Professional Level – Options Module

Advanced Taxation (United Kingdom)

Friday 6 December 2013

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 2012/13 and for the financial year to 31 March 2013 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 – £34,370	20	10
Higher rate	£34,371 – £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 £2,710 of taxable income.

Personal allowances

		£
Personal allowance	Standard	8,105
	65 – 74	10,500
	75 and over	10,660
Income limit for age related allowances		25,400
Income limit for standard personal allowance		100,000

Car benefit percentage

The relevant base level of CO_2 emissions is 100 grams per kilometre.

The percentage rates applying to petrol cars with CO_2 emissions up to this level are:

	%
75 grams per kilometre or less	5
76 grams to 99 grams per kilometre	10
100 grams per kilometre	11

Car fuel benefit

The base figure for calculating the car fuel benefit is £20,200.

Individual savings accounts (ISAs)

The overall investment limit is £11,280, of which £5,640 can be invested in a cash ISA.

Pension scheme limits

Annual allowance	£50,000
Lifetime allowance	£1,500,000
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	18
Special rate pool	8
Motor cars	
New cars with CO_2 emissions up to 110 grams per kilometre	100
CO_2 emissions between 111 and 160 grams per kilometre	18
CO_2 emissions over 160 grams per kilometre	8
Annual investment allowance	
First £25,000 of expenditure	100

Corporation tax

Financial year	2010	2011	2012
Small profits rate	21%	20%	20%
Main rate	28%	26%	24%
	£	£	£
Lower limit	300,000	300,000	300,000
Upper limit	1,500,000	1,500,000	1,500,000
Standard fraction	7/400	3/200	1/100

Marginal Relief

Standard fraction x (U – A) x N/A

Value added tax (VAT)

Standard rate	20%
Registration limit	£77,000
Deregistration limit	£75,000

Inheritance tax: nil rate bands and tax rates

	£	
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	
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	
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 – £7,605 per year	Nil
		£7,606 – £42,475 per year	12·0
		£42,476 and above per year	2·0
Class 1	Employer	£1 – £7,488 per year	Nil
		£7,489 and above per year	13·8
Class 1A			13·8
Class 2		£2·65 per week	
		Small earnings exception limit – £5,595	
Class 4		£1 – £7,605 per year	Nil
		£7,606 – £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	1
£250,001 – £500,000	3
£500,001 – £1,000,000	4
£1,000,001 – £2,000,000 (2)	5
£2,000,001 or more (2)	7

(1) For residential property, the nil rate is restricted to £125,000.

(2) The 5% and 7% rates apply to residential properties only. The 4% rate applies to all non-residential properties where the consideration is in excess of £500,000.

Stamp duty

Shares	0·5%

Section A – BOTH questions are compulsory and MUST be attempted

1 Your manager has had a meeting with Farina and Lauda, potential new clients, who are partners in the FL Partnership. The memorandum recording the matters discussed, together with an email from your manager, is set out below.

Memorandum

To	The files
From	Tax manager
Date	5 December 2013
Subject	FL Partnership

Background

Farina and Lauda began trading as the FL Partnership on 1 May 2008. Accounts have always been prepared to 31 March each year. They are each entitled to 50% of the revenue profits and capital profits of the business.

On 1 March 2014, the whole of the FL Partnership business will be sold as a going concern to JH plc, a quoted trading company. The consideration for the sale will be a mixture of cash and shares. Capital gains tax relief on the transfer of a business to a company (incorporation relief) will be available in respect of the sale.

Farina and Lauda will both pay income tax at the additional rate in the tax year 2013/14 and anticipate continuing to do so in future years. They are very wealthy individuals, who use their capital gains tax annual exempt amounts every year. Both of them are resident, ordinarily resident and domiciled in the UK.

The sale of the business on 1 March 2014

The assets of the FL Partnership business have been valued as set out below. All of the equipment qualified for capital allowances.

	Value	Cost
	£	£
Goodwill	1,300,000	Nil
Inventory and receivables	30,000	30,000
Equipment (no item to be sold for more than cost)	150,000	200,000
Total	1,480,000	

The total value of the consideration will be equal to the value of the assets sold. Farina and Lauda will **each** receive consideration of £740,000; £140,000 in cash and 200,000 shares in JH plc. Following the purchase of the FL Partnership, JH plc will have an issued share capital of 8,400,000 shares.

Future transactions

Farina:

On 1 August 2014, Farina will make a gift of 15,000 of her shares in JH plc to the trustees of a discretionary (relevant property) trust for the benefit of her nieces and nephews. Farina will pay any inheritance tax liability in respect of this gift. The trustees will transfer the shares to the beneficiaries over the life of the trust.

Lauda:

On 1 June 2015, Lauda will give 40,000 of her shares in JH plc to her son.

For the purposes of giving our advice, the value of a share in JH plc can be assumed to be:

	£
On 1 March 2014	3
On 1 August 2014	4
On 1 June 2015	5

Email from your manager

I want you to prepare a memorandum for the client file in respect of the following:

(i) Capital allowances

A DETAILED explanation of the calculation of the capital allowances of the FL Partnership for its final trading period ending with the sale of its equipment to JH plc for £150,000 on 1 March 2014.

(ii) Farina

BRIEF explanations of:

(1) The manner in which any inheritance tax payable by Farina in her lifetime in respect of the gift of the shares to the trustees of the discretionary (relevant property) trust will be calculated and the date on which the tax would be payable.

(2) The availability of capital gains tax gift relief in respect of the transfer of the shares to the trustees of the discretionary (relevant property) trust and the subsequent transfers of shares from the trustees to the beneficiaries.

(iii) Lauda

A review of whether or not Lauda should disclaim incorporation relief.

The review should encompass the sale of the FL Partnership business, the gift of the shares to Lauda's son and the effect of incorporation relief on the base cost of the remaining shares owned by Lauda, as she intends to sell all of her shares in JH plc in the next few years.

It is important that you include a summary of your calculations and a statement of the key issues for me to discuss with Lauda. You should also include BRIEF explanations of the amount of incorporation relief available, the availability of any additional or alternative reliefs, and the date(s) on which any capital gains tax will be payable.

Tax manager

Required:

(a) It is anticipated that Farina and Lauda will require some highly sophisticated and specialised tax planning work in the future.

Prepare a summary of the information which would be required, together with any action(s) which should be taken by the firm before it agrees to become the tax advisers to Farina and Lauda. (5 marks)

(b) Prepare the memorandum requested in the email from your manager. The following marks are available.

(i) Capital allowances. (5 marks)

(ii) Farina. (7 marks)

(iii) Lauda. (14 marks)

Note: Ignore value added tax (VAT).

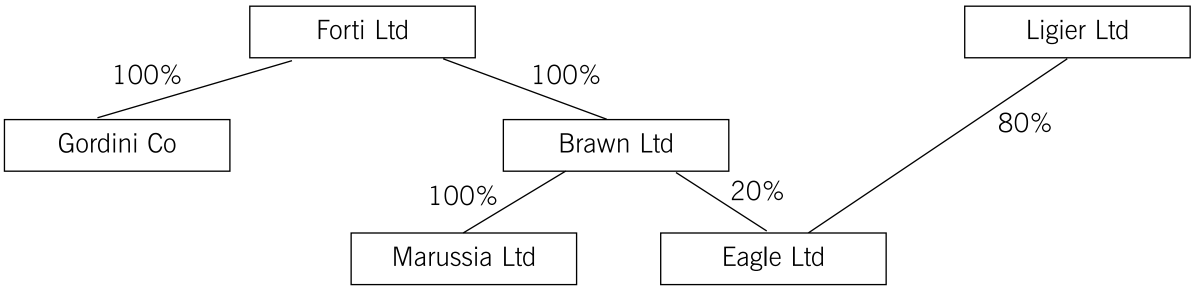
Professional marks will be awarded in part (b) for the overall presentation of the memorandum, the provision of relevant advice and the effectiveness with which the information is communicated. (4 marks)

(35 marks)

2 You have received an email from your manager with an attached schedule in connection with the Forti Ltd group of companies. The schedule and the email are set out below.

Email from your manager

The Forti Ltd group



Forti Ltd has an issued share capital of 120,000 ordinary shares. It is owned by 12 shareholders, each of whom owns 10,000 ordinary shares.

All six of the companies are trading companies. Gordini Co is resident in and trades in the country of Arrowsia; it does not carry out any activities in the UK. The other five companies are all resident in the UK. There is no double tax treaty between Arrowsia and the UK.

The only changes to the group structure in recent years relate to the purchase and subsequent sale of Marussia Ltd as set out in note 2 to the attached schedule.

Ligier Ltd has no links to the Forti Ltd group other than its shareholding in Eagle Ltd.

The work I require you to do is set out below.

(a) Brawn Ltd – Review of the corporation tax computation

I attach a schedule detailing the corporation tax computation for Brawn Ltd for the year ended 31 March 2013. This schedule has been prepared by an inexperienced tax assistant. I can confirm that the substantial shareholding exemption is not available and that the figures given for the indexed cost of Marussia Ltd in the schedule, the degrouping charge in note 2, and the tax adjusted trading losses referred to in notes 3 and 4 have all been calculated correctly.

Please review the computation and related notes in order to identify any errors and prepare a revised schedule showing calculations of the correct taxable total profits and the corporation tax liability. You should include notes explaining the errors you have identified and the changes you have made.

(b) Other corporate matters

(i) Brawn Ltd will only be a close company if Forti Ltd is a close company.

Set out the matters which need to be considered in order to determine whether or not Forti Ltd is a close company.

(ii) Set out the matters which need to be considered in connection with the sale of components to Gordini Co referred to in note 6 to the schedule.

(c) Value added tax (VAT) annual accounting scheme

The management of the Forti Ltd group have asked for advice on the VAT annual accounting scheme.

State the conditions which must be satisfied by any company wishing to operate the annual accounting scheme and explain the operation of the scheme.

Tax manager

Schedule prepared by a tax assistant

Brawn Ltd – Corporation tax computation for the year ended 31 March 2013

		Notes	£	£
Tax adjusted trading income		1		250,100
Sale of Marussia Ltd –	Proceeds	2	484,000	
	Less: Indexed cost		(390,000)	
	Annual exempt amount		(10,600)	
				83,400
				333,500
Less losses transferred from:				
Marussia Ltd (£60,000 x 5/12)		3		(25,000)
Eagle Ltd (£52,500 x 20%)		4		(10,500)
Taxable total profits				298,000
Corporation tax at 24%		5		71,520

Notes

1. The treatment of the following items of expenditure needs to be checked.

	£	
The cost of establishing and obtaining HM Revenue and Customs' approval of a company share option plan	6,000	Disallowed
The cost of entertaining overseas customers	4,000	Disallowed
Accrued management bonuses to be paid on 1 February 2014	7,000	Allowed

2. Marussia Ltd was purchased on 1 August 2012. On 1 November 2012, Brawn Ltd signed a contract to sell Marussia Ltd for £484,000, and the sale took place on 31 December 2012. Accordingly, the substantial shareholding exemption was not available. The sale of Marussia Ltd resulted in a degrouping charge of £21,500. This has been included as a chargeable gain in the corporation tax computation of Marussia Ltd.
3. Marussia Ltd made a tax adjusted trading loss of £60,000 in the year ended 31 March 2013.
4. Eagle Ltd made a tax adjusted trading loss of £52,500 in the year ended 31 March 2013 and did not pay a dividend.
5. Although there are five companies in the group, I have calculated corporation tax at the main rate because I think that Brawn Ltd is a close company.
6. During the year ended 31 March 2013, Brawn Ltd began selling components to Gordini Co. Are there any issues which need to be considered in respect of these sales in relation to Brawn Ltd's corporation tax liability?

Required:

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

(a) Brawn Ltd – Review of the corporation tax computation.

Note: Ignore value added tax (VAT). (12 marks)

(b) Other corporate matters.

(i) Close companies; (5 marks)

(ii) Note 6 to the schedule. (3 marks)

(c) Value added tax (VAT) annual accounting scheme. (5 marks)

(25 marks)

Section B – TWO questions ONLY to be attempted

3 Pescara requires advice on the inheritance tax payable on death and on the gift of a property, and on the capital gains tax due on a disposal of shares, together with the relief available in respect of the purchase of enterprise investment scheme shares.

Pescara and her parents:

– Pescara is a higher rate taxpayer who is resident, ordinarily resident and domiciled in the UK.
– Pescara's father, Galvez, died on 1 June 2007.
– Pescara's mother, Marina, died on 1 October 2013.
– Both Galvez and Marina were resident, ordinarily resident and domiciled in the UK.

Galvez – lifetime gifts and gifts on death:

– Galvez had not made any lifetime gifts.
– In his will, Galvez left cash of £80,000 to Pescara and a further £80,000 to Pescara's brother.
– Galvez left the remainder of his estate to his wife, Marina.

Marina – lifetime gifts and gifts on death:

– On 1 February 2009, Marina gave Pescara 375,000 shares in Sepang plc.
– Marina had made no other lifetime gifts.

Marina – gift of 375,000 shares in Sepang plc to Pescara:

– 1 January 2006 – Marina purchased 375,000 shares for £420,000.
– 1 February 2009 – Marina gave all of the shares to Pescara.
The shares were quoted at £1·84–£1·96
The highest and lowest marked bargains were £1·80 and £1·92.
– The shares did not qualify for business property relief or capital gains tax gift relief.

Acquisition of Sepang plc by Zolder plc and subsequent bonus issue:

– 1 January 2011 – Zolder plc acquired the whole of the ordinary share capital of Sepang plc.
Pescara received 30 pence and two ordinary shares in Zolder plc, worth £1 each, for each share in Sepang plc.
The takeover was for genuine commercial reasons and not for the avoidance of tax.
– 1 July 2012 – Zolder plc declared a 2 for 1 bonus issue.

Pescara's actual and intended capital transactions in the tax year 2013/14:

			£
15 November 2013	Sale	1,000,000 shares in Zolder plc	445,000
1 April 2014	Purchase	Qualifying enterprise investment scheme (EIS) shares	50,000

Pescara – gift of a UK property:

– Pescara intends to give a UK property to her son on 1 October 2014.
– Pescara intends to continue to use this property, rent-free, such that this gift will be a gift with reservation.

Required:

(a) Calculate the inheritance tax payable in respect of Marina's gift of the shares in Sepang plc, as a result of her death. (7 marks)

(b) (i) Calculate Pescara's capital gains tax liability for the tax year 2013/14 on the assumption that enterprise investment scheme (EIS) relief is claimed in respect of the shares to be purchased on 1 April 2014 and that entrepreneurs' relief is not available. (6 marks)

(ii) State the capital gains tax implications of Pescara selling the EIS shares at some point in the future. (3 marks)

(c) Explain how the proposed gift of the UK property will be treated for the purposes of calculating the inheritance tax due on Pescara's death. (4 marks)

(20 marks)

4 The management of the Spetz Ltd group requires advice on the value added tax (VAT) annual adjustment for a partially exempt company, the tax position of a company incorporated and trading overseas, and the income tax treatment of the costs relating to an employee working abroad.

The Spetz Ltd group of companies:

- Spetz Ltd has a large number of subsidiaries, such that they all pay corporation tax at the main rate.
- Novak Ltd and Kraus Co are two of the 100% subsidiaries of Spetz Ltd.
- Novak Ltd has a VAT year end of 30 September.
- Spetz Ltd acquired Kraus Co on 1 October 2012.
- Meyer, an employee of Spetz Ltd, has been seconded to work for Kraus Co.

Novak Ltd – Figures for the year ended 30 September 2013:

		£
Taxable supplies (excluding VAT)		1,190,000
Exempt supplies		430,000
Input tax:	attributed to taxable supplies	12,200
	attributed to exempt supplies	4,900
	unattributed	16,100
	recovered on the four quarterly returns prior to the annual adjustment	23,200

Kraus Co:

- Is incorporated in, and trades through, a permanent establishment in the country of Mersano.
- Has no taxable income or chargeable gains apart from trading profits.
- Has taxable trading profits for the year ended 30 September 2013 of £520,000, all of which arose in Mersano.
- Is not a controlled foreign company.
- Has not made an election to exempt its overseas trading profits from UK tax.

The tax system in the country of Mersano:

- It can be assumed that the tax system in the country of Mersano is the same as that in the UK.
- However, the rate of corporation tax is 21%.
- There is no double tax treaty between the UK and Mersano.

Meyer:

- Will work for Kraus Co in the country of Mersano from 15 December 2013 to 31 March 2014.
- Will continue to be employed by Spetz Ltd.
- Will continue to be resident, ordinarily resident and domiciled in the UK.

The costs relating to Meyer's secondment to Kraus Co:

- Meyer will be reimbursed for the cost of the flights at the start and end of the contract.
- Meyer will return to the UK for a holiday in February 2014, and will pay his own transport costs.
- Meyer will be reimbursed for the cost of laundry and telephone calls home.
- Spetz Ltd does not have a Form P11D dispensation (PAYE dispensation) in place with HM Revenue and Customs.

Required:

(a) Calculate the value added tax (VAT) partial exemption annual adjustment for Novak Ltd for the year ended 30 September 2013 and state when it must be reported to HM Revenue and Customs. You should state, with reasons, whether or not each of the three *de minimis* tests is satisfied. (7 marks)

(b) (i) Explain how to determine whether or not Kraus Co is resident in the UK. (3 marks)

(ii) Explain, with supporting calculations, the UK corporation tax liability of Kraus Co for the year ended 30 September 2013 on the assumption that it is resident in the UK, and discuss the advantages and disadvantages of making an election to exempt its overseas profits from UK tax. (5 marks)

(c) Explain the UK income tax implications for Meyer of the costs relating to his secondment to Kraus Co. (5 marks)

(20 marks)

5 Your firm has been asked to advise two unrelated clients, Monisha and Horner. The advice relates to furnished holiday accommodation, tax planning for a married couple, and the personal service company (IR 35) rules.

(a) Monisha:

– Is married to Asmat.
– Earns a salary of £80,000 per year and realises chargeable gains of £6,000 per year.
– Owns a UK investment property, which is let to short-term tenants.

Asmat:

– Looks after the couple's children and has no income or chargeable gains.
– Expects to return to work on 6 April 2019 on an annual salary of £18,000.

The UK investment property owned by Monisha:

– The property cost £270,000 and is currently worth £300,000.
– The letting does not qualify as a commercial letting of furnished holiday accommodation.
– Annual income and expenditure

	£
Rental income	20,000
Repairs and maintenance	1,600
Council tax	1,200
Agent's fees	2,000

– Monisha claims the wear and tear allowance in respect of this property.
– The property will be sold on 5 April 2020 and is expected to create a chargeable gain of £100,000.

Proposals to reduce the couple's total tax liability:

– Monisha will give a 20% interest in the investment property to Asmat on 1 April 2014.
– The couple will ensure that, from 6 April 2014, the letting of the investment property will qualify as a commercial letting of furnished holiday accommodation.
– From the tax year 2014/15 onwards, Monisha will claim annual capital allowances equal to the current annual wear and tear allowance.

Required:

(i) State the conditions which must be satisfied in order for the letting of a UK furnished property to qualify as a commercial letting of furnished holiday accommodation. (3 marks)

(ii) Calculate the total tax saving in the six tax years 2014/15 to 2019/20 if ALL of the proposals to reduce the couple's tax liabilities are carried out. In respect of the second proposal, you should assume that the letting will qualify as a commercial letting of furnished holiday accommodation for the whole of the period of joint ownership and that all beneficial reliefs are claimed.

Note: You should ignore inheritance tax. (10 marks)

(b) Horner:

– Horner owns all of the shares of Otmar Ltd.
– All of the income of Otmar Ltd is subject to the personal service company (IR 35) rules.
– Budgeted figures for Otmar Ltd for the year ending 5 April 2014 are set out below. Where applicable, these amounts are stated exclusive of value added tax (VAT).

	£
Income in respect of relevant engagements carried out by Horner	85,000
Costs of administering the company	3,900
Horner's annual salary	50,000
Dividend paid to Horner	15,000
Contributions paid into an occupational pension scheme in respect of Horner	2,000

Required:

(i) Outline the circumstances in which the personal service company (IR 35) rules apply. (3 marks)

(ii) Calculate the deemed employment income of Horner for the year ending 5 April 2014. (4 marks)

(20 marks)

End of Question Paper