Answers

1 Wanda

Notes for use in a client meeting

Client	Wanda
Subject	Various matters
Prepared by	Tax senior
Date	4 December 2018

(a) Wanda's post-tax inheritance from Lucy

	£	£
Chargeable estate		
(£340,000 + £510,000)		850,000
Residence nil rate band available		
Lucy	100,000	
Pavel's unused amount transferred to Lucy	100,000	
		200,000
Nil rate band available		
Lucy		325,000
Pavel's unused amount transferred to Lucy		
Nil rate band	325,000	
Less: legacy to Wanda	(160,000)	
		165,000
		490,000
Less: gift to Wanda on 1 April 2013 (£180,000 – £3,000 – £3,000)		(174,000)
		316,000
Inheritance tax		
((£850,000 – £200,000 – £316,000) x 40%)		133,600
Post-tax inheritance		
(£850,000 – £133,600)		716,400

(b) Voluntary registration for value added tax (VAT)

Voluntary registration will be permitted because the business will be making taxable (zero rated) supplies.

Advantages of voluntary registration

– It would remove the need to monitor the turnover of the business with regard to the compulsory registration limit and avoid the possibility of any penalty for late registration.

– It would enable the business to recover any input tax incurred.

Disadvantages of voluntary registration

– There will be additional administration due to the need to record and report the VAT position of the business.

– There will be the possibility of interest and/or penalties if inaccurate figures are reported or reporting deadlines are not adhered to.

Tutorial note: *Credit was also available for other relevant points.*

(c) Choice of business structure

(i) Income tax and corporation tax payable

Business operated as a partnership

Roth – income tax

	£
Salary from existing employment	90,000
Partnership profit share ((£100,000 – £14,000) x 40%)	34,400
	124,400
Personal allowance	Nil
Taxable income	124,400
£33,500 x 20%	6,700
£90,900 x 40%	36,360
Income tax liability	43,060

Business operated as a company

Roth – income tax

		£
Salary from existing employment		90,000
Salary from new company		32,000
Dividend from new company		6,000
		128,000
Personal allowance		Nil
Taxable income		128,000
Employment income:	£33,500 x 20%	6,700
	£88,500 x 40%	35,400
Dividend income:	£5,000 x 0%	0
	£1,000 x 32·5%	325
Income tax liability		42,425

Corporation tax

((£100,000 – £42,000 – £32,000) x 19%)	4,940

Summary

		Partnership	Company
		£	£
Income tax:	Wanda (email from manager)	14,940	9,025
	Roth (as above)	43,060	42,425
Corporation tax (as above)		N/A	4,940
		58,000	56,390

(ii) Other matters

Tax relief available in respect of a trading loss arising in the first year of trading

Business operated as a partnership

– Wanda's only option would be to carry her share of the loss forward for relief against future profits of the same trade.

– Roth would be able to offset his share of the loss against his total income of the tax year of the loss, 2019/20, or the preceding year, 2018/19, or, under the opening year rules, 2016/17. Regardless of the year of offset, he will obtain a tax saving now, rather than in the future, equal to 40% of his share of the loss.

Business operated as a company

– On the assumption that the business has no other source of income and does not realise any chargeable gains, the loss could only be carried forward for relief against future profits of the same trade.

Summary

If the business is operated as a partnership, relief will be available immediately, rather than in the future, for a proportion of any trading loss.

Tutorial note: *The changes to the rules in relation to the carry forward of company losses introduced by Finance Act (No. 2) 2017 apply to losses arising from 1 April 2017, although they are not examinable until the June 2019 exam. However, candidates who referred to these new rules received equal credit.*

Choice of accounting date where the business is operated as a partnership

An accounting date of 30 June would have the following advantages:

– Where, as in this situation, profits are expected to increase, it is beneficial to have an accounting date which is early in the tax year. This is because, under the basis of assessment for opening years, earlier, lower profits will be taxed twice before later, higher profits are taxed.
– The earlier the accounting date is in the tax year, the greater the time period between earning the taxable profits for that tax year and paying the tax due in respect of them.
– The earlier the accounting date is in the tax year, the greater the time period between knowing how much taxable profits there are and the end of the tax year. This time period can be used to plan the taxpayer's affairs, for example, in respect of pensions.

Tutorial note: *Only two advantages were required.*

(d) Income tax refund

We should assist Wanda in investigating whether or not there was a valid reason for the refund of income tax.

If we are unable to identify a valid reason, we would have to conclude that the refund was made as a result of an error on the part of HM Revenue and Customs (HMRC). In these circumstances we should inform Wanda:

– that the amount should be repaid immediately;
– that failing to return the money may well be a civil and/or a criminal offence;
– that HMRC should be informed of their error as soon as possible in order to minimise any interest and penalties which may otherwise become payable.

If Wanda is unwilling to return the money, we would have to consider ceasing to act as her tax advisers. We would then have to notify the tax authorities that we no longer act for her, although we would not provide them with any reason for our action. We should also consider whether or not it is necessary to make a report under the money laundering rules.

2 Eet Ltd group

(a) Relief for the capital loss of Han Ltd

The companies to which the capital loss on the sale of the Po building could be transferred

The capital loss on the sale of the Po building could be transferred to any company in the Eet Ltd capital gains group.

– The Eet Ltd capital gains group consists of Eet Ltd (the principal company) together with its 75% subsidiaries and their 75% subsidiaries.
– Eet Ltd must have an interest of more than 50% in any non-directly held subsidiary.
– Accordingly, the group consists of Eet Ltd, Fip Ltd, Han Ltd, Jek Ltd and Kid Ltd. The capital loss can therefore be transferred to Eet Ltd, Fip Ltd, Jek Ltd or Kid Ltd.

In order for the group's cash flow position to be improved, the capital loss should **not** be transferred to:

– Eet Ltd, because it does not have any chargeable gains.
– Fip Ltd, because it is not required to pay corporation tax in instalments.

The capital loss should therefore be transferred to either Jek Ltd or Kid Ltd.

Corporation tax payment due from Jek Ltd on 14 January 2019

	£'000
Trading profit	530
Chargeable gain	90
Less: Han Ltd capital loss	(80)
Taxable total profits	540
Corporation tax liability at 19%	103

	£'000
Two quarterly payments (liability x ¼ x 2)	52
Less: tax already paid	(32)
Payable on 14 January 2019	20

Tutorial note: *The payment due on 14 January 2019 is the second payment in respect of the 12-month accounting period ending on 31 March 2019, i.e. the payment on the 14th day of the 10th month of the period.*

Potential advantage to the Eet Ltd group of entering into group payment arrangements

Where group payment arrangements are not in place, each company is charged interest on underpayments of tax and is paid interest on overpayments. However, the rate of interest on underpayments of tax is higher than that on overpayments of tax.

The advantage of group payment arrangements is that one of the companies in the group would make a single payment of corporation tax each quarter in respect of the amounts due from all of the group companies. This would offset any underpayments and overpayments such that interest would only be charged/paid on the net under/over payment.

This is likely to result in a lower amount of interest being payable on any underpaid tax.

(b) Loj Co

Why Loj Co will be a controlled foreign company (CFC)

Loj Co will be a controlled foreign company (CFC) following the purchase of 60% of its shares by Eet Ltd because:

- Loj Co is not resident in the UK; and
- Eet Ltd, a UK resident person, will control Loj Co.

Basis for calculating the CFC charge

- The taxable amount will be 60% (Eet Ltd's shareholding in Loj Co) of those profits of Loj Co (calculated using UK corporation tax rules) which have been artificially diverted from the UK. Any chargeable gains of Loj Co are excluded for these purposes.
- The taxable amount is subject to tax at 19%.
- A deduction is then available for any UK taxes suffered by Loj Co and for double tax relief (DTR). The DTR is the amount which would be available if Loj Co were a UK resident company, i.e. the lower of the UK tax which would be charged on the overseas profits and the overseas tax on those same overseas profits.

Availability of the exempt period exemption

The 12-month exempt period exemption is available where:

- a non-UK resident company comes under the control of UK resident persons. This will occur when Eet Ltd acquires control of Loj Co; and
- Loj Co continues to be a CFC in the next accounting period; and
- in that next accounting period Eet Ltd is not subject to a CFC charge in respect of the profits of Loj Co.

(c) Jek Ltd – value added tax (VAT) on the sale of the Mar building

Charging of VAT on the sale of the Mar building

If the group finance director does not opt to tax the Mar building, the sale will be an exempt supply. This is because the building will be more than three years old. Accordingly, VAT should not be charged.

If the group finance director opts to tax the Mar building, the sale will be a standard rated supply, such that Jek Ltd will have to charge 20% VAT on the sale.

Final VAT adjustment

Option to tax **not made**
Payment required to HM Revenue and Customs (HMRC)
(0 – 72%) x £90,000/10 x 2 years £12,960

Option to tax **made**
Repayment from HMRC
(100 – 72%) x £90,000/10 x 2 years £5,040

Tutorial note: *Where the sale of the building is an exempt supply, there is no taxable use of the building in the remainder of the ten-year adjustment period. Where the sale of the building is a taxable supply, there is 100% taxable use of the building in the remainder of the ten-year adjustment period.*

3 (a) Liber

(i) Capital gains tax implications of the takeover of Vulcan Ltd on 1 June 2018 and a subsequent sale of the Mercury plc shares on 1 January 2019

Gain on the cash received in the takeover

The share-for-share exchange rules will automatically apply on the takeover of Vulcan Ltd on 1 June 2018, as this was a *bona fide* commercial transaction, and Mercury plc has acquired more than 25% of the ordinary shares in Vulcan Ltd. The shares in Mercury plc will 'stand in the shoes' of the shares in Vulcan Ltd and no gain will be chargeable in respect of these shares until they are sold. The receipt of cash is treated as a part-disposal of the Vulcan Ltd shares and a chargeable gain will arise at the date of the takeover.

The chargeable gain in respect of the cash received is £9,789 (£12,000 – £2,211 (W)).

Entrepreneurs' relief will not be available in respect of the gain arising on the cash consideration, as Liber was not a director or employee of Vulcan Ltd.

Gain on the sale of the Mercury plc shares

	£
Proceeds (3,200 x £28)	89,600
Less: cost (W)	(11,789)
Chargeable gain	77,811

Entrepreneurs' relief will not be available on the sale of the Mercury plc shares as Liber is not a director or employee of Mercury plc, and holds less than 5% of the ordinary shares in Mercury plc.

Tutorial note: *Where there is a share-for-share exchange, the 12-month ownership requirement includes the holding period of the original shares.*

	£
Gain on cash received on takeover	9,789
Gain on sale of shares in Mercury plc	77,811
Total chargeable gains	87,600
Less: annual exempt amount	(11,300)
Taxable gains	76,300

Capital gains tax (CGT) payable is £14,910 (((£33,500 – £30,000) x 10%) + ((£76,300 – £3,500) x 20%)).

Working: Allocation of cost at time of takeover

	Market value £	Apportioned cost £
Consideration received:		
Ordinary shares in Mercury plc		
(800 x 4 x £20)	64,000	
(£64,000/£76,000) x £14,000		11,789
Cash (800 x £15)	12,000	
(£12,000/£76,000) x £14,000		2,211
	76,000	14,000

(ii) Reasons why it is beneficial to sell the Mercury plc shares on 1 May 2019 instead of on 1 January 2019

The calculation of the gain on the sale of the Mercury plc shares will be the same, but the sale will be in the following tax year, 2019/20, so the following tax implications will arise:

The gain on the cash received on the takeover in 2018/19 will be covered by the annual exempt amount for that year and so there will be no CGT liability in 2018/19.

The whole of the 2019/20 annual exempt amount will be available to be deducted from the gain on the sale of the Mercury plc shares. This will result in a CGT liability of £12,952 in 2019/20 (W). The overall tax saving if the Mercury plc shares are sold on 1 May 2019 is therefore £1,958 (£14,910 (as in (a)(i)) – £12,952).

Tutorial note: *Alternatively, delaying the sale of the shares until 1 May 2019 results in the gain on the cash received in the takeover of £9,789 being fully covered by the annual exempt amount for 2018/19 and therefore a CGT saving of £1,958 (20% x £9,789).*

The tax relating to the sale of the Mercury plc shares will be due a year later on 31 January 2021, rather than 31 January 2020.

Working: CGT liability if Mercury plc shares disposed of on 1 May 2019

	£
Gain on sale of shares in Mercury plc	77,811
Less: annual exempt amount	(11,300)
Taxable gains	66,511

CGT payable is £12,952 (((£33,500 – £30,000) x 10%) + ((£66,511 – £3,500) x 20%)).

(b) Vesta

Capital gains tax and inheritance tax advantages of gifting the investment property on 31 December 2018

Capital gains tax (CGT)

If the property remains in Vesta's estate on her death, there will be no CGT implications, such that the fall in value of the property will not give rise to an allowable loss.

If the property is gifted to Janus on 31 December 2018, an allowable loss will arise as a result of the fall in value. However, as Vesta will make no disposals for CGT purposes in 2019/20, she will not be able to relieve this loss.

Therefore, for CGT purposes, Vesta will be indifferent as to whether to gift the property to Janus in her lifetime, or to leave it to him in her estate on death.

However, Janus's base cost of the property on a future disposal is its market value at the date it is transferred to him. Accordingly, as the property is expected to be worth less at the date of Vesta's death than it is currently, it will be advantageous from Janus's point of view if Vesta gifts the property to him on 31 December 2018 as he will then have a higher base cost for CGT purposes on a future sale.

Tutorial note: *As Janus and Vesta are connected persons, the CGT loss on the gift of the property to Janus on 31 December 2018 could only have been relieved against a gain arising on a later disposal by Vesta to Janus.*

Inheritance tax (IHT)

If the property remains in Vesta's estate at the date of her death, it will be included at its value on death, which is expected to be lower than its current market value.

If the property is gifted to Janus on 31 December 2018, it will be a potentially exempt transfer (PET), such that there will be no immediate charge to IHT. This PET will become chargeable as a result of Vesta's death within seven years.

As the value of the property is expected to have decreased between the date of the gift and the date of death, fall in value relief will be available (assuming that Janus still owns the property, or has sold it in an arm's length transaction), so the lifetime gift will not result in any more IHT being payable on the property than if it were left to Janus in the death estate.

No annual exemptions are available as they have been used on the cash gift to Janus on 1 June 2018.

No taper relief will be available as Vesta will not have survived for three years after making the gift.

Therefore, for IHT purposes, both Vesta and Janus will be indifferent between a lifetime gift and leaving the property in her estate on death.

4 Demeter

(a) Receipt of the one-off lump sum inducement payment and relocation package

The one-off lump sum inducement payment of £20,000 paid on commencement of Demeter's employment is fully taxable as it wholly relates to future services to be performed by Demeter.

The total amount received by Demeter in relation to his relocation is £11,000 (£5,000 + (£1,500 x 4)). Demeter did not previously live within a reasonable daily travelling distance of his new employment, so is eligible for a maximum tax allowable amount of £8,000, provided he has spent at least this amount on qualifying expenditure.

Demeter's qualifying expenditure comprises all the costs relating to his move, including the estate agent fees on the sale of his house of £2,800, and the rent on his accommodation in London of £1,700 per month from 1 December 2018 until he purchases a new house on 1 April 2019. His total qualifying expenditure is therefore £12,800 (£6,000 + (£1,700 x 4)). This clearly exceeds £8,000, so the taxable amount of Demeter's relocation package is £3,000 (£11,000 – £8,000).

(b) Reliefs available to Demeter to reduce the chargeable gain on the sale of his house in Manchester

As the house was Demeter's only residence, principal private residence (PPR) relief will be available to exempt the proportion of the gain which relates to his actual or deemed occupation of the property. The relief is calculated as follows:

Demeter owned the house for 13·5 years (1 May 2005 to 31 October 2018).

Availability of PPR relief:

		Exempt years
1 May 2005 to 30 April 2007	100% occupation	2
1 May 2007 to 30 April 2017	70% occupation (10 years x 70%)	7
1 May 2017 to 31 October 2018	Last 18 months treated as 100% occupation	1·5
Total exempt years		10·5

The PPR relief will exempt £73,111 (£94,000 x 10·5/13·5) of the gain. The remainder of the gain, i.e. £20,889 (£94,000 x 3/13·5), is attributable to the let part of the property.

Letting relief provides an extension to the PPR exemption in relation to the gain arising on the part of Demeter's house which was let. The additional exemption is restricted to the lowest of:

(1) The amount of the gain which is exempt under the PPR exemption (£73,111).

(2) The gain attributable to the letting (£20,889).

(3) £40,000.

Therefore, the letting relief available is £20,889.

(c) (i) Tax consequences for Demeter of participating in Poseidon Ltd's approved occupational pension scheme in 2019/20

Poseidon Ltd's contribution into its occupational pension scheme on Demeter's behalf of £13,000 (10% x £130,000) will be an exempt benefit for Demeter, so no tax liability will arise on this.

However, the contributions will count towards Demeter's annual allowance. This will remain at £40,000 as Demeter's threshold income of £90,000 (net income (£130,000) less Demeter's personal pension contributions (£40,000)) does not exceed the £110,000 threshold.

Demeter has no unused annual allowance to bring forward from earlier tax years as he has made contributions up to the maximum amount each year. As the total contributions in 2019/20 of £53,000 (£13,000 + £40,000) will exceed the annual allowance, an annual allowance charge will be payable. Accordingly, as a higher rate taxpayer Demeter will pay an annual allowance charge of £5,200 (40% x £13,000 (£53,000 – £40,000)).

Tutorial note: *There is no need to calculate Demeter's adjusted income as the amount of annual allowance will not be reduced regardless because his threshold income is below £110,000.*

(ii) Tax consequences for Demeter of participating in Poseidon Ltd's unapproved share option scheme

No income tax will be payable by Demeter on the grant of the options on 1 December 2018.

When Demeter exercises the options on 6 April 2024, income tax will be payable on the excess of the market value of the shares at the date of exercise over the price paid by Demeter, i.e. £6,030 ((£6·00 – (£4·20 x 95%) x 3,000). The income tax payable is therefore £2,412 (£6,030 x 40%).

The exercise of the shares has no impact on Demeter's personal allowance because his adjusted net income is below £100,000. There will also be no impact on Demeter's annual allowance charge because his threshold income remains below £110,000.

As Demeter will sell the shares immediately following the exercise of the options, the shares will not have increased in value and so no chargeable gain will arise.

				Available	Maximum
1	(a)	Residence nil rate band		1·5	
		Nil rate band			
			Lucy	2	
			Pavel	1·5	
		Post-tax inheritance		1·5	
				6·5	6
	(b)	One mark for each point – maximum four marks		4	4
	(c)	(i) Partnership			
			Roth – income tax		
			Income	2·5	
			Personal allowance and income tax liability	2	
		Company			
			Roth – income tax		
			Income	1·5	
			Personal allowance and income tax liability	3	
			Corporation tax	2	
		Summary		1	
				12	11
		(ii) Relief for trading loss			
			Business operated as a partnership	3	
			Business operated as a company	1	
			Comparison	1	
		Accounting date			
			One mark for each point – maximum two marks	2	
				7	5
	(d)	The need to repay the tax		4	
		Ceasing to act		3	
				7	5
	Problem solving			1	
	Clarity of explanations and calculations			1	
	Effectiveness of communication			1	
	Overall presentation and style			1	
				4	4
	Total				**35**

				Available	Maximum
2	**(a)**	Transfer of capital loss			
			Members of the capital gains group	4·5	
			Improvement of the group's cash flow position	2	
		Calculation of instalment due		4	
		Group payment arrangements		3	
				13·5	11
	(b)	Why Loj Co would be a CFC		2	
		Calculating the CFC charge		4	
		Exempt period exemption		3	
				9	8
	(c)	Explanations		3	
		Calculations		3·5	
				6·5	6
	Total				**25**
3	**(a)**	**(i)**	Gain on cash at date of takeover	4·5	
			Gain on sale of Mercury plc shares on 1 January 2019	2·5	
			Capital gains tax payable	2	
				9	8
		(ii)	2019/20 annual exempt amount available	1	
			Calculation of tax saving	3	
			Tax payable later	1	
				5	4
	(b)	Capital gains tax implications		4	
		Inheritance tax implications		5·5	
				9·5	8
	Total				**20**
4	**(a)**	One-off lump sum payment		2	
		Financial assistance with relocation		3·5	
				5·5	5
	(b)	Principal private residence relief		4	
		Letting relief		3	
				7	6
	(c)	**(i)**	Poseidon Ltd's contributions	1·5	
			Annual allowance charge	4·5	
				6	5
		(ii)	Grant of options	1	
			Exercise of options	2	
			Sale of shares	1	
			Consideration of impact on personal allowance/annual allowance charge	1	
				5	4
	Total				**20**