Strategic Professional – Options

Advanced Taxation – United Kingdom (ATX – UK)

September/December 2020 – Sample Questions

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 2019/20 and for the financial year to 31 March 2020 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 – £37,500	20%	7·5%
Higher rate	£37,501 – £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	£12,500
Transferable amount	£1,250
Income limit	£100,000

Where adjusted net income is £125,000 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 (and diesel cars meeting the RDE2 standard) with CO_2 emissions up to this level are:

50 grams per kilometre or less	16%
51 grams to 75 grams per kilometre	19%
76 grams to 94 grams per kilometre	22%
95 grams per kilometre	23%

Car fuel benefit

The base figure for calculating the car fuel benefit is £24,100.

Individual savings accounts (ISAs)

The overall investment limit is £20,000.

Property income

Basic rate restriction applies to 75% 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	£1,055,000

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	6%

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	6%

Annual investment allowance

Rate of allowance	100%
Expenditure limit	£1,000,000

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 2019	19%
	– Financial year 2018	19%
	– Financial year 2017	19%
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 2019 to 5 April 2020	325,000
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

Residence nil rate band		£150,000
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	£12,000
Entrepreneurs' relief and investors' relief:	
– Lifetime limit	£10,000,000
– Rate of tax	10%

National insurance contributions

Class 1	Employee	£1 – £8,632 per year	Nil
		£8,633 – £50,000 per year	12%
		£50,001 and above per year	2%
Class 1	Employer	£1 – £8,632 per year	Nil
		£8,633 and above per year	13·8%
		Employment allowance	£3,000
Class 1A			13·8%
Class 2		£3·00 per week	
		Small profits threshold	£6,365
Class 4		£1 – £8,632 per year	Nil
		£8,633 – £50,000 per year	9%
		£50,001 and above per year	2%

Rates of interest (assumed)

Official rate of interest	2·5%
Rate of interest on underpaid tax	3·25%
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%

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Question 1 begins on page 7.

Section A – BOTH questions are compulsory and MUST be attempted

1 Your manager has received an email from Lamar. Lamar is the managing director and majority shareholder in REP Ltd. Lamar and REP Ltd are clients of your firm. Your manager has forwarded the email to you together with an email detailing the work you are required to do.

Email extract from Lamar: dated 7 September 2020

Potential investment in JAY Ltd

We are in discussion with the management of CRO Ltd regarding the establishment of a new company, JAY Ltd. If it proceeds, JAY Ltd will commence trading on 1 April 2021 and carry on its business activities in the country of Garia, where it will manufacture computer components.

CRO Ltd is proposing that REP Ltd would own 30% of the ordinary share capital of JAY Ltd with CRO Ltd owning the remaining 70%. However, we regard this potential investment as somewhat risky, such that if we decide to proceed, we may prefer to own just 20% of JAY Ltd rather than 30%.

JAY Ltd is expected to be profitable in the year ending 31 March 2022. However, there is the possibility that it will be loss making in either that year or in future years.

JAY Ltd's tax adjusted trading profit for the year ending 31 March 2022 is budgeted to be £135,000, all of which will relate to its activities in Garia. JAY Ltd will have no other source of taxable income and will not make any chargeable gains during this year.

We have not been involved in a joint venture like this before and we have no experience of carrying on a business outside the UK. We would appreciate your advice on the following three extracts from the documentation provided to us by CRO Ltd:

(i) 'It has not yet been determined whether JAY Ltd will be resident in the UK or in Garia. If JAY Ltd is resident in the UK, it will be considered to be carrying on its business through a permanent establishment in Garia.'

(ii) 'If JAY Ltd is resident in the UK, we will consider making an election to exempt its overseas trading profits from UK tax.'

(iii) 'We have been advised that if JAY Ltd is resident in Garia, this will not result in a charge under the controlled foreign company (CFC) rules.'

Purchase of investment property

We are considering the purchase by REP Ltd of a new, unused commercial building for £200,000 plus 20% value added tax (VAT). REP Ltd would then grant a 20-year lease of this building to a retailer. Will REP Ltd be able to recover the VAT charged by the vendor on the sale of this building?

Proposed gift of shares to trust

I established a discretionary trust for the benefit of my nieces and nephews on 1 August 2010.

On 1 November 2020, I am planning to give 20,000 of my shares in REP Ltd to this trust. After I have made the gift, I will still own 60,000 shares (60% of the company). You have already advised me that these shares are not relevant business property for the purposes of business property relief, due to the investment activities of REP Ltd. Accordingly, I am aware that the gift on 1 November 2020 may result in an inheritance tax (IHT) liability. If I decide to make the gift, I will pay any IHT due.

I have made the following gifts in the past:

		£
1 August 2010	Cash to trustees on the creation of the trust	120,000
1 February 2016	Cash to brother	35,000
1 May 2016	Additional cash to trustees	170,000
1 July 2020	Cash to sister	45,000

None of these gifts has resulted in an IHT liability.

Email extract from your manager: dated 8 September 2020.

Please prepare notes for use at a meeting with Lamar.

I want you to lead the meeting. You should therefore set out the notes in a manner which will make it easy for you to refer to them during the meeting.

The notes should cover the following matters:

(a) Knowledge obtained from advising other clients

We have a number of existing clients which trade from permanent establishments situated overseas, and a few years ago we had a client with a presence in the country of Garia.

Set out the points you will make in order to explain the extent to which REP Ltd can benefit from the knowledge we have gained from advising these other clients.

(b) Investment in JAY Ltd

Additional Information

– REP Ltd and CRO Ltd are UK resident companies which prepare accounts to 31 March each year.

– Business profits generated in Garia are subject to 13% business tax in that country.

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

(i) Residency of JAY Ltd

Explanations of the relevance of the country of residency of JAY Ltd in relation to:

– the amount of corporation tax payable in the UK and Garia in respect of its profits; and

– the relief available to REP Ltd if JAY Ltd's business in Garia were to make a trading loss.

Before you start, take some time to identify the different possibilities which need to be addressed, recognising that we do not yet know what percentage of JAY Ltd will be owned by REP Ltd.

(ii) Election to exempt the profits of JAY Ltd's overseas permanent establishment from UK tax

List the implications of JAY Ltd making this election.

(iii) Controlled foreign company (CFC) rules

I can confirm that a CFC charge will not arise if JAY Ltd is resident in Garia. However, I want to provide Lamar with an explanation of the purpose of the CFC rules and the charge which can be levied under them.

(c) Purchase of investment property

Explain the matters which Lamar should be aware of in relation to REP Ltd recovering the value added tax (VAT) which would be incurred on the purchase of the investment property.

There is no need to consider partial exemption or the capital goods scheme.

(d) Proposed gift of shares to trust on 1 November 2020

A calculation of the inheritance tax (IHT) which would be payable by Lamar if he were to give 20,000 shares in REP Ltd to the trust on 1 November 2020 as planned. Your calculation should indicate the availability or otherwise of all relevant annual exemptions.

Where relevant, you should use the following values for a single ordinary share in REP Ltd:

Shareholding	Up to 25%	26% to 50%	51% to 74%	75% or more
Value per share	£8	£11	£17	£24

Lamar currently owns 80% of the ordinary share capital of REP Ltd. The remaining shares in the company are owned by individuals who have no connection with Lamar.

Tax manager

Required:

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

(a) Knowledge obtained from advising other clients. (5 marks)

(b) Investment in JAY Ltd.

- **(i) Residency of JAY Ltd.** (9 marks)
- **(ii) Election to exempt the profits of JAY Ltd's overseas permanent establishment from UK tax.** (3 marks)
- **(iii) Controlled foreign company (CFC) rules.** (3 marks)

(c) Purchase of investment property. (5 marks)

(d) Proposed gift of shares to trust on 1 November 2020. (6 marks)

Professional marks will be awarded for the approach taken to planning the content, 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 had a meeting with Freya, a client of your firm. She has sent you the memorandum she prepared following the meeting and an email detailing the work you are required to do.

Memorandum extract from your manager: dated 7 September 2020.

Background

Freya has been domiciled and resident in the UK more than 30 years and has not spent any significant periods of time overseas. She started trading as an unincorporated business in 2012 and has always prepared accounts to 31 May each year. Freya's business is her only source of income.

Sale of Freya's business

Freya has received an offer of £2,300,000 from an unconnected party for all of the assets of her business. If the offer is accepted, her only chargeable assets for capital gains tax purposes will be goodwill and her business premises. The aggregate chargeable gains arising in respect of these assets will be £850,000. However, once she is no longer working full time, Freya intends to live in the country of Benida and has asked us to consider whether she would save UK tax if she were to delay the sale of her business until after she has left the UK.

I agreed to advise Freya on the following strategy:

31 October 2020	Freya will sell all of the assets of her business to FIM Ltd, a UK resident limited company, in exchange for ordinary shares worth £2,300,000. Freya will own the whole of the ordinary share capital of FIM Ltd.
5 April 2021	Freya and her family will move to Benida.
30 April 2021	Freya will sell the whole of the ordinary share capital of FIM Ltd for cash proceeds.

Freya's ideal scenario

Freya would like to live in Benida for no more than three years. She would buy a home there and would also retain her home in the UK. Freya would stay in her UK home for 55 days in each tax year, of which 25 would be working days. She would spend the rest of her time in Benida. Freya does not intend to carry out any work in Benida. Freya's husband and children would remain in Benida throughout the three-year period and would not be resident in the UK.

Unincorporated business – financial information

– A single set of accounts will be prepared for the 17-month period ending 31 October 2020. The budgeted tax adjusted profit for this period, before deduction of capital allowances, is £94,000.

– The tax written down values as at 31 May 2019 were: main pool – zero, car with private use – £8,700.

– On 1 September 2019, Freya purchased plant and machinery for use in her business costing £4,200.

– On 31 October 2020, the plant and machinery used in her business (excluding the motor car) will have a market value on that date of £6,300. Every item will be sold for less than its cost.

– Freya will withdraw a motor car from the business on 30 September 2020. The car has always been used 65% for business purposes and will have a market value of £11,100, which is less than the car's original cost.

– Freya and FIM Ltd will submit a succession election to HM Revenue and Customs (HMRC).

– There are unrelieved overlap profits from the commencement of the business of £31,400.

Land in Benida

Freya's father, Alvaro, moved to the UK (and became UK resident) on 6 April 2006. He is domiciled in Benida and has owned a plot of land there for many years. He is considering giving this land to Freya within the next 12 months. I agreed to advise Freya on whether or not such a gift could result in an inheritance tax (IHT) liability for her.

Alvaro is not well and is unlikely to live for a further seven years; we should therefore assume all future potentially exempt transfers will become chargeable to IHT.

Because Alvaro makes regular, substantial lifetime gifts of assets situated in the UK, we should also assume there will be no nil rate band or annual exemptions available in respect of a gift of this land.

Email extract from your manager: dated 8 September 2020.

Additional information in respect of the country of Benida

– There is no capital gains tax (CGT) in Benida.

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

Please carry out the following work:

(a) Sale of business

– Calculate the CGT which would be payable by Freya on the sale of her business if she does not incorporate her business but simply sells all of her business assets for £2,300,000 on 31 October 2020 to an unconnected purchaser. Explain the rate of CGT which would be charged.

The annual exempt amount WILL NOT be available to Freya, and she will be a higher rate taxpayer in the tax year of sale.

– Explain the CGT implications of the proposed sale of Freya's business to FIM Ltd in exchange for shares worth £2,300,000. I can confirm that all of the conditions necessary for incorporation relief to apply to this transaction will be satisfied and that no election will be made to disapply this relief.

– On the assumption Freya lives in Benida for three years from 5 April 2021 in accordance with her ideal scenario, explain her UK residence status for those three tax years.

I have done some preliminary work on Freya's residence status and can confirm that Freya will be neither automatically non-UK resident nor automatically UK resident whilst she is living in Benida.

– On the assumption that Freya is non-UK resident for the tax year 2021/22, explain any changes which would need to be made to Freya's ideal scenario in respect of her time in Benida in order for there to be no UK CGT on the sale of her shares in FIM Ltd.

(b) Liability to income tax and class 4 national insurance contributions (NIC)

On the assumption Freya sells her business to FIM Ltd on 31 October 2020, calculate her liability to income tax and class 4 NIC for her final tax year of trading.

I can confirm that Freya will not receive any taxable income from FIM Ltd.

(c) Land in Benida

Explain whether or not a gift of the land by Alvaro to Freya at some time in the next 12 months could result in a UK inheritance tax (IHT) liability.

Tax manager

Required:

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

(a) Sale of business. (13 marks)

(b) Liability to income tax and class 4 national insurance contributions (NIC). (8 marks)

(c) Land in Benida. (4 marks)

(25 marks)

Section B – BOTH questions are compulsory and MUST be attempted

3 Amelia is a sole trader. She is seeking advice in respect of a loss incurred by her business, the tax implications of replacing a warehouse, and deregistration for value added tax (VAT) purposes.

Amelia:

– Has owned her unincorporated business, AS Trading, for many years.
– Has savings income of £6,000 each year.
– Had rental income of £11,600 from a UK residential property in the tax year 2019/20.
– Has no rental income in the tax year 2020/21 as the letting ceased on 31 March 2020.
– Sold this property on 30 April 2020.

AS Trading – tax adjusted trading profit/(loss):

	£
Year ended 31 December 2019	30,000
Year ending 31 December 2020 (forecast)	(14,000)

Amelia – recent capital disposals:

– Amelia's capital disposals are as follows:

Asset	Date of disposal	(loss)/gain £
Painting	1 June 2019	(11,000)
UK rental property	30 April 2020	45,000
Shares in Swartz Ltd	16 August 2020	28,000

– All of these disposals were made to unconnected persons.
– Amelia had never lived in the UK rental property.
– Swartz Ltd is an unquoted trading company.
– Amelia sold the whole of her 3% shareholding in Swartz Ltd.

Proposed sale of Warehouse 1:

– Amelia acquired Warehouse 1 on 1 May 2014 for £86,000.
– Amelia will sell Warehouse 1 on 1 May 2021 for its expected market value at that date of £118,000.
– AS Trading occupies three out of the four floors of Warehouse 1.
– The remaining floor has been rented to tenants throughout Amelia's ownership of the building.

Proposed purchase of Warehouse 2:

– Amelia will purchase this warehouse, and a forklift truck for use in the warehouse, on 1 March 2021.
– Amelia will pay £83,000 for Warehouse 2, and will pay £23,000 for the forklift truck.
– Amelia will start to use the whole of Warehouse 2 in her business from 1 May 2021.

AS Trading – taxable turnover for value added tax (VAT) purposes:

	£
Year ended 31 December 2019	92,000
Year ending 31 December 2020 (forecast)	65,000
Year ending 31 December 2021 (forecast)	79,000

– Amelia expects that the taxable turnover of the business will continue to increase gradually in the next few years.
– AS Trading makes wholly standard-rated supplies.
– Amelia wishes to apply for voluntary deregistration for VAT purposes on 31 December 2020.

Required:

(a) (i) **State the reliefs available to Amelia in respect of her trading loss of the year ending 31 December 2020, on the assumption that Amelia does not wish to carry forward any of the loss.** (3 marks)

(ii) **Explain, with supporting calculations, how much tax would be saved for each of the reliefs identified in requirement (a)(i).** (8 marks)

(b) **Explain, with supporting calculations, the capital gains tax and income tax implications for Amelia of the proposed sale of Warehouse 1, and the acquisition of Warehouse 2 and the forklift truck.** (6 marks)

(c) **Explain why Amelia can apply to voluntarily deregister for value added tax (VAT) purposes on 31 December 2020, from what date her VAT registration would be cancelled, and the immediate consequences for her of deregistering.** (3 marks)

(20 marks)

4 You have been asked to provide advice to Dorian, the managing director of Taupe Ltd, in relation to Taupe Ltd's status as a close company, the company's provision of employment benefits to Dorian, and the late filing of the company's corporation tax return.

Taupe Ltd:

– Is a UK resident trading company, and is also a close company.
– Has six directors, Dorian and five other, unrelated, individuals.
– Prepares accounts to 30 April each year.
– Always pays all amounts due to HM Revenue and Customs (HMRC) by the due date.
– Is not a large company for the purpose of being required to pay its corporation tax liability in instalments.

Taupe Ltd – shareholders:

– The shares in Taupe Ltd are held as follows:

	Percentage of issued ordinary shares
Dorian	5%
The other five directors (each holding 5%)	25%
Basil (Dorian's father)	23%
Other, unrelated, shareholders (each holding less than 2%)	47%
	100%

Dorian:

– Has an annual salary of £78,000 from Taupe Ltd.
– Was provided with an interest-free loan of £7,500 from Taupe Ltd on 6 April 2019. Notional tax was payable on this loan by Taupe Ltd.
– Is due to repay this loan on 30 June 2022, but may repay it earlier, on 30 April 2022.
– Has no other income.
– Works full time at Taupe Ltd's office in London.

Taupe Ltd – assistance with Dorian's home to work travel costs:

– Taupe Ltd is considering two alternatives to assist Dorian with the costs of his daily travel from home to work for the tax year 2021/22.

Alternative 1:

– On 6 April 2021, Taupe Ltd will make an interest-free loan to Dorian of £4,800, equal to the cost of his annual travel season ticket.
– Taupe Ltd will write off this loan on 5 April 2022.
– Dorian will incur no additional travel costs under this alternative.

Alternative 2:

– Taupe Ltd will pay Dorian a mileage allowance for driving his own car to work, amounting to £3,600 for the year ending 5 April 2022.
– Taupe Ltd will pay an unconnected company an annual fee of £1,200 for a car parking space for Dorian near the company's London office.
– Dorian has estimated that his current annual cost of driving from home to work is £5,220, including £1,320 for parking.

Taupe Ltd – late filing of corporation tax returns:

– Taupe Ltd filed its corporation tax return for the year ended 30 April 2019 on 29 August 2020.
– HMRC issued a notice requiring the filing of this return on 8 June 2019.
– Taupe Ltd had filed its corporation tax return for the year ended 30 April 2018 on 6 July 2019.
– All previous corporation tax returns had been filed on time.

Required:

(a) Explain why Taupe Ltd is classed as a close company. (4 marks)

(b) Explain, with supporting calculations, the tax implications for both Dorian and Taupe Ltd, if Dorian repays the £7,500 loan on 30 April 2022 rather than on 30 June 2022. (5 marks)

(c) Explain, with supporting calculations, which of the two alternatives for providing assistance with travel costs, will produce the lower overall cost for Dorian. (8 marks)

(d) State, with reasons, the due date for filing Taupe Ltd's corporation tax return for the year ended 30 April 2019, and the implications for Taupe Ltd in respect of filing it late. (3 marks)

(20 marks)

End of Question Paper