Professional Level – Options Module

Advanced Taxation (United Kingdom)

Friday 15 June 2012

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

This paper is divided into two sections:

Section A – BOTH questions are compulsory and MUST be attempted

Section B – TWO questions ONLY to be attempted

Tax rates and allowances are on pages 2–5

Do NOT open this paper until instructed by the supervisor.
During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.
This question paper must not be removed from the examination hall.

The Association of Chartered Certified Accountants

Paper P6 (UK)

ACCA

SUPPLEMENTARY INSTRUCTIONS

1. You should assume that the tax rates and allowances for the tax year 2011/12 and for the financial year to 31 March 2012 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 – £35,000	20	10
Higher rate	£35,001 to £150,000	40	32·5
Additional rate	£150,001 and over	50	42·5

A starting rate of 10% applies to savings income where it falls within the first £2,560 of taxable income.

Personal allowances

		£
Personal allowance	Standard	7,475
	65 – 74	9,940
	75 and over	10,090
Income limit for age related allowances		24,000
Income limit for standard personal allowance		100,000

Car benefit percentage

The base level of CO_2 emissions is 125 grams per kilometre.

A rate of 5% applies to petrol cars with CO_2 emissions of 75 grams per kilometre or less, and a rate of 10% applies where emissions are between 76 and 120 grams per kilometre.

Car fuel benefit

The base figure for calculating the car fuel benefit is £18,800.

Individual savings accounts (ISAs)

The overall investment limit is £10,680, of which £5,340 can be invested in a cash ISA.

Pension scheme limits

Annual allowance	£50,000
Lifetime allowance	£1,800,000
The maximum contribution that can qualify for tax relief without evidence of earnings	£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	20
Special rate pool	10
Motor cars (purchases since 6 April 2009 (1 April 2009 for limited companies))	
New cars with CO_2 emissions up to 110 grams per kilometre	100
CO_2 emissions between 111 and 160 grams per kilometre	20
CO_2 emissions over 160 grams per kilometre	10

Annual investment allowance

First £100,000 of expenditure	100

Corporation tax

Financial year	2009	2010	2011
Small profits rate	21%	21%	20%
Main rate	28%	28%	26%
	£	£	£
Lower limit	300,000	300,000	300,000
Upper limit	1,500,000	1,500,000	1,500,000
Standard fraction	7/400	7/400	3/200

Marginal Relief

Standard fraction x (U – A) x N/A

Value added tax (VAT)

Standard rate	20%
Registration limit	£73,000
Deregistration limit	£71,000

Inheritance tax: nil rate bands and tax rates

		£
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
6 April 2002 to 5 April 2003		250,000
6 April 2001 to 5 April 2002		242,000
6 April 2000 to 5 April 2001		234,000
6 April 1999 to 5 April 2000		231,000
6 April 1998 to 5 April 1999		223,000
6 April 1997 to 5 April 1998		215,000
Rate of tax on excess over nil rate band	– Lifetime rate	20%
	– Death rate	40%

Inheritance tax: taper relief

Years before death:	% 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

Rate of tax – Lower rate	18%
– Higher rate	28%
Annual exempt amount	£10,600
Entrepreneurs' relief – Lifetime limit	£10,000,000
– Rate of tax	10%

National insurance contributions
(not contracted out rates)

			%
Class 1	Employee	£1 – £7,225 per year	Nil
		£7,226 – £42,475 per year	12·0
		£42,476 and above per year	2·0
Class 1	Employer	£1 – £7,072 per year	Nil
		£7,073 and above per year	13·8
Class 1A			13·8
Class 2		£2·50 per week	
		Small earnings exception limit – £5,315	
Class 4		£1 – £7,225 per year	Nil
		£7,226 – £42,475 per year	9·0
		£42,476 and above per year	2·0

Rates of interest (assumed)

Official rate of interest	4·0%
Rate of late payment interest	3·0%
Rate of repayment interest	0·5%

Stamp duty land tax

	%
£150,000 or less (1)	Nil
£150,001 – £250,000 (2)	1
£250,001 – £500,000	3
£500,001 – £1,000,000	4
£1,000,001 or more (3)	5

(1) For residential property, the nil rate is restricted to £125,000.
(2) From 25 March 2010 to 24 March 2012 there is an exemption for first time buyers purchasing residential properties for no more than £250,000.
(3) The 5% rate applies to residential properties only.

Stamp duty

Shares	0·5%

Section A – BOTH questions are compulsory and MUST be attempted

1 Your manager has sent you an email, together with an attachment in respect of a new client called Una. The email and the attachment are set out below.

Email from your manager

I have had a meeting with Una, a new client of the firm. Una is 74 years old and a widow. She has a son, Won, who is 49 years old.

Una is resident, ordinarily resident and domiciled in the UK. Her annual taxable income is approximately £90,000. She makes sufficient capital gains every year to use her annual exempt amount.

Una made a gift of cash of £40,000 to Won in May 2008. This is the only transfer she has made for the purposes of inheritance tax in the last seven years. Una has left the whole of her estate to Won in her will. Her estate is expected to be worth more than £3 million at the time of her death.

For the purposes of this work I want you to assume that Una will die on 31 December 2017.

Gift to son

Una is considering making a gift to Won of either some farmland situated in the UK or a villa situated in the country of Soloria. Una has prepared a schedule setting out the details of the farmland and the villa. The schedule is attached to this email. Una will make the gift to Won on his birthday on 18 November 2012; she is not prepared to delay the gift, even if it would be advantageous to do so.

The tax system in the country of Soloria

Capital gains tax	There is no capital gains tax in Soloria.
Inheritance tax	If Una still owns the villa at her death on 31 December 2017, the inheritance tax liability in Soloria would be £170,000.
	If Una gifts the villa to Won on 18 November 2012 and dies on 31 December 2017, the inheritance tax liability in Soloria would be £34,000, all of which would be payable following Una's death.

The Double Taxation Agreement between the UK and the country of Soloria includes an exemption clause whereby assets situated in one of the countries that is party to the agreement are subject to inheritance tax in that country only and not in the other country.

Gift to granddaughter

Una's granddaughter, Alona, will begin a three-year university course in September 2012. Una has agreed to pay Alona's rent of £450 per month while she is at university.

Undeclared income

Una purchased a luxury motor car for her own use in 2008, but found that many of her friends wanted to borrow it for weddings. In June 2009, she began charging £200 per day for the use of the car but is of the opinion that the income received cannot be subject to income tax as she only charges a fee 'to help cover the car's running costs'. However, I have considered the situation and concluded that the hiring out of the car has resulted in taxable profits.

I want you to prepare the following:

(a) Gifts to son and granddaughter

A **memorandum** for the client file that addresses the following issues.

(i) In respect of the gift to Won

– Calculations of the potential reduction in the inheritance tax payable on Una's death as a result of each of the possible gifts to Won. The farmland will not qualify for business property relief, but you will need to consider the availability of agricultural property relief.
– Calculations of the capital gains tax liability in respect of each of the possible gifts.

- Explanations where the calculations are not self-explanatory, particularly in relation to the availability of reliefs, and a note of any assumptions made.
- A concise summary of your calculations in relation to these capital taxes in order to assist Una in making her decision as to which asset to give to Won.
- Any other tax and financial implications in respect of the gifts of which Una should be aware before she makes her decision.

(ii) In respect of the payment of Alona's rent

- The conditions that would need to be satisfied in order for the payments to be exempt for the purposes of inheritance tax.

(b) Undeclared income

A **brief letter** to be sent from me to Una in relation to the luxury motor car.

The letter should explain the implications for Una and our firm of failing to declare the income to HM Revenue and Customs and the implications for Una of not having declared the income sooner.

Tax manager

Attachment – Schedule from Una – Details of the farmland and villa

	Notes	Date acquired	Cost	Estimated value 18 November 2012	Estimated value 31 December 2017
			£	£	£
Farmland	1	September 2009	720,000	900,000	1,100,000
Villa	2	August 1998	510,000	745,000	920,000

Notes

1 The agricultural value of the farmland is approximately 35% of its market value. The farmland has always been rented out to tenant farmers.

2 I inherited the villa when my husband died on 14 January 2002. Its market value at that date was £600,000. The villa has never been my principal private residence. It is situated in the country of Soloria and rented out to long-term tenants. The income is subject to Solorian income tax at the rate of 50%. I do not own any other assets situated in Soloria.

3 The whole of my husband's nil rate band was used at the time of his death.

Required:

(a) Prepare the memorandum requested in the email from your manager.

Note: For guidance, the calculations in part (a) of this question are worth no more than half of the total marks available. (21 marks)

Professional marks will be awarded in part (a) for the overall presentation of the memorandum and the effectiveness with which the information is communicated. (3 marks)

(b) Prepare the letter requested in the email from your manager. (6 marks)

A professional mark will be awarded in part (b) for the overall presentation of the letter. (1 mark)

(31 marks)

2 Your manager has had a meeting with Mrs Pairz, the Group Finance Director of the Janus plc group of companies. The memorandum recording the matters discussed at the meeting is set out below.

Memorandum recording matters discussed at the meeting with Mrs Pairz

To	**The files**
From	**Tax manager**
Date	**15 June 2012**
Subject	**Janus plc group**

Mrs Pairz has recently been appointed the Group Finance Director of the Janus plc group. She has asked for advice on the use of the trading loss of Janus plc for the year ended 31 March 2012 and on a number of other matters.

The Janus plc group of companies

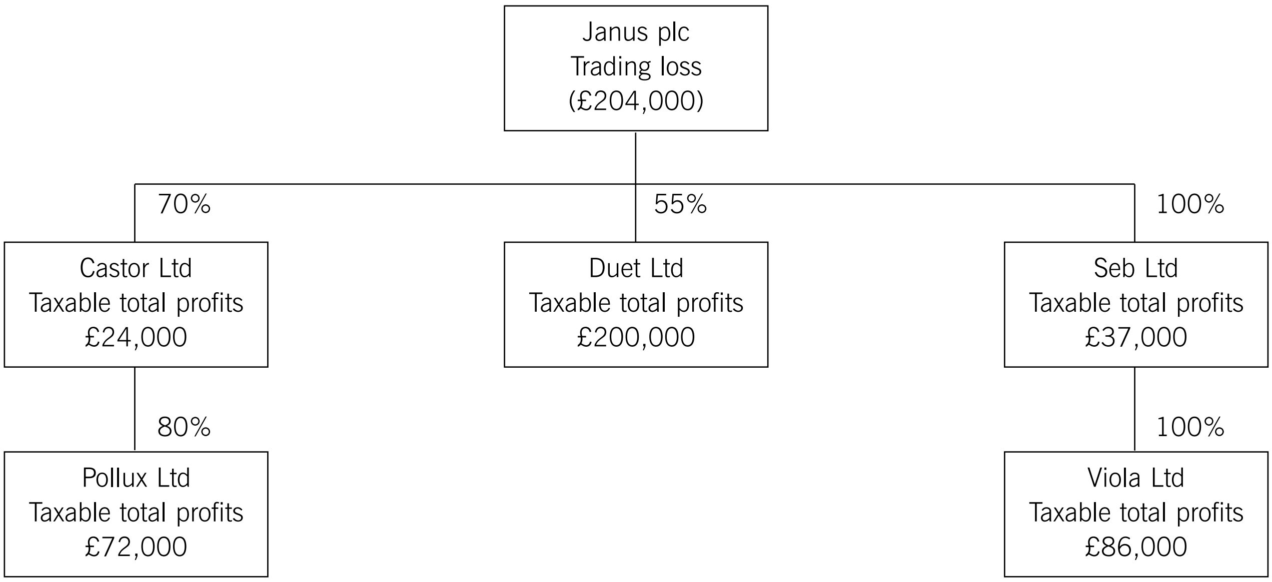
The group structure indicating the trading loss of Janus plc and the taxable total profits of each of the other group companies for the year ended 31 March 2012 is set out below. All of the companies are UK resident trading companies.

Janus plc purchased Seb Ltd, together with its subsidiary, Viola Ltd, on 1 December 2011 from Mr Twinn. Mr Twinn has never owned any other companies. There have not been any other changes to the group structure in recent years.

The minority holdings in Castor Ltd and Pollux Ltd are owned by UK resident individuals. The minority holding in Duet Ltd is owned by Bi plc, a UK resident company, such that Duet Ltd is a consortium company.

The group policy is for an amount equal to the corporation tax saved to be paid for any losses transferred between group companies.

Each of the companies is separately registered for the purposes of value added tax (VAT).



Additional information in respect of Janus plc

– Janus plc made a chargeable gain of £44,500 in the year ended 31 March 2012.
– Janus plc had taxable total profits in the year ended 31 March 2011 of £95,000 and did not make any charitable donations in the year.

Assets to be sold

(i) Pollux Ltd is to sell its administrative premises, 'P HQ', to Janus plc on 1 July 2012 for their market value of £285,000. Pollux Ltd acquired these premises from Castor Ltd on 1 March 2009 for their market value of £240,000.

(ii) Viola Ltd is to sell a warehouse to an unrelated company on 1 August 2012 for £350,000 plus VAT of £70,000. Viola Ltd acquired this warehouse on 1 February 2011 for £320,000 plus VAT of £64,000.

Mrs Pairz understands that the input tax relating to the warehouse should be recovered in accordance with the capital goods scheme because Viola Ltd is a partially exempt company, but suspects that the calculations may not have been done correctly.

The relevant VAT recovery percentages for Viola Ltd are:

Year ended 31 March 2011	70%
Year ended 31 March 2012	55%
Period from 1 April 2012 to 1 August 2012	50%

(iii) Castor Ltd is to sell patent rights to an unrelated company on 1 September 2012 for £41,000. Castor Ltd acquired these patent rights for use in its trade on 1 September 2008 for £45,000. The patent rights are being written off in Castor Ltd's accounts on a straight-line basis over a ten-year period.

Investment in Kupple Inc

Janus plc intends to purchase 15% of the ordinary share capital of Kupple Inc on 1 October 2012. Kupple Inc is a profitable trading company, resident in the country of Halven. Kupple Inc will provide consultancy services to Janus plc. This is intended to be a short-term commercial investment; Janus plc will sell the shares at some point in the next two years.

Required:

(a) Use of the trading loss of Janus plc:

(i) Explain the alternative ways in which the loss can be relieved, on the assumption that it is not to be carried forward.

(ii) Advise how the loss should be relieved in order to maximise the corporation tax saved. You should include a summary showing the rate(s) of tax at which relief for the loss will be obtained. (11 marks)

(b) Assets to be sold:

(i) Explain how the chargeable gain on the disposal of P HQ will be calculated and state any further information required from Mrs Pairz to enable us to carry out this calculation. (5 marks)

(ii) Calculate the input tax recoverable from/repayable to HM Revenue and Customs in respect of the warehouse for each of the three years ending 31 March 2013, on the assumption that the sale of the warehouse goes ahead as planned. (4 marks)

(iii) Explain, with supporting calculations, the corporation tax implications of the sale of the patent rights. (3 marks)

(c) Investment in Kupple Inc:

(i) Explain the VAT implications for Janus plc of purchasing consultancy services from Kupple Inc. (2 marks)

(ii) Explain the corporation tax treatment of any profit or loss arising on the eventual sale of the shares in Kupple Inc. (4 marks)

(d) Janus plc group senior accounting officer:

Explain, briefly, whether or not Mrs Pairz will be the senior accounting officer of the Janus plc group, the circumstances in which the rules relating to the group's tax accounting systems will apply to the Janus plc group, and the statutory responsibilities of a senior accounting officer when the rules apply. (4 marks)

(33 marks)

Section B – TWO questions ONLY to be attempted

3 Jerome is an unincorporated sole trader who is about to sell his business to a company. He requires advice on the value added tax (VAT) implications of the sale of the business, whether a new lease in respect of a motor car for use by him should be entered into by him or by the company and the payment of travel expenses in respect of the family of an employee working overseas.

Jerome's business:

– Has annual taxable profits of £75,000 and is growing.
– Is registered for the purposes of VAT.
– Jerome leases a motor car in which he drives 20,000 miles per year of which 14,000 miles are on business. He anticipates that this level and pattern of mileage will continue in the future.
– The assets of the business include a building that was completed in 2010 and purchased by Jerome in April 2010 for £320,000.

The sale of Jerome's business to Tricycle Ltd:

– The business will be sold to Tricycle Ltd on 1 August 2012.
– Jerome will own the whole of the share capital of Tricycle Ltd.
– Tricycle Ltd will not change the nature of the business but will look to expand it by exporting its products to Italy.

The lease of the motor car:

– The existing lease will end on 31 July 2012.
– A new lease will be entered into on 1 August 2012 by either Jerome or Tricycle Ltd.
– The annual leasing costs of the new car will be £4,400.

The motor car to be leased on 1 August 2012:

– Will be diesel powered and have a list price when new of £31,000.
– Will have CO_2 emissions of 172 grams per kilometre.
– Will have annual running costs, including fuel, of £5,000 in addition to the leasing costs.

Remuneration to be paid by Tricycle Ltd to Jerome:

– A salary of £4,000 per month.
– If Tricycle Ltd leases the motor car, Jerome will use it for business and private purposes and will be provided with fuel for all of his motoring.
– If Jerome leases the motor car, he will be paid 50 pence per mile for driving it on business journeys.

Expansion into Europe:

– An employee of Tricycle Ltd will work for up to three months in Italy between April and July 2013.
– The employee will continue to be resident, ordinarily resident and domiciled in the UK.
– Tricycle Ltd will pay the travel costs of the employee's wife and three-year-old child when they visit him in June 2013.
– The travel costs will be taxable in the hands of the employee as employment income.

Required:

(a) Explain the value added tax (VAT) implications of the sale of Jerome's business to Tricycle Ltd. (6 marks)

(b) Prepare calculations for a 12-month period to show the total tax cost, for Tricycle Ltd and Jerome, of the car being leased by:

(i) Tricycle Ltd;
(ii) Jerome.

Note: Ignore VAT for part (b) of this question. (10 marks)

(c) State the conditions that must be satisfied for a deduction for the travel costs paid by Tricycle Ltd to be given against the employee's total employment income. (2 marks)

(18 marks)

4 Tetra has recently been made redundant and joined a trading partnership. He requires advice on the redundancy payments he has received, a potential investment in a venture capital trust and on making pension contributions. He has also asked for a calculation of his class 4 national insurance contributions in respect of his income from the partnership.

Tetra:
- Is 44 years old.
- Was made redundant by Ivy Ltd on 31 March 2012.
- Became a partner in the Winston partnership on 1 June 2012.
- Is considering two alternative investments.

Redundancy payments made by Ivy Ltd to Tetra:
- Statutory redundancy of £4,200.
- A non-contractual payment of £46,000 as compensation for loss of office.
- £7,000 in consideration of Tetra agreeing not to work for any competitor of Ivy Ltd for 12 months.

The Winston Partnership:
- Prior to 1 June 2012, there were two partners in the partnership: Zia and Fore.
- Budgeted tax adjusted trading profits of the partnership
  - Year ending 31 December 2012 – £300,000
  - Year ending 31 December 2013 – £380,000
- Profit sharing arrangements

			Zia	Fore	Tetra
Up to 31 May 2012	–	Profit share	60%	40%	N/A
From 1 June 2012	–	Annual salary	–	£24,000	£18,000
	–	Profit share	40%	30%	30%

Two alternative investments:
- In the tax year 2012/13 Tetra will either:
  subscribe £36,000 for shares in a venture capital trust; or
  make a payment of £36,000 to a registered personal pension fund.

Required:

(a) Explain briefly whether or not the redundancy payments made by Ivy Ltd to Tetra are subject to income tax.
(3 marks)

(b) Calculate the class 4 national insurance contributions payable by Tetra for the tax year 2012/13.
(7 marks)

(c) Compare the effect of the two alternative investments on Tetra's income tax liability for the tax year 2012/13 and identify any non-tax matters relevant to the investment decision of which he should be aware.

Note: For part (c) of this question it should be assumed that Tetra's net income in the tax year 2012/13 (before deduction of the personal allowance) will be £120,000, none of which is savings income or dividend income.
(8 marks)

(18 marks)

5 Sank Ltd and Kurt Ltd are two unrelated clients of your firm. Sank Ltd requires advice in connection with the payment of its corporation tax liability and the validity of a compliance check enquiry it has received from HM Revenue and Customs. Kurt Ltd requires advice in connection with the purchase of machinery and expenditure on research and development.

(a) Sank Ltd:

– Has paid corporation tax at the main rate for many years.
– Has a large number of associated companies.
– Will prepare its next accounts for the 11 months ending 30 September 2012.
– Has received a compliance check enquiry from HM Revenue and Customs.

Taxable total profits for the 11 months ending 30 September 2012:

– Figures prepared on 31 March 2012 indicated taxable total profits for this 11-month period of £640,000.
– As at 1 June 2012, taxable total profits for this 11-month period are expected to be £750,000.

The compliance check enquiry from HM Revenue and Customs:

– HM Revenue and Customs raised the enquiry on 31 May 2012.
– It relates to Sank Ltd's corporation tax return for the year ended 31 October 2009.
– No amendments have been made to the corporation tax return since it was submitted.

Required:

In relation to Sank Ltd:

(i) Explain, with supporting calculations, the payment(s) required in respect of the company's corporation tax liability for the 11 months ended 30 September 2012 and the implications of the increase in the expected taxable total profits: (7 marks)

(ii) In relation to the date on which the compliance check enquiry into the corporation tax computation for the year ended 31 October 2009 was raised, explain the circumstances necessary for it to be regarded as valid. You should assume that Sank Ltd has not been fraudulent or negligent. (3 marks)

(b) Kurt Ltd:

– Was incorporated and began to trade on 1 August 2011.
– Is owned by Mr Quinn, who also owns three other trading companies.
– Has made a tax adjusted trading loss in the eight months ending 31 March 2012.
– Has no other income or chargeable gains in the eight months ending 31 March 2012.
– Is expected to be profitable in future years.
– Is a small enterprise for the purposes of research and development.

Expenditure in the period ending 31 March 2012:

– Machinery for use in its manufacturing activities – £140,000.
– The cost of staff carrying out qualifying scientific research in connection with its business – £28,000.

Required:

In relation to Kurt Ltd, explain the tax deductions and/or credits available in the period ending 31 March 2012 in respect of the expenditure on machinery and scientific research and comment on any choices available to the company. (8 marks)

(18 marks)

End of Question Paper