Professional Level – Options Module

Advanced Taxation (United Kingdom)

September/December 2016 – Sample Questions

Time allowed: 3 hours and 15 minutes

This question 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 question paper until instructed by the supervisor.

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

Paper P6 (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 2015/16 and for the financial year to 31 March 2016 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 – £31,785	20%	10%
Higher rate	£31,786 to £150,000	40%	32·5%
Additional rate	£150,001 and over	45%	37·5%

A starting rate of 0% applies to savings income where it falls within the first £5,000 of taxable income.

Personal allowance

Personal allowance	£10,600
Transferable amount	£1,060
Income limit	£100,000

Residence status

Days in UK	Previously resident	Not previously resident
Less than 16	Automatically not resident	Automatically not resident
16 to 45	Resident if 4 UK ties (or more)	Automatically not resident
46 to 90	Resident if 3 UK ties (or more)	Resident if 4 UK ties
91 to 120	Resident if 2 UK ties (or more)	Resident if 3 UK ties (or more)
121 to 182	Resident if 1 UK tie (or more)	Resident if 2 UK ties (or more)
183 or more	Automatically resident	Automatically resident

Remittance basis charge

UK resident for	
7 out of the last 9 years	£30,000
12 out of the last 14 years	£60,000
17 out of the last 20 years	£90,000

Child benefit income tax charge

Where income is between £50,000 and £60,000, the charge is 1% of the amount of child benefit received for every £100 of income over £50,000.

Car benefit percentage

The relevant base level of CO_2 emissions is 95 grams per kilometre.

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

50 grams per kilometre or less	5%
51 grams to 75 grams per kilometre	9%
76 grams to 94 grams per kilometre	13%
95 grams per kilometre	14%

Car fuel benefit

The base figure for calculating the car fuel benefit is £22,100.

Individual savings accounts (ISAs)

The overall investment limit is £15,240.

Pension scheme limits

Annual allowance – 2014/15 and 2015/16	£40,000
– 2012/13 and 2013/14	£50,000
Lifetime allowance	£1,250,000
The maximum contribution that can qualify for tax relief without any 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 75 grams per kilometre	100%
CO_2 emissions between 76 and 130 grams per kilometre	18%
CO_2 emissions over 130 grams per kilometre	8%

Annual investment allowance

Rate of allowance	100%
Expenditure limit	£500,000

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	20%
Profit threshold	£1,500,000

Patent box – deduction from net patent profit

Net patent profit x ((main rate – 10%)/main rate)

Value added tax (VAT)

Standard rate	20%
Registration limit	£82,000
Deregistration limit	£80,000

Inheritance tax: nil rate bands and tax rates

	£	
6 April 2015 to 5 April 2016	325,000	
6 April 2014 to 5 April 2015	325,000	
6 April 2013 to 5 April 2014	325,000	
6 April 2012 to 5 April 2013	325,000	
6 April 2011 to 5 April 2012	325,000	
6 April 2010 to 5 April 2011	325,000	
6 April 2009 to 5 April 2010	325,000	
6 April 2008 to 5 April 2009	312,000	
6 April 2007 to 5 April 2008	300,000	
6 April 2006 to 5 April 2007	285,000	
6 April 2005 to 5 April 2006	275,000	
6 April 2004 to 5 April 2005	263,000	
6 April 2003 to 5 April 2004	255,000	
6 April 2002 to 5 April 2003	250,000	
6 April 2001 to 5 April 2002	242,000	
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

Rates of tax – Lower rate	18%
– Higher rate	28%
Annual exempt amount	£11,100
Entrepreneurs' relief – Lifetime limit	£10,000,000
– Rate of tax	10%

National insurance contributions
(Not contracted out rates)

Class 1	Employee	£1 – £8,060 per year	Nil
		£8,061 – £42,385 per year	12%
		£42,386 and above per year	2%
Class 1	Employer	£1 – £8,112 per year	Nil
		£8,113 and above per year	13·8%
		Employment allowance	£2,000
Class 1A			13·8%
Class 2		£2·80 per week	
		Small earnings exception limit	£5,965
Class 4		£1 – £8,060 per year	Nil
		£8,061 – £42,385 per year	9%
		£42,386 and above per year	2%

Rates of interest (assumed)

Official rate of interest	3%
Rate of interest on underpaid tax	3%
Rate of interest on overpaid tax	0·5%

Stamp duty land tax

Non-residential properties	
£150,000 or less	Nil
£150,001 – £250,000	1%
£250,001 – £500,000	3%
£500,001 and above	4%
Residential properties	
£125,000 or less	Nil
£125,001 – £250,000	2%
£250,001 – £925,000	5%
£925,001 – £1,500,000	10%
£1,500,001 and above	12%

Stamp duty

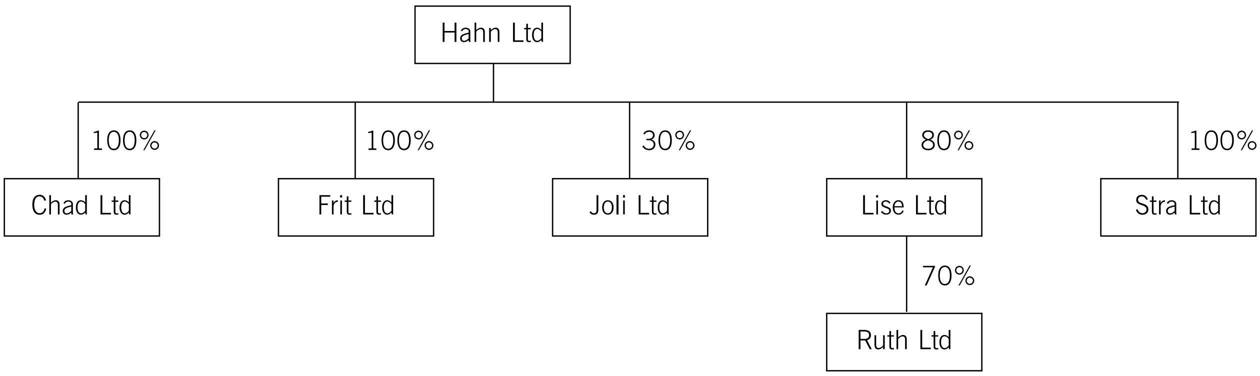
Shares	0·5%

Section A – BOTH questions are compulsory and MUST be attempted

1 Your manager has had a meeting with the finance director of Hahn Ltd, which is a client of your firm. Extracts from the memorandum she prepared following the meeting, and an email from her in connection with the Hahn Ltd group are set out below:

Extracts from the memorandum – dated 8 September 2016

Hahn Ltd group



Notes

1. All of the companies are UK resident trading companies with a year end of 31 March.
2. All of the companies are registered for the purposes of value added tax (VAT).
3. With the exception of Chad Ltd, all of the companies have been members of the Hahn Ltd group for many years.
4. Hahn Ltd purchased Chad Ltd from Zeno Ltd on 1 September 2016. Prior to its disposal to Hahn Ltd, Zeno Ltd had owned Chad Ltd, and six other wholly-owned subsidiaries, for many years.
5. Joli Ltd is not a consortium company.

Budgeted results for the year ending 31 March 2017

	Hahn Ltd £'000	Chad Ltd £'000	Frit Ltd £'000	Joli Ltd £'000	Lise Ltd £'000	Ruth Ltd £'000	Stra Ltd £'000
Tax adjusted trading profit/(loss)	180	675	(540)	410	375	320	38
Chargeable gains	–	–	65	–	–	–	–
Trading loss brought forward	–	–	–	–	–	–	46
Capital loss brought forward	–	–	31	–	–	–	–
Assets purchased which qualify for rollover relief	–	–	14	–	–	6	10

Notes

1. The budgeted results include £94,000 of sales made by Hahn Ltd to Stra Ltd. The arm's length price of these sales would be £104,000. Both of these figures are exclusive of VAT. No tax adjustments have been made in respect of these sales. The Hahn Ltd group is a large group for the purposes of the transfer pricing rules.
2. Frit Ltd's chargeable gain will be in respect of the sale of a building to an unconnected third party for £125,000. The building is a qualifying business asset for the purposes of rollover relief.
3. None of the companies will receive any franked investment income in the year ending 31 March 2017.
4. Frit Ltd will not be able to carry its loss back to the year ended 31 March 2016.
5. All of the companies, with the exception of Frit Ltd and Stra Ltd, were required to pay their corporation tax liabilities for the year ended 31 March 2016 by instalments.

Extracts from the memorandum – dated 8 September 2016 (continued)

VAT

- The Hahn Ltd group is considering registering as a VAT group. Frit Ltd makes some exempt supplies, such that it is a partially exempt company. The other six companies all make standard rated supplies only. Stra Ltd uses both the annual accounting scheme and the cash accounting scheme.
- On 1 September 2016, Chad Ltd received a refund of VAT from HM Revenue and Customs (HMRC). The company has not been able to identify any reason for this refund.

Email from your manager – dated 8 September 2016

Please prepare a memorandum for the client files which addresses the following issues:

(a) (i) Chargeable gain of Frit Ltd

Calculate the additional amount which would need to be spent on assets qualifying for rollover relief, such that the unrelieved gain would be fully covered by Frit Ltd's brought forward capital loss.

(ii) Relieving the trading loss of Frit Ltd

- Prepare explanations, together with supporting calculations, to show how the trading loss of Frit Ltd should be allocated between the companies in the group. The group's priority is its cash flow position and the need to minimise the corporation tax payable by instalments.

  When preparing these calculations, you should assume that the whole of the chargeable gain of Frit Ltd will be relieved by rollover relief.
- Prepare a schedule setting out the amounts of corporation tax payable by Hahn Ltd, and the companies it controls (i.e. not Joli Ltd) in respect of the year ending 31 March 2017, together with the related payment dates.

(b) Group registration for the purposes of value added tax (VAT)

By reference to the specific information in my memorandum only, set out the matters which will need to be considered when deciding which of the companies should be included in a group registration.

(c) Chad Ltd – refund of VAT

Prepare a summary of the actions which we should take, and any matters of which Chad Ltd should be aware, in respect of the refund of VAT.

Tax manager

Required:

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

(a) (i) Chargeable gain of Frit Ltd. (3 marks)

(ii) Relieving the trading loss of Frit Ltd. (18 marks)

(b) Group registration for the purposes of value added tax (VAT). (5 marks)

(c) Chad Ltd – refund of VAT. (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.
(4 marks)

(35 marks)

This is a blank page.
Question 2 begins on page 9.

2 Your manager has been advising a client, Waverley, on his plans to sell his business. An email from your manager setting out the current situation and some notes on the tax system in the country of Surferia are set out below:

Email from your manager – dated 8 September 2016

Waverley

Waverley was born in 1976. He divorced his wife in 2014. His three children, all of whom are under 18, live with his ex-wife in the UK.

Waverley began trading as a sole trader on 1 March 2008. We are advising him on the sale of this unincorporated business with the objective of minimising his capital gains tax liability. It has been concluded that it will be very difficult to sell the business as an unincorporated entity, so Waverley is going to sell the business to a newly-formed company which he owns, Roller Ltd. Waverley will then sell his shares in Roller Ltd.

Waverley has decided to emigrate to the country of Surferia. He wants to make a fresh start and has heard from friends that moving abroad could be advantageous from the point of view of UK tax. He will move to Surferia on 5 April 2017.

Waverley wants to see his children regularly and is also an enthusiastic member of an amateur football team in the UK. As a result, he intends to spend as many days as possible in the UK in the tax year 2017/18. He will continue to work for Roller Ltd until the company is sold and it is also possible that the purchaser of Roller Ltd will ask Waverley to do further work for the company whilst he is in the UK.

Waverley will sell his home in the UK in March 2017. The house is Waverley's principal private residence, such that there will be no capital gains tax in respect of its disposal. Once the house has been sold, whenever Waverley is in the UK he will stay in a hotel, as he does not have any other UK property available for his use. When he is not in the UK, he will live in a new house which he plans to buy in Surferia.

Unincorporated business

Waverley will cease trading as a sole trader on 15 January 2017 when he sells his unincorporated business to Roller Ltd. Roller Ltd will be wholly-owned by Waverley.

The tax adjusted trading profits of the business (actual and budgeted) up to the date of cessation are:

Year ended 30 June 2016	£125,400
Period ended 15 January 2017	£72,150

The assets of the unincorporated business are expected to be worth £540,000 on 15 January 2017. They will be sold at market value to Roller Ltd in exchange for 270,000 £1 ordinary shares in the company. This will result in chargeable gains, before incorporation relief, of £160,000 on the business premises and £30,000 in respect of goodwill.

The shares in Roller Ltd will be sold for £600,000 at some point during the six months following Waverley's emigration to Surferia on 5 April 2017.

Residence status

Waverley has always been resident and domiciled in the UK, but it is likely to be beneficial for him to be non-UK resident for the tax year 2017/18.

Investment property

Waverley owns an investment property located in the UK. The property is a residential house, which is tenanted under a lease which expires on 31 October 2021. This house has never been Waverley's principal private residence and it is not available for him to use.

Waverley plans to sell this house as soon as possible following the end of the lease. He will then give the proceeds from the sale to his sister.

Email from your manager – dated 8 September 2016 (continued)

Please carry out the following work:

(a) Unincorporated business

- State the basis period for 2016/17, the final tax year of trading, and calculate the taxable trading profits for that year, noting any further information required in order to finalise this figure.
- State the conditions which must be satisfied in order for incorporation relief to be available on the sale of the unincorporated business to Roller Ltd.
- Prepare calculations in order to conclude whether or not it will be advantageous for Waverley to disclaim incorporation relief on the sale of the unincorporated business to Roller Ltd.

  To do this you will need to calculate Waverley's total capital gains tax liability, in the UK and in the country of Surferia, in respect of both the sale of the unincorporated business to Roller Ltd in the tax year 2016/17 and the sale of the Roller Ltd shares in the tax year 2017/18. In respect of the sale of the Roller Ltd shares, you should consider two possible situations: first where Waverley is resident **only** in the UK at the time of the sale; and second where he is resident **only** in Surferia at the time of the sale. You should not consider the rules concerning individuals who are temporarily non-UK resident.

  You should assume that Waverley will be a higher rate taxpayer in the tax years 2016/17 and 2017/18 (if UK resident) and that he realises sufficient additional chargeable gains every year to use his annual exempt amount.

(b) Residence status

Explain the maximum number of days which Waverley will be able to spend in the UK in the tax year 2017/18 without being UK resident. I have already concluded that for the tax year 2017/18, Waverley will be neither automatically resident overseas nor automatically resident in the UK.

(c) Investment property

- Explain the capital gains tax implications in the tax year 2021/22 of the sale of the investment property, assuming that it gives rise to a chargeable gain and that Waverley is resident **only** in the country of Surferia in that tax year.
- Discuss, by reference to Waverley's domicile status, whether or not Waverley's gift to his sister of the proceeds from the sale of the investment property will be within the scope of UK inheritance tax.

Tax manager

Notes on the tax system in the country of Surferia

- Individuals who are resident in Surferia are subject to capital gains tax on disposals of worldwide assets at the rate of 12%. There is no annual exempt amount.
- For the purposes of capital gains tax in Surferia, Waverley's chargeable gains will be the same as they would be in the UK.
- The payment date for capital gains tax in Surferia is the same as the payment date for capital gains tax in the UK.
- There is no inheritance tax in Surferia.
- There is a double tax treaty between the UK and Surferia.

Required:

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

(a) Unincorporated business. (12 marks)

(b) Residence status. (6 marks)

(c) Investment property. (7 marks)

(25 marks)

Section B – TWO questions ONLY to be attempted

3 Juanita has contacted you following the death of her husband, Don. As the executor of his estate, she is seeking advice regarding the inheritance tax liability arising as a result of his death on shares which he owned. She also requires advice on the timing of her ceasing to trade.

Don:
- Died on 1 July 2016.
- Had always been UK resident and domiciled.
- Was married to Juanita, and they have one daughter, Lexi.

Lifetime gifts:
- Don made only two lifetime gifts.
- On 9 May 2011, Don gifted his overseas villa to Lexi.
- The villa was valued at £355,000 on 9 May 2011, and at £370,000 on 1 July 2016.
- On 1 March 2013, on the advice of a financial adviser, Don gifted 3,500 of his shares in Estar Ltd to Lexi.
- Prior to receiving this advice, Don had been planning to leave these shares to Lexi on his death.
- Under the terms of Don's will, Don's cousin will inherit the remaining 3,500 shares in Estar Ltd owned by Don at his death.

Estar Ltd:
- Is an investment company; no business property relief is available on the transfer of its shares.
- Before the gift on 1 March 2013, Don owned 7,000 ordinary shares in Estar Ltd.
- The remaining 3,000 ordinary shares issued by Estar Ltd are held by Juanita.
- The shares were valued as follows:

Percentage shareholding	Value per share	
	1 March 2013	1 July 2016
0%–50%	£9·00	£10·80
51%–75%	£15·00	£18·00
76%–100%	£20·00	£24·00

Juanita:
- Has carried on a business as a sole trader for many years, preparing accounts to 30 June annually.
- Following Don's death, intends to cease trading and retire.
- Would like to cease trading on 28 February 2017, in which case the business will be sold to an unconnected person.
- Is willing to continue to trade until 30 April 2017, when Lexi will be able to take over the business.
- Does not anticipate having any other source of taxable income in either of the tax years 2016/17 or 2017/18.

Juanita's business:
- Has taxable trading profits of £51,000 for the year ended 30 June 2016.
- Has budgeted tax-adjusted profits of £48,000 (before capital allowances) in the period ending 28 February 2017.
- Has budgeted further taxable profits of £4,000 per month if Juanita continues to trade after 28 February 2017.
- Has overlap profits from commencement of £17,000.
- The tax written down value on the main pool was £nil at 1 July 2016.
- The market value of the assets in the main pool will be £6,000 at the date of cessation.

Required:

(a) **Advise Juanita of the reduction in the inheritance tax liability arising on Don's death in respect of the shares in Estar Ltd as a result of Lexi having received her shares as a lifetime gift, rather than on Don's death.** (8 marks)

(b) **Advise Juanita, by reference to the increase in her trading income after tax and national insurance contributions, whether it would be beneficial for her to continue to trade until 30 April 2017, rather than ceasing to trade on 28 February 2017. You should assume any elections which are beneficial to Juanita are made and should support your advice with a brief explanation of the available capital allowances in each case.**

Note: Where necessary, you should assume that there are four weeks in each month of the years 2016 and 2017. (12 marks)

(20 marks)

4 Your firm has been asked to provide advice to Methley Ltd, a close company, in respect of the provision of share incentives, a motor car and an interest-free loan to employees. A non-UK domiciled employee also requires advice in relation to the remittance basis.

Methley Ltd:

– Is a UK resident trading company which is a close company.

Simon – share incentives:

– Simon is a director of Methley Ltd and owns 20% of its ordinary shares.
– Methley Ltd intends to provide Simon with shares worth £25,000, in the form of either free shares or share options.
– The free shares would be issued as employee shareholder shares in June 2017.
– The share options would be issued under an approved company share option scheme (CSOP) in June 2017 and Simon would exercise the options in October 2021.
– In either case, Simon will sell the shares in December 2022.
– Simon is a higher rate taxpayer.

Chris:

– Is employed by Methley Ltd and owns 10% of its ordinary shares.
– Has been offered the sole use of a company motor car or, alternatively, a loan to enable him to purchase the same motor car himself.
– Is a higher rate taxpayer.

Chris – alternative 1 – company motor car:

– Methley Ltd would purchase the motor car on 1 October 2016 for £9,600, which is £800 less than the list price.
– The motor car would immediately be made available to Chris exclusively for his private use.
– The motor car has CO_2 emissions of 108 grams per kilometre and is diesel powered.
– Chris would contribute £700 per year towards the private use of the motor car.
– Methley Ltd would give the motor car to Chris after three years, when its market value is expected to be £6,300.

Chris – alternative 2 – loan:

– Methley Ltd would provide Chris with an interest-free loan of £9,600 on 1 October 2016.
– The loan would be written off in three years' time.

Yara – non-UK domiciled employee:

– Is currently resident in the UK but domiciled in the country of Setubia.
– Became UK resident when she was employed by Methley Ltd on 1 April 2008.
– Receives an annual salary from Methley Ltd of £80,000 and has no other UK source of income.
– Receives rental income from an unfurnished residential property in Setubia.

Yara – overseas rental income:

– The gross annual rental income from the overseas property is £24,000.
– Yara only remits £15,000 of this income to the UK each year.
– Yara has previously claimed the remittance basis each tax year.

Required:

(a) **Compare and contrast the tax implications of both the acquisition and disposal of the shares in Methley Ltd if Simon acquires the shares through an approved company share option scheme (CSOP) or, alternatively, as employee shareholder shares.**

Note: You are not required to comment on any national insurance contributions implications. (7 marks)

(b) **Prepare calculations to determine which of the two proposed benefits (the company motor car or the loan) will result in the lower overall income tax cost for Chris.** (6 marks)

(c) **Advise Yara whether or not it would be beneficial for her to claim the remittance basis in the tax year 2015/16, and calculate the increase, if any, in her income tax liability for the tax year 2015/16 compared to that of previous years, assuming that she chooses the most tax beneficial course of action.**

Note: You are not required to consider the potential availability of double taxation relief (DTR). (7 marks)

(20 marks)

5 Acryl Ltd and Cresco Ltd are two unrelated companies. Acryl Ltd requires advice on the implications of being placed into liquidation, particularly the timing of distributions to its shareholders. Cresco Ltd requires advice on the relief for losses on the cessation of trade, and its obligations in relation to value added tax (VAT).

(a) Acryl Ltd:
- Is a UK resident trading company.
- Has always prepared accounts to 30 June annually.
- Has substantial distributable profits.
- 70% of the company's share capital is owned by Mambo Ltd.
- The remaining 30% of the share capital is owned by Mambo Ltd's managing director, Alan.
- Mambo Ltd and Alan both subscribed for their shares at par value on 1 March 2010.

Mambo Ltd:
- Is a UK resident trading company.

Alan:
- Will be an additional rate taxpayer in the tax year 2016/17.
- Will be eligible for entrepreneurs' relief on the disposal of his shares in Acryl Ltd.

Liquidation of Acryl Ltd:
- Winding up will commence on 1 January 2017 with the appointment of a liquidator.
- It is anticipated that the winding up will be completed on 31 March 2017, when the company will cease trading.

Alternative timing of distributions being considered by Acryl Ltd:
- Acryl Ltd is prepared to distribute the available profits to its shareholders on 31 December 2016.
- Alternatively, Acryl Ltd will delay the distribution until the completion of the winding up of the company on 31 March 2017.

Required:

(i) State the corporation tax consequences arising from the commencement of Acryl Ltd's winding up on 1 January 2017. (2 marks)

(ii) Explain the tax implications for both Mambo Ltd and Alan if the distribution to be made by Acryl Ltd occurs either on 31 December 2016, or alternatively on 31 March 2017, and conclude as to which date would be preferable. (7 marks)

(b) Cresco Ltd:
- Is a UK resident trading company.
- Commenced trading on 1 April 2012.
- Is registered for the purposes of value added tax (VAT).
- Has made significant trading losses in recent months such that the company will need to cease trading on 31 October 2016.

Cresco Ltd – trading losses:
- Recent and anticipated results are as follows:

	Year ended 31 March 2013	Year ended 31 March 2014	Year ended 31 March 2015	Year ended 31 March 2016	Period ending 31 October 2016
	£	£	£	£	£
Trading (loss)/profit	(5,000)	21,000	8,000	(24,000)	(40,000)
Bank interest receivable	1,000	3,000	3,000	nil	nil

- Cresco Ltd always claims relief for trading losses as early as possible.

Required:

(i) Set out, together with supporting explanations, how Cresco Ltd will claim relief for the trading losses incurred and identify the amount of trading losses which will remain unrelieved after all available loss reliefs have been claimed. (8 marks)

(ii) Advise Cresco Ltd of the value added tax (VAT) implications of the cessation of its trade. (3 marks)

(20 marks)

End of Question Paper