savings income nil rate band of £500. Following the expansion of the business, he will be an additional rate taxpayer and will not be entitled to this allowance.

Workings

1. Strategy A – recoverable input tax

	£
Partial exemption percentage	<u>76%</u>
Total input tax (£18,000 + ((£38,000 + £2,000) x 20%))	26,000
Attributable to taxable supplies (£26,000 x 76%)	<u>(19,760)</u>
Attributable to exempt supplies	<u>6,240</u>

The VAT attributable to exempt supplies can be recovered in full as it is below the annual *de minimis* limit of £7,500 (£625 x 12) and is less than half of the total input tax.

2. Strategy B – recoverable input tax

	£
Partial exemption percentage	76%
Total input tax (£18,000 + ((£90,000 + £2,000) x 20%))	36,400
Attributable to taxable supplies (£36,400 x 76%)	(27,664)
Attributable to exempt supplies	8,736

The VAT attributable to exempt supplies cannot be recovered as it exceeds the annual *de minimis* limit of £7,500 (£625 x 12).

(iii) Procedures we should follow before we agree to become Snowdon's tax advisers

- We must obtain evidence of Snowdon's identity (for example, his passport) and his address.
 - We must have regard to the fundamental principles of professional ethics. This requires us to consider whether becoming tax advisers to Snowdon would create any threats to compliance with these principles.
 - Integrity: we must consider the appropriateness of Snowdon's attitude to complying with the law and the disclosure of information to HM Revenue and Customs (HMRC).
 - Professional competence: we must ensure that we have the skills and competence necessary to be able to deal with the matters which may arise in connection with Snowdon's affairs.
- If any such threats are identified, we should not accept the appointment unless the threats can be reduced to an acceptable level via the implementation of safeguards.
- We should contact Snowdon's existing tax adviser(s) in order to ensure that there has been no action by Snowdon which would preclude the acceptance of the appointment on ethical grounds.
 - We must carry out a review in order to satisfy ourselves that Snowdon is not carrying on any activities which may be regarded as money laundering.

2 Set Ltd group of companies

(a) Ghost Ltd – corporation tax payments

Steam Ltd capital loss

Ghost Ltd and Steam Ltd are members of a capital gains group because Set Ltd owns at least 75% of the ordinary share capital of both companies.

Accordingly, the capital loss in respect of the disposal of the building by Steam Ltd could be transferred to Ghost Ltd. However, the loss could only be offset against chargeable gains (i.e. not trading profit or other income) realised by Ghost Ltd after it became a member of the Set Ltd capital gains group on 1 June 2018.

Wagon Ltd trading losses

Ghost Ltd and Wagon Ltd are members of a group relief group because Set Ltd owns at least 75% of the ordinary share capital of both companies. Trading losses made whilst the companies are members of the group can be transferred from one company to the other.

Ghost Ltd became a member of the Set Ltd group relief group on 1 June 2018. Its eight-month accounting period ending on 31 December 2018 will have seven months in common with the 12-month accounting period of Wagon Ltd ending on 31 December 2018. Accordingly, the maximum trading loss which can be transferred from Wagon Ltd to Ghost Ltd is the lower of:

- 7/12 of the trading loss of Wagon Ltd for the year ending 31 December 2018; and
- 7/8 of the taxable trading profit of Ghost Ltd for the eight-month period ending 31 December 2018.

The trading loss brought forward by Wagon Ltd cannot be transferred to Ghost Ltd.

Payments of corporation tax

In respect of the year ended 30 April 2018

14 August 2018 The final payment for this accounting period will be due. The amount due is £597,500 (the total liability for the accounting period), less all the instalment payments already made in respect of the period.

In respect of the eight-month period ended 31 December 2018

14 November 2018 The first payment for this accounting period will be due. The amount due will be 3/8 of the estimated corporation tax liability for the eight-month period, i.e. £172,500 (3/8 x £460,000).

(b) Wagon Ltd – value added tax (VAT)

Purchases from Line Co

On the assumption that the manufacturing components would be a standard rated supply if they were supplied in the UK, Wagon Ltd would normally be required to pay UK VAT at the standard 20% rate when it imports the components into the UK. However:

- if the goods are placed in a bonded warehouse, the VAT will not be due for payment until the goods are removed from the warehouse; and
- if Wagon Ltd is an approved trader within the duty deferment system, the payment of the VAT can be deferred.

Provided the components are used to make taxable supplies, the VAT paid can be reclaimed by Wagon Ltd as input tax on its VAT return.

Sales to Signal Co

Wagon Ltd will be required to charge UK VAT at 20% on the sales made to Signal Co because Signal Co is not registered for VAT. Signal Co will not be able to recover this VAT (because it is not VAT registered).

Wagon Ltd will be required to register for VAT in France if its sales to Signal Co and other non-registered customers in France exceed the European Union distance selling threshold for France.

(c) Dee Co and En Co – controlled foreign company (CFC) charge

Dee Co

No CFC charge can arise in respect of Dee Co because Set Ltd owns less than 25% of Dee Co's ordinary share capital.

En Co

Low profits exemption

The low profits exemption does not apply even though En Co has taxable total profits of less than £500,000. This is because the company's non-trading income exceeds £50,000.

Low profit margin exemption

The low profit margin exemption applies because En Co's accounting profit of £280,000 does not exceed 10% of its operating expenditure of £3,200,000.

(d) Steam Ltd – Project Whistle

Loss reliefs available

A trading loss made by Steam Ltd in the year ending 31 December 2019 can be relieved, broadly speaking, in two ways:

- (i) It can be offset against the income and gains of Steam Ltd and/or the taxable total profits of other companies in the Set Ltd group relief group.
 - Steam Ltd could offset the loss against its total income and gains of the loss-making accounting period, and then against its total income and gains of the previous 12 months.
 - The loss could also be offset against the current period taxable total profits of Set Ltd and any other company which is an effective 75% subsidiary of Set Ltd. Current period only.
 - Any loss remaining will be carried forward by Steam Ltd for relief against its future profits arising in respect of the same trade.
- (ii) Any amount of the loss up to a maximum of 230% of the qualifying research and development expenditure can be surrendered in exchange for a cash payment of 14.5% of the surrendered amount.

Factors to consider when choosing between the available reliefs

Relief under (i) above will result in a corporation tax saving of 19% of the loss relieved. This equates to a saving of 43.7% (230% x 19%) of the cost incurred in respect of the research and development.

Relief under (ii) above equates to a corporation tax saving of only 33.35% (230% x 14.5%) of the cost incurred.

Accordingly, a greater tax saving will be achieved by relieving the loss against taxable profits (under (i)) rather than surrendering it in exchange for a cash payment (under (ii)).

However, if there are insufficient profits to relieve all of the trading loss, any loss remaining will have to be carried forward unless it is surrendered in exchange for the 14.5% cash payment.

From a cash flow point, it will be better to claim the cash payment rather than to carry the loss forward. The cash payment option is also beneficial if it transpires that Steam Ltd will not make sufficient profits in the future to relieve the losses carried forward.

Tutorial note: *The changes made to the rules relating to the relief for corporate losses introduced by the Finance No. 2 Act 2017 are not examinable until the June 2019 exam. However, credit was given to candidates who applied these new rules rather than the old rules.*

3 Max

(a) (i) Availability of gift relief in respect of the gift of the office premises

The office premises are eligible for gift relief as they were used for the purpose of Max's trade. However, as they ceased to be used in the business on 31 May 2016, the proportion of the gain to be held over is restricted to the gain on disposal x period of business use/total period of ownership. Therefore the proportion of the gain eligible for gift relief is 74/99 ((1 April 2010 – 31 May 2016)/(1 April 2010 to 30 June 2018)). The relief will only be available if the donee, Fara, is UK resident.

(ii) Maximum potential inheritance tax (IHT) liability in respect of the gift of the office premises

No IHT is payable at the time the gift is made, but a liability may arise if Max dies within seven years of making the gift.

Business property relief is not available as this is a gift of an individual asset which has been used in an unincorporated sole trader business, rather than the gift of the business itself. However, annual exemptions are available for the tax years 2018/19 and 2017/18, such that the gross chargeable value of the gift will be £162,000 (£168,000 – £3,000 – £3,000).

Max has made one prior gift, on 6 May 2015, which will use part of his nil rate band if he dies before 6 May 2022. Taper relief will be available if Max dies after 30 June 2021 (three years after the date of the gift on 30 June 2018), so the maximum potential IHT liability will arise if Max dies before this date.

The maximum potential inheritance tax liability is therefore £12,400 (£162,000 – (£325,000 – £194,000) x 40%) and will arise if Max dies on or before 30 June 2021.

(b) Effect of Max's two-and-a-half-year period overseas on his UK residence status and the capital gains tax (CGT) consequences on the sale of the warehouse

Max will leave the UK on 1 November 2018. As Max was resident in the UK for one or more of the previous three tax years, and he will spend more than 91 days in the UK in the tax year 2018/19, then he will NOT satisfy any of the automatic overseas tests.

Max WILL satisfy the first automatic UK residence test in 2018/19 as he will spend 183 days or more in the UK in that tax year.

In the tax years 2019/20 and 2020/21 Max will satisfy the first automatic overseas residence test as he is in the UK for 16 days or less in each tax year.

In the tax year 2021/22 Max's return to live permanently in the UK from 30 June 2021 means that he will not satisfy any of the automatic overseas residence tests, but will satisfy the UK residence test as he will spend 183 days or more in the UK in that tax year.

(1) Sale in June 2018

As Max is resident in the UK in June 2018, the disposal will give rise to a chargeable gain in 2018/19.

(2) Sale in June 2019

Disposals of assets made by non-UK resident individuals are not chargeable to CGT in the UK. However, Max will be regarded as a temporary non-resident, as his period of non-residence will be less than five years, and he has been UK resident for at least four of the seven tax years prior to the tax year of departure. Accordingly, any gains made in the period of non-residence in respect of assets held prior to Max's departure, and disposed of while he is overseas, will become chargeable in 2021/22 (the tax year of his return).

(c) Availability of entrepreneurs' relief on the sale of the warehouse

The sale of the warehouse will satisfy two of the conditions for entrepreneurs' relief in that it was in use within Max's business at the date of cessation, and the business had been owned by Max for at least one year prior to cessation. However, the third condition, that the disposal must be within three years of the date of cessation, will only be satisfied if the disposal takes place before 1 June 2019. Accordingly, if the sale takes place in June 2018, entrepreneurs' relief will be available, but if it does not take place until June 2019, it will not.

Sale in June 2018

If the sale of the warehouse takes place in June 2018, this will give rise to a chargeable gain of £22,000 (£84,000 – £62,000 (W))

As Max will be able to claim entrepreneurs' relief in respect of this chargeable gain, the after-tax proceeds will be £81,800 (£84,000 – (£22,000 x 10%)).

Sale in June 2019

If the sale of the warehouse is delayed until June 2019, this will give rise to a chargeable gain of £28,000 (£90,000 – £62,000 (W)) in 2020/21.

As Max will not be able to claim entrepreneurs' relief in respect of this chargeable gain, the after-tax proceeds will be £84,400 (£90,000 – (£28,000 x 20%)).

The increase in after-tax proceeds is therefore £2,600 (£84,400 – £81,800).

Working:

	£
Chargeable gain on disposal of showroom	16,000
Proceeds not reinvested (£78,000 – £72,000)	(6,000)
Rollover relief available	<u>10,000</u>

The base cost of the warehouse is £62,000 (£72,000 – £10,000).

4 Jessica

(a) Income tax implications of the redundancy package

The statutory redundancy pay is fully exempt from income tax. However, it reduces the £30,000 exemption available for the *ex-gratia* payment.

The taxable amount of the *ex-gratia* payment is therefore £20,000 (£32,000 – (£30,000 – £18,000)).

The cash equivalent of the gift of the laptop computer must also be included. This is the higher of:

- (1) the market value at 31 March 2018, i.e. £540; and
- (2) the value of the laptop computer at the date it was first provided to Jessica, less the amounts subsequently taxed on her as a benefit, i.e. £680 (£850 – £170 (20% x £850))

The total taxable amount of the package is therefore £20,680 (£20,000 + £680).

The package is taxed as the top slice of Jessica's income for the tax year 2017/18, so the income tax payable on the redundancy package will be £9,306 (£20,680 x 45%).

Tutorial note: *Jessica's taxable income for the tax year 2017/18 already exceeds £150,000 (salary £145,000 + rental income £6,000; no personal allowance is available). Jessica is therefore an additional rate taxpayer.*

(b) (i) Reliefs available for Jessica's share of the partnership loss

The trading loss for tax purposes has arisen in the tax year 2018/19.

It can be relieved against Jessica's total income for 2018/19, the tax year of the loss, and/or 2017/18, the previous tax year.

Alternatively, because the loss has arisen in one of the first four tax years in which Jessica will be a partner, it can be relieved against her total income of the three years prior to the year of the loss starting with the earliest year (i.e. 2015/16).

(ii) Strategy for loss relief to maximise Jessica's income tax savings

Jessica will join the Langley Partnership on 1 July 2018. Accordingly, her share of the partnership loss for the year ending 31 March 2019 will be £48,000 (£160,000 x 9/12 x 40%).

In 2018/19, Jessica's only source of income will be rental income of £6,000. As this will be covered by her personal allowance, relieving the loss in this year will not result in any tax saving.

In 2017/18, Jessica's taxable income before loss relief will be £171,850 (£145,000 + £6,000 + £170 + £20,680).

As Jessica is an additional rate taxpayer, the loss of £48,000 will generate a tax saving of £20,293 ((£21,850 (£171,850 – £150,000) x 45%) + (£26,150 (£48,000 – £21,850) x 40%)).

If, alternatively, Jessica carries the loss back to 2015/16 it will be relieved against her total income of that year of £145,000. As the resulting total income of £97,000 (£145,000 – £48,000) is below £100,000, the personal allowance will become available. Accordingly, the total income tax saving will be £23,800 ((£48,000 x 40%) + (£11,500 x 40%)).

Therefore the most beneficial claim is to carry back the loss and offset it in 2015/16 as this results in the highest tax saving, of £23,800.

(c) Jessica – maximum pension contributions 2018/19 and 2019/20

The maximum gross contribution which Jessica can make attracting tax relief each tax year is the higher of

- (1) Jessica's relevant earnings in the tax year; and
- (2) the basic amount of £3,600.

Jessica has no relevant earnings in the tax year 2018/19 as the Langley Partnership has made a loss in that year, and she has no other source of earned income. So the maximum contribution she can make in 2018/19 is £3,600.

In 2019/20, Jessica has relevant earnings of £82,000 (£205,000 x 40%) comprising her share of the partnership profit for the year ending 31 March 2020. Accordingly, she can make a contribution into the scheme of up to £82,000. This exceeds

the annual allowance available of £40,000, but as she was a member of a registered pension scheme in 2018/19 she can bring forward her unused allowance from that tax year of £36,400 (£40,000 – £3,600).

Therefore the total amount of annual allowance available is £76,400 (£40,000 + £36,400), so this is the maximum contribution which Jessica can pay without incurring an annual allowance charge.

Tutorial note: *No unused relief can be brought forward from years prior to 2018/19 as Jessica was not a member of a registered pension scheme until 1 May 2018.*

**Professional Level – Options Module, Paper P6 (UK)
Advanced Taxation (United Kingdom)**

June 2018 Marking Scheme

	<i>Available</i>	<i>Maximum</i>
1 (i) Identification of errors		
Value of the gift	1.5	
Annual exemptions	1.5	
Taper relief	2	
Nil rate band	1	
Calculation of inheritance tax	2.5	
Base cost for the purpose of capital gains tax	2	
	<u>10.5</u>	9
(ii) Additional tax adjusted trading profit – strategy A		
Additional turnover	0.5	
Salary, class 1 NIC and overheads	2	
Recoverable input tax	3	
Additional tax adjusted trading profit – strategy B		
Additional turnover and fee paid to Tor Ltd	1	
Recoverable input tax	3	
Conclusion	1	
Additional post-tax income		
Taxable income	3	
Income tax and class 4 NIC on trading income	2.5	
Income tax on interest income	1	
Remainder of calculation	3	
	<u>20</u>	17
(iii) Identity	1	
Fundamental principles	3	
Contact existing tax advisers	1	
Money laundering	1	
	<u>6</u>	5
Problem solving	1	
Clarity of explanations and calculations	1	
Effectiveness of communication	1	
Overall presentation and style	1	
	<u>4</u>	4
Total		<u>35</u>

	<i>Available</i>	<i>Maximum</i>
2 (a) Steam Ltd capital loss	2·5	
Wagon Ltd trading losses		
Loss brought forward	1	
Current period loss	2·5	
Payments of corporation tax		
In respect of the year ended 30 April 2018	2·5	
In respect of the eight-month period ended 31 December 2018	<u>2</u>	
	<u>10·5</u>	9
(b) Purchases from Line Co	4	
Sales to Signal Co	<u>3</u>	
	<u>7</u>	5
(c) Dee Co	1	
En Co	<u>3</u>	
	<u>4</u>	4
(d) Loss reliefs available		
Relief against profits	4	
Surrendered for cash payment	1	
Evaluation of the reliefs	<u>4</u>	
	<u>9</u>	<u>7</u>
Total		<u>25</u>
3 (a) (i) Gift relief	<u>4</u>	3
(ii) Gross chargeable value of the gift	2·5	
Circumstances in which maximum liability arises	2·5	
Calculation of maximum liability	<u>1</u>	
	<u>6</u>	5
(b) Max's residence status	3	
Sale in June 2018	1	
Sale in June 2019	<u>3</u>	
	<u>7</u>	6
(c) Entrepreneurs' relief	3	
After-tax proceeds from sale in June 2018	2·5	
After-tax proceeds from sale in June 2019	1·5	
Increase in after-tax proceeds	<u>0·5</u>	
	<u>7·5</u>	<u>6</u>
Total		<u>20</u>

	<i>Available</i>	<i>Maximum</i>
4 (a) Cash amounts received	2.5	
Laptop computer	2	
Calculation of income tax payable	1.5	
	<u>6</u>	5
(b) (i) Options for relief of Jessica's share of the partnership loss	<u>3</u>	3
(ii) Share of partnership loss year ending 31 March 2019	1	
Relief in 2018/19	1.5	
Relief in 2017/18	3	
Relief in 2015/16	2.5	
Conclusion	0.5	
	<u>8.5</u>	7
(c) Maximum contribution 2018/19	2.5	
Maximum contribution 2019/20	4	
	<u>6.5</u>	<u>5</u>
Total		<u>20</u>