Strategic Professional – Options

Advanced Taxation – United Kingdom (ATX – UK)

Tuesday 3 March 2020

ATX UK ACCA EN

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 Corey, a client of your firm. Extracts from the memorandum prepared by your manager following the meeting, and an email from him detailing the work he requires you to do are set out below.

Extracts from the memorandum prepared by your manager – dated 2 March 2020

Background

Corey had always lived in the UK until, on 6 April 2016, he sold his home in the UK and moved to the country of Medora with his wife, Dana, and their daughter. They always planned to return to the UK at some point, such that they continued to be domiciled in the UK. Corey began working for a company in Medora on 1 May 2016.

In March 2019, Corey's sister, Florence, became seriously ill. Consequently, Corey and his family returned to live in the UK on 6 April 2019.

Period from 6 April 2016 to 5 April 2019

Corey was not resident in the UK during this period. However, he visited the UK (staying in hotels) as follows:

Tax year	Days in the UK
2016/17	49
2017/18	105
2018/19	74

Since 6 April 2019

On 1 June 2019, Corey and Dana purchased a new home in the UK. On the same date, Dana started a new full-time job in the UK and became UK resident. Corey and Dana have retained their home in Medora because Corey has continued working there and does not work in the UK. It is envisaged that Corey will have been in the UK for 115 days in the tax year 2019/20.

Disposals of assets in the tax year 2018/19

– On 1 December 2018, Corey sold a statue situated in the garden of his home in Medora. He had purchased the statue for £17,000 on 1 September 2016. The sale resulted in a capital loss of £7,400.

– On 1 February 2019, as a result of a commercial takeover, Corey received 4,000 shares in TW plc (a holding of less than 1%) and £12,000 in cash in exchange for 2,000 shares in SQ plc. One share in TW plc was worth £3·50 on that day. Corey had purchased his 2,000 shares in SQ plc (a holding of less than 1%) for £13,500 on 1 June 2013. SQ plc and TW plc are quoted companies.

Disposals of assets in the tax year 2019/20

– On 1 August 2019, Corey sold a house situated in Medora. This house was purchased on 1 July 2015 and has always been rented out. The sale realised a gain of £33,900.

– On 1 December 2019, Corey gave his sister, Florence, 700 of the 4,000 shares he owned in TW plc. One share in TW plc was worth £4·50 on that day.

Paintings owned by Corey's mother

Corey has asked for advice on the inheritance tax (IHT) advantages of his mother, Emer, who is UK domiciled, making lifetime gifts to Corey of either or both of the following paintings.

	Current market value £	Anticipated change in value
Watercolour	41,000	Falling in value
Portrait	37,000	Increasing in value

Income tax refund

A few months ago, Corey received a refund of income tax from HM Revenue and Customs (HMRC) in respect of the tax year 2015/16. He has not been able to determine why the refund was made.

Extracts from the email from your manager – dated 3 March 2020

Taxation in the country of Medora

– There is no capital gains tax (CGT).

– There is no double tax treaty between the UK and Medora.

Please prepare a memorandum for the client file consisting of the work set out below:

(a) Corey's UK residence status for the tax year 2019/20

- Explain how Corey's UK residence status for the tax year 2019/20 will be determined and conclude on his likely residence status for that year. Corey will have lived in both of his houses (i.e. in the UK and Medora) during the year, such that he will not have 'his only home' in the UK for the purposes of the automatic UK residency tests.
- State how becoming UK resident would affect Corey's liability to UK income tax.

(b) Corey's disposals of assets in the tax years 2018/19 and 2019/20

For this part of the work, you should assume Corey is UK resident for the tax year 2019/20 and will receive taxable income in that year of £38,400, before deduction of his personal allowance.

- Explain how each of Corey's disposals in the tax year 2018/19 will be treated for the purposes of CGT.
- Calculate Corey's CGT liability for the tax year 2019/20.

(c) Lifetime gifts of paintings by Emer

- Explain, with respect to the amount of inheritance tax (IHT) payable ONLY, whether or not it would be beneficial for Emer to make a lifetime gift of either or both of her paintings (as opposed to retaining them until her death).

There is no need to address the annual exemption, as Emer makes use of this every year.

You should assume there will be no nil rate band available regardless of when the transfer takes place.

(d) Refund of income tax

In respect of the income tax refund, set out the actions which our firm should take and the matters which should be brought to Corey's attention.

Tax manager

Required:

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

(a) Corey's UK residence status for the tax year 2019/20. (9 marks)

(b) Corey's disposals of assets in the tax years 2018/19 and 2019/20. (11 marks)

(c) Lifetime gifts of paintings by Emer. (6 marks)

(d) Refund of income tax. (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 memorandum. (4 marks)

(35 marks)

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Question 2 begins on page 9.

2 Your manager has received a letter from Mita, the owner and managing director of Porth Ltd, a client of your firm. Extracts from that letter, together with extracts from an email from your manager detailing the work you are required to do, are set out below.

Extracts from the letter from Mita – dated 2 March 2020

Sale of 4,000 ordinary shares in Porth Ltd

On 1 May 2020, I am going to sell 4,000 shares in Porth Ltd to my brother, Ned. I note from the work you have already done that the current market value of these shares is £260,000. However, because I am keen to get Ned involved, I have agreed a price of £200,000. Ned, who is UK resident, will sign the claim for capital gains tax gift relief in respect of this sale.

Joint venture – Quod Ltd

On 1 April 2020, I shall incorporate a new company, Quod Ltd. On that day, Quod Ltd will register for value added tax (VAT) and begin to trade. It will develop a range of products over the next few years.

The planned ownership of the ordinary share capital of Quod Ltd is as follows:

Porth Ltd	60%
Either Mr Berm or Mr Berm's company, BJB Ltd	30%
CX Ltd	10%

Porth Ltd, BJB Ltd and CX Ltd are UK resident companies. Mr Berm is resident in the UK.

Quod Ltd – financial information

I have calculated Quod Ltd's budgeted tax adjusted trading loss for the year ending 31 March 2021 to be £44,000.

When calculating the loss, I deducted the whole of the costs attributable to scientific research amounting to £102,000 (note 1). I also deducted £1,000 in respect of the Cloque brand (note 2), as it will be amortised over a period of 35 years.

Note 1: Scientific research costs

	£
Equipment and computer hardware	27,500
Materials	21,000
Rent	17,400
Electricity and water	6,600
Staff costs	29,500
	102,000

– The rent is an appropriate allocation of the rent payable for Quod Ltd's premises for the year.

– All of the staff costs relate to employees of Quod Ltd with the exception of £7,000 paid to an external contractor provided by an unconnected company.

Note 2: Purchase of the Cloque brand

On 1 April 2020, Quod Ltd will purchase the Cloque brand for £35,000. Advice will then be required on how to develop this brand through the use of social media. It is intended that Quod Ltd will purchase this advice from a company based outside the EU (in a country where the rate of VAT is 9%) rather than as a standard rated supply from a VAT registered supplier based in the UK.

Acquisition of Ryb Ltd

On 1 May 2020, Porth Ltd will purchase the whole of the ordinary share capital of Ryb Ltd. For the purposes of UK tax, Ryb Ltd is resident in the UK. Ryb Ltd trades through a permanent establishment (PE) in the country of Tirona.

Ryb Ltd's budgeted taxable trading profit for the year ending 31 March 2021, all of which relates to its activities in Tirona, is £75,000. Ryb Ltd has no other source of taxable income and is not expected to make any chargeable gains during the year.

Once we are confident of the profitability of the PE in Tirona, it is intended that Ryb Ltd will establish PEs in two other countries.

Extracts from the email from your manager – dated 3 March 2020

Additional information in respect of Porth Ltd, Quod Ltd and Ryb Ltd

Porth Ltd

– Mita owns the whole of the ordinary share capital of Porth Ltd, which is an unquoted trading company.

– Mita began trading as an unincorporated business on 1 June 2012. On 1 April 2015, when the assets of her business were worth £120,000, she incorporated her business by selling all of the assets to Porth Ltd in exchange for 10,000 ordinary shares. This sale resulted in total chargeable gains of £37,400, all of which were relieved by incorporation relief.

– Porth Ltd prepares accounts to 31 March each year. It does not own any assets other than those which are used in its trade.

Quod Ltd

– Quod Ltd will be a small enterprise for the purposes of the additional tax relief available for expenditure on research and development.

– I have already established that the research to be carried out by Quod Ltd will qualify for this relief.

– Quod Ltd WILL NOT surrender any part of the loss in return for a cash refund from HM Revenue and Customs (HMRC).

Ryb Ltd

– Ryb Ltd has not made an election to exempt the profits of its overseas permanent establishment (PE) from UK tax.

– The rate of corporation tax in the country of Tirona is 14%. Other than that, the tax system in Tirona is the same as that in the UK. There is no double tax treaty between the UK and Tirona.

Please carry out the following work:

(a) Sale of 4,000 shares in Porth Ltd on 1 May 2020

– Calculate Mita's capital gains tax (CGT) liability in respect of this proposed sale to Ned assuming all available reliefs will be claimed.

Mita is resident in the UK. You should assume she will be a higher rate taxpayer in the tax year 2020/21 and that the CGT annual exempt amount WILL NOT be available to her.

(b) Quod Ltd

– Explain the tax deduction which will be available to Quod Ltd in respect of the scientific research costs of £102,000 to be incurred in the year ending 31 March 2021.

– Explain the tax treatment of the proposed purchase of the Cloque brand (an intangible fixed asset) for £35,000.

– Calculate the amended budgeted tax adjusted trading loss for Quod Ltd for the year ending 31 March 2021 taking into account the explanations requested above.

– Explain how much of Quod Ltd's amended budgeted trading loss will be available for use by Porth Ltd.

– Explain the value added tax (VAT) implications of Quod Ltd purchasing advice from the overseas supplier, rather than the one based in the UK.

(c) Ryb Ltd

– Explain why the profits of Ryb Ltd are subject to UK corporation tax.

– Calculate Ryb Ltd's expected UK corporation tax liability for the year ending 31 March 2021 based on the information available.

– Discuss the advantages and disadvantages of Ryb Ltd making an election to exempt the profits of its PE in Tirona from UK tax.

Tax manager

Required:

Carry out the work required as requested in the email from your manager. The following marks are available:

(a) Sale of 4,000 shares in Porth Ltd on 1 May 2020. (4 marks)

(b) Quod Ltd. (15 marks)

(c) Ryb Ltd. (6 marks)

(25 marks)

Section B – BOTH questions are compulsory and MUST be attempted

3 Tomas requires advice on the tax implications of commencing to trade, the choice of accounting date for his business, and whether or not to register voluntarily for value added tax (VAT) purposes. Ines, his wife, requires advice on the tax implications of selling shares in respect of which relief has been obtained under the enterprise investment scheme (EIS).

Tomas:

- Is UK resident and domiciled.
- Uses his capital gains tax (CGT) annual exempt amount every year.
- Receives dividends of £2,000 every year.

Tomas – sale of sporting memorabilia:

- Tomas started selling items of sporting memorabilia from his collection during the tax year 2018/19.
- HM Revenue and Customs (HMRC) agreed that these sales should be subject to CGT in the tax year 2018/19.
- In April 2019, Tomas started purchasing and selling more items of sporting memorabilia, such that HMRC have said that he will be regarded as trading with effect from 6 April 2019.
- Tomas will not be required to register for value added tax (VAT) for the foreseeable future.
- Tomas will, however, consider registering voluntarily for VAT if it is financially beneficial for him to do so.

Tomas – expected trading results from the sale of sporting memorabilia:

- Tomas is considering either a 31 March or 30 April year end for his business.
- Tomas estimates that his total income less expenditure for the 12 months ending 31 March 2020 will be £11,500.
- Each item of memorabilia is purchased and sold for no more than £1,000.
- All of the costs he incurs are deductible for tax purposes.
- Tomas expects his profits to increase steadily after 1 April 2020.

Ines:

- Is UK resident and domiciled.
- Is a higher rate taxpayer.
- Has made/will make no disposals for CGT purposes, other than as described below.

Ines – sale of painting:

- Ines sold a painting on 4 July 2017 for proceeds of £196,000.
- The sale gave rise to a gain of £86,000.

Ines – acquisition of shares in Tavira Ltd:

- Ines subscribed £72,000 for 20,000 shares in Tavira Ltd on 8 October 2017.
- These shares are qualifying enterprise investment scheme (EIS) shares.
- Ines elected to defer the maximum possible amount of the gain on the sale of the painting against the acquisition of these shares.
- Ines obtained EIS relief of £18,600 against her income tax liability for the tax year 2017/18.
- Ines intends to sell all of the shares in Tavira Ltd for £95,000 on 1 June 2020.
- If undertaken, this sale would qualify for entrepreneurs' relief.

Required:

(a) On the assumption that Tomas prepares his first set of accounts to 31 March 2020, explain, with supporting calculations, the difference in the total amount of tax payable by him for the tax year 2019/20 as a result of the profit on the sales of sporting memorabilia being treated as trading income, rather than chargeable gains. (5 marks)

(b) Identify Tomas' basis period for the tax year 2020/21 if he adopts a year-end date of (1) 31 March, or (2) 30 April, and state TWO tax advantages for Tomas of adopting 30 April as his year-end date. (5 marks)

(c) Explain TWO matters which Tomas should consider in deciding whether or not it will be financially beneficial to voluntarily register for value added tax (VAT). (3 marks)

(d) Explain the tax implications for Ines of her intended sale of the Tavira Ltd shares on 1 June 2020, and calculate her after-tax proceeds from this sale. (7 marks)

(20 marks)

4 Pedro requires advice on the reason he has had to pay inheritance tax in respect of a holiday cottage following the death of his aunt, Marina, an explanation of why his letting of this cottage qualifies as a furnished holiday letting, and the income tax implications of a significant contribution into his personal pension scheme.

Pedro:

– Was given a holiday cottage in the UK by his aunt, Marina, on 4 March 2009.
– Paid inheritance tax in respect of this gift of the holiday cottage, following Marina's death on 8 June 2019.
– Inherited a portfolio of UK unfurnished residential properties, valued at £670,000 on Marina's death.

Gift of the holiday cottage in the UK by Marina:

– Marina and Pedro agreed that she could stay in the house for two months each year, rent-free, which she did every year until her death.
– For the remainder of each year, Marina lived in her main home.

Pedro – property income:

– The cottage (which is fully furnished) has been available for rental on a commercial basis since 1 July 2019, and will have a 70% occupancy rate for the first year of letting.
– No tenant will have stayed in the cottage for more than 14 consecutive days during the first year of letting.
– The net rental income from the cottage in the tax year 2019/20 will be £14,500.
– In the tax year 2019/20, Pedro will also receive net rental income of £32,000 from the unfurnished residential properties which he inherited from Marina.

Employment income:

– Pedro has been employed by Loule Ltd since 6 April 2018.
– Pedro receives an annual gross salary of £75,000 from Loule Ltd.
– Loule Ltd has contributed £8,000 in each of the tax years 2018/19 and 2019/20 to its occupational pension scheme on behalf of Pedro.

Personal pension scheme:

– Pedro had never been a member of a pension scheme prior to taking up employment with Loule Ltd.
– Pedro wishes to start contributing to a personal pension scheme in the tax year 2019/20.
– Pedro intends to make his first contribution into the new personal pension scheme, of £85,000 (gross), on 31 March 2020.
– The annual allowance available to Pedro was not restricted in any previous tax year.
– Pedro's income tax liability for the tax year 2019/20, before taking into account the planned contribution into his personal pension scheme, is £41,260.

Required:

(a) Explain the inheritance tax implications of the gift of the cottage to Pedro at the time the gift was made, and as a result of Marina's death. (5 marks)

(b) Explain, by reference to the relevant conditions, why the holiday cottage will qualify as a furnished holiday letting for the first 12-month period of letting. (5 marks)

(c) Calculate the reduction in Pedro's income tax liability for the tax year 2019/20 as a result of making the planned contribution of £85,000 (gross) into his personal pension scheme on 31 March 2020. Your answer should include an explanation of the amount of the personal allowance available to Pedro in this case. (10 marks)

(20 marks)

End of Question Paper