Strategic Professional – Options

Advanced Taxation – United Kingdom (ATX – UK)

Tuesday 4 December 2018

ATX UK ACCA

ATX – UK

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 2–6

Do NOT open this question paper until instructed by the supervisor.

This question paper must not be removed from the examination hall.

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 2017/18 and for the financial year to 31 March 2018 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 – £33,500	20%	7·5%
Higher rate	£33,501 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	£11,500
Transferable amount	£1,150
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	9%
51 grams to 75 grams per kilometre	13%
76 grams to 94 grams per kilometre	17%
95 grams per kilometre	18%

Car fuel benefit

The base figure for calculating the car fuel benefit is £22,600.

Individual savings accounts (ISAs)

The overall investment limit is £20,000.

Property income

Basic rate restriction applies to 25% of finance costs.

Pension scheme limits

Annual allowance	£40,000
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

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 2017	19%
	– Financial year 2016	20%
	– Financial year 2015	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	£85,000
Deregistration limit	£83,000

Inheritance tax: nil rate bands and tax rates

Nil rate band

	£
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
6 April 2003 to 5 April 2004	255,000

Residence nil rate band		£100,000
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	£11,300
Entrepreneurs' relief – Lifetime limit	£10,000,000
– Rate of tax	10%

National insurance contributions

Class 1	Employee	£1 – £8,164 per year	Nil
		£8,165 – £45,000 per year	12%
		£45,001 and above per year	2%
Class 1	Employer	£1 – £8,164 per year	Nil
		£8,165 and above per year	13·8%
		Employment allowance	£3,000
Class 1A			13·8%
Class 2		£2·85 per week	
		Small profits threshold	£6,025
Class 4		£1 – £8,164 per year	Nil
		£8,165 – £45,000 per year	9%
		£45,001 and above per year	2%

Rates of interest (assumed)

Official rate of interest	2·5%
Rate of interest on underpaid tax	2·75%
Rate of interest on overpaid tax	0·5%

Stamp duty land tax

Non-residential properties	
Up to £150,000	0%
£150,001 – £250,000	2%
£250,001 and above	5%
Residential properties (note)	
Up to £125,000	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 had a meeting with Wanda, a client of your firm. Extracts from the memorandum prepared by your manager following the meeting, together with an email detailing the work he requires you to do, are set out below.

Extracts from the memorandum prepared by your manager – dated 3 December 2018

Background

Wanda intends to start a new business, KS, selling children's clothes. This business will be partly financed by an inheritance which Wanda will receive following the recent death of her mother. Wanda's husband, Roth, will also be involved in the business.

Wanda has not been employed since 31 December 2012 and has not received any taxable income since that date. Roth is employed and earns a gross salary of £90,000 per year. This salary is his only source of income. Wanda and Roth have not made any chargeable disposals for the purposes of capital gains tax and will not make any in the tax year 2019/20.

Wanda's inheritances and gift from her parents

On 1 February 2013, Wanda's father, Pavel, died. He left £160,000 to Wanda and the residue of his estate to his wife, Lucy (Wanda's mother). The residue of Pavel's estate was valued at £720,000 and included the family home. Pavel had not made any gifts during his life.

On 1 April 2013, Lucy gave Wanda £180,000 in cash. This was the only lifetime gift Lucy made.

On 1 November 2018, Lucy died. Wanda inherited the whole of Lucy's estate, which was valued at £850,000. The estate consisted of the family home (valued at £340,000), together with furniture, cash and quoted shares (valued in total at £510,000).

Wanda's new business – KS

Wanda intends to begin trading on 1 April 2019. The business will be operated either:

– by Wanda and Roth in partnership; or

– by a limited company owned 70% by Wanda and 30% by Roth.

The turnover of the business for the year ending 31 March 2020 is expected to be £48,000.

Budgeted profitability of KS

In its first year of trading the business will make either a small profit or, possibly, a loss (of no more than £20,000). However, once the business is fully operational, it is budgeted to make a tax adjusted trading profit of £100,000 per year. This figure is before deducting any salaries paid to Wanda and Roth.

The manner in which the profits will be extracted from the business depends on whether the business is operated as a partnership or as a limited company. The two alternatives are summarised below.

	Partnership		Company	
	Wanda	Roth	Wanda	Roth
Salary	£14,000	£0	£42,000	£32,000
Profit share percentage	60%	40%	N/A	N/A
Dividend	N/A	N/A	£14,000	£6,000

In addition to advising her on the tax cost of the alternative business structures, Wanda has asked us to advise her on the relief available in respect of the possible trading loss in the first year of trading and on the choice of 31 March as the accounting date where the business is operated as a partnership.

Income tax refund

Wanda has received an unexpected refund of income tax from HM Revenue and Customs (HMRC) in respect of the tax year 2011/12.

Email from your manager – dated 4 December 2018

Please prepare the following notes and calculations for use in a meeting with Wanda.

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

Calculate the amount which Wanda will inherit from Lucy after any inheritance tax has been paid.

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

The sale of children's clothes is a zero rated supply for the purposes of VAT. With this is mind, explain:

– why the business would be permitted to register for VAT from 1 April 2019; and

– the advantages and disadvantages of doing so.

(c) Choice of business structure

(i) Income tax and corporation tax payable

For a single tax year, calculate the income tax payable by Roth and any corporation tax payable:

– if the business is operated as a partnership; and

– if the business is operated as a company.

Prepare a summary of the total tax payable if Wanda's income tax liabilities are:

Business operated:	as a partnership	£14,940
	as a company	£9,025

You should assume that:

– the business is fully operational and makes a tax adjusted trading profit of £100,000. This figure is before deducting any salaries paid to Wanda and Roth.

– profits are extracted from the business in accordance with the summary in my memorandum.

– Roth continues to earn his existing gross salary of £90,000 per year.

When carrying out this work, you should **ignore** any national insurance contribution liabilities and any relief available in respect of losses.

(ii) Other matters

– Compare the tax relief available to Wanda and Roth in respect of a trading loss arising in the first year of trading, depending on whether the business is operated as a partnership or as a company.

– On the assumption that the business is always profitable and is operated as a partnership, explain TWO tax advantages of having an accounting date of 30 June as opposed to 31 March.

(d) Income tax refund

Prepare a summary of the actions which we should take, and the matters of which Wanda should be aware, in relation to the income tax refund.

Tax manager

Required:

Prepare the notes for use in a meeting with Wanda as requested in the email from your manager. The following marks are available:

(a) Wanda's post-tax inheritance from Lucy. (6 marks)

(b) Voluntary registration for value added tax (VAT). (4 marks)

(c) Choice of business structure.

(i) Income tax and corporation tax payable. (11 marks)

(ii) Other matters. (5 marks)

(d) Income tax refund. (5 marks)

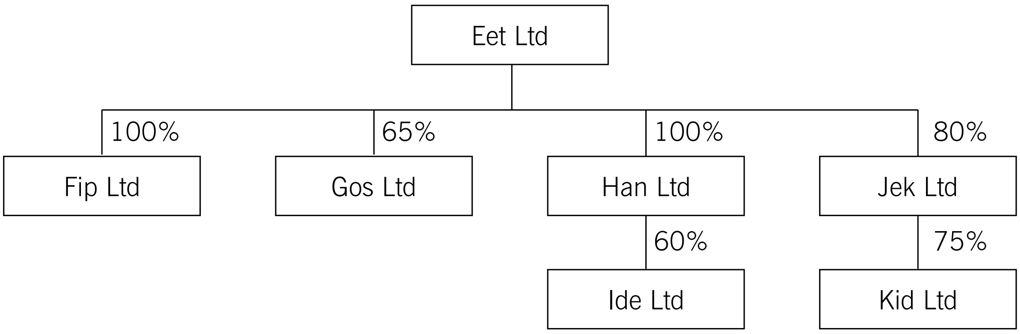
Professional marks will be awarded for the approach taken to problem solving, the clarity of the explanations and calculations, the effectiveness with which the information is communicated, and the overall presentation and style of the notes. (4 marks)

(35 marks)

2 Your manager has sent you an email, with two attachments, concerning the Eet Ltd group. The attachments consist of extracts from the group's files and a schedule of information from the group finance director. The email details the work your manager requires you to do. The three documents are set out below.

Attachment 1: Eet Ltd group – extracts from the group's files

Group structure



All seven companies are UK resident trading companies.

Fip Ltd was incorporated and began trading on 1 December 2018. There have been no other changes to the ownership of the group for many years.

Attachment 2: Schedule of information from the group finance director – dated 3 December 2018

Budgeted results for the year ending 31 March 2019 (as at 3 December 2018)

	Eet Ltd	Fip Ltd	Gos Ltd	Han Ltd	Ide Ltd	Jek Ltd	Kid Ltd
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Trading profit	430	240	440	410	395	530	340
Chargeable gain (notes 1 and 2)	0	110	130	0	85	90	220
Taxable total profits	430	350	570	410	480	620	560
Corporation tax paid to date	19	0	31	23	18	32	24

Notes:

1. On 2 December 2018, Han Ltd sold the Po building. This sale resulted in a capital loss of £80,000. This loss is not reflected in the figures above.
2. Rollover relief **will not** be claimed in respect of any of the group companies' chargeable gains.

Loj Co

Eet Ltd is planning to purchase 60% of the ordinary share capital of Loj Co in April 2019.

Loj Co has been a wholly-owned subsidiary of Typ Co since 1 January 2008. Both Loj Co and Typ Co are, and will continue to be, resident in the country of Shalia.

Jek Ltd – sale of the Mar building

Jek Ltd purchased the Mar building on 1 June 2012 for £450,000 plus value added tax (VAT) of £90,000. In the year ended 31 March 2013, and in all subsequent years, 72% of this building was used to make taxable supplies and 28% was used to make exempt supplies. The capital goods scheme applies to the Mar building.

Jek Ltd will sell the Mar building during the year ending 31 March 2020 for £700,000.

Email from your manager – dated 4 December 2018

Please carry out the following work in respect of the Eet Ltd group:

(a) Relief for the capital loss of Han Ltd

- Identify, with supporting explanations, those companies to which the capital loss on the sale of the Po building could be transferred, such that the group's cash flow position would be improved.

  Note: All of the companies in the group, apart from Fip Ltd, are required to pay corporation tax in quarterly instalments. This will be true regardless of how the capital loss on the sale of the Po building is relieved.

- On the assumption that the whole of the capital loss is transferred to Jek Ltd, calculate the quarterly payment of corporation tax due on 14 January 2019 from that company. Please carry out this calculation in £'000s.

  Note: On each instalment payment date, each group company pays the amount of corporation tax necessary in order to ensure that it has paid the correct total amount of tax based on the latest budgeted figures.

- Explain the potential advantage to the Eet Ltd group of entering into group payment arrangements for corporation tax.

(b) Loj Co

In respect of the proposed purchase of 60% of the shares of Loj Co:

- explain why Loj Co will be a controlled foreign company (CFC) following the purchase;
- explain how any CFC charge in respect of Loj Co would be calculated;
- state the conditions which need to be met in order for the 12-month exempt period exemption to be available.

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

The group finance director is considering whether or not to opt to tax the Mar building. In respect of the two alternatives:

- explain whether or not VAT should be charged on the sale of the building in March 2020;
- calculate the final VAT adjustment (i.e. only the sale adjustment) which will be made under the capital goods scheme.

Tax manager

Required:

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

(a) Relief for the capital loss of Han Ltd. (11 marks)

(b) Loj Co. (8 marks)

(c) Jek Ltd – value added tax (VAT) on the sale of the Mar building. (6 marks)

(25 marks)

Section B – BOTH questions are compulsory and MUST be attempted

3 Liber has requested advice on the timing of the sale of the shares which he acquired in a recent company takeover. His sister, Vesta, requires advice on the tax consequences of making a lifetime gift, rather than leaving an asset in her estate upon her death.

Liber:

– Is UK resident and domiciled.

– Has taxable income of £30,000 each year.

Liber – acquisition of ordinary shares in Mercury plc:

– Liber purchased 800 ordinary shares (a 40% holding) in Vulcan Ltd for £14,000 on 1 July 2008.

– Mercury plc acquired 100% of the ordinary share capital of Vulcan Ltd on 1 June 2018.

– In exchange for each ordinary share in Vulcan Ltd Liber received the following:

  – Four ordinary shares in Mercury plc valued at £20 per share immediately after the takeover; and
  – £15 cash

– Mercury plc has 200,000 issued ordinary shares.

– Liber has never been a director or employee of either Vulcan Ltd or Mercury plc.

– The takeover was for *bona fide* commercial reasons and not for the avoidance of tax.

Liber – proposed transaction in Mercury plc shares:

– Liber now wishes to sell all of his shares in Mercury plc.

– He has received an offer from an unconnected person to purchase these shares on 1 January 2019 at a price of £28 per share.

– Liber would prefer to sell the shares to his nephew, Janus. However, this would delay the sale as his nephew will not have the necessary funds to purchase the shares until 1 May 2019.

– Janus has said he will also pay £28 per share.

Vesta:

– Is 66 years old and has never married or had a civil partner.

– Is in ill-health and is expected to die at some time within the tax year 2019/20.

– Has made no disposals for capital gains tax purposes in the tax year 2018/19 to date and will not make any in the tax year 2019/20.

– Has made one previous lifetime gift, of £350,000 cash, to her son, Janus, on 1 June 2018.

Vesta – investment property:

– Vesta owns an investment property, which has never been used as her principal private residence.

– The current market value of the property is less than the price Vesta paid for it, and its value is expected to fall further throughout the tax year 2019/20.

– Vesta is considering gifting the investment property to Janus in her lifetime, rather than leaving it to him in her estate on death.

– Janus is the sole beneficiary of Vesta's estate.

Required:

(a) (i) Explain, with supporting calculations, the capital gains tax implications for Liber of the takeover of Vulcan Ltd by Mercury plc on 1 June 2018, and a subsequent sale of his Mercury plc shares on 1 January 2019. (8 marks)

(ii) Explain, with supporting calculations, why it would be beneficial for Liber to sell his Mercury plc shares on 1 May 2019, instead of on 1 January 2019. (4 marks)

(b) Advise Vesta whether or not there are any capital gains tax or inheritance tax advantages, for herself, or for Janus, if she were to gift the investment property to Janus on 31 December 2018, rather than leaving it to him in her estate on death. (8 marks)

(20 marks)

4 Demeter has recently taken up a new employment and is seeking advice on the tax treatment of certain components of his remuneration package, and the relief(s) available to reduce the chargeable gain on the sale of his house.

Demeter:

– Is UK resident and domiciled.

– Commenced employment with Poseidon Ltd on 1 December 2018.

– Will have no source of income, other than from Poseidon Ltd, in all relevant future tax years.

– Will be a higher rate taxpayer in all relevant future tax years.

– Has relocated to London, from Manchester, a city more than 150 miles north of London, to take up this employment.

Remuneration package from Poseidon Ltd:

– Demeter will receive an annual salary of £130,000.

– On 1 December 2018, Poseidon Ltd made a one-off lump sum payment of £20,000 to Demeter as an inducement to take up employment with the company.

– Poseidon Ltd paid Demeter £5,000 towards his costs of relocating to London. The company is also paying him £1,500 each month for four months from 1 December 2018 towards renting accommodation in London until he purchases a new house on 1 April 2019.

– On 1 December 2018, Demeter was granted share options in Poseidon Ltd's unapproved share option scheme.

– From 6 April 2019, Demeter will participate in Poseidon Ltd's approved occupational pension scheme.

Relocation to London:

– Demeter incurred costs in relation to his relocation to London of £6,000. This amount includes estate agent fees of £2,800 in connection with the sale of his house in Manchester on 31 October 2018.

– Demeter signed a four-month lease for a flat in London from 1 December 2018 at a monthly rental of £1,700.

House in Manchester:

– Demeter purchased the house on 1 May 2005 and lived in it as his main residence.

– Demeter let the top floor of the house (comprising 30% of the total house) to tenants from 1 May 2007 to 31 October 2018. The tenants did not share Demeter's living accommodation or take meals with him.

– Demeter continued to occupy the remainder of the house as his main residence until 31 October 2018, when the entire house was sold.

– The sale gave rise to a gain, before any reliefs, of £94,000.

– Demeter did not own any other house throughout the period from 1 May 2005 to 31 October 2018.

Demeter – pension contributions:

– Demeter has made tax-allowable contributions of £40,000 (gross) to a personal pension plan for the last five tax years and will continue to do so in future tax years.

– From the tax year 2019/20, Poseidon Ltd will contribute an amount equal to 10% of Demeter's annual salary to its approved occupational pension scheme.

– Demeter will make no contributions to Poseidon Ltd's occupational pension scheme.

Poseidon Ltd's share option scheme:

– On 1 December 2018, Poseidon Ltd granted Demeter options over 3,000 shares in its unapproved share option scheme at a 5% discount on the market value of the shares on that date.

– The market value of Poseidon Ltd shares on 1 December 2018 was £4·20 per share.

– Demeter will exercise the options on 6 April 2024, and immediately sell the shares.

– Poseidon Ltd believes that the market value of its shares on 6 April 2024 will be £6·00 per share.

Required:

(a) **Explain the extent to which the receipt of the £20,000 lump sum inducement payment, and the relocation package in relation to Demeter's move to London, will give rise to taxable employment income for him.** (5 marks)

(b) **Identify, and calculate, with brief explanations, the relief(s) available to Demeter to reduce the chargeable gain of £94,000 on the sale of his house in Manchester on 31 October 2018.** (6 marks)

(c) **Explain, with supporting calculations, the tax consequences for Demeter of participating in:**

(i) **Poseidon Ltd's approved occupational pension scheme in the tax year 2019/20.** (5 marks)

(ii) **Poseidon Ltd's unapproved share option scheme, in respect of the grant of the options on 1 December 2018 and the exercise of the options and subsequent sale of the shares on 6 April 2024.** (4 marks)

Note: Ignore national insurance contributions (NIC) in parts (i) and (ii).

(20 marks)

End of Question Paper