

Professional Level – Options Module

# Advanced Taxation (United Kingdom)

Friday 7 December 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<sub>2</sub> emissions is 125 grams per kilometre.

A rate of 5% applies to petrol cars with CO<sub>2</sub> 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
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

	%
<b>Plant and machinery</b>	
Main pool	20
Special rate pool	10
<b>Motor cars (purchases since 6 April 2009 (1 April 2009 for limited companies))</b>	
New cars with CO <sub>2</sub> emissions up to 110 grams per kilometre	100
CO <sub>2</sub> emissions between 111 and 160 grams per kilometre	20
CO <sub>2</sub> emissions over 160 grams per kilometre	10
<b>Annual investment allowance</b>	
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%
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**Section A – BOTH questions are compulsory and MUST be attempted**

- 1 Your manager has had a meeting with Gordon, the Group Finance Director of the Flame plc group of companies. Flame plc is quoted on the UK Stock Exchange. An extract from the memorandum prepared by your manager after the meeting, together with an email from him detailing the tasks for you to perform, is set out below.

**Extract from the memorandum prepared by your manager**

**Background**

Flame plc is a UK resident company, which has annual taxable profits of more than £200,000. It owns the whole of the ordinary share capital of Inferno Ltd, Bon Ltd and six other companies. All of the companies in the Flame plc group are UK resident companies with a 31 March year end.

**Flame plc – sale of Inferno Ltd**

Flame plc purchased the whole of the ordinary share capital of Inferno Ltd on 1 March 2008 for £600,000. The value of Inferno Ltd has increased and Gordon has decided to sell the company. For the purposes of our work, we are to assume that the sale will take place on 1 January 2013. The budgeted taxable profits of Inferno Ltd for the nine months ending 31 December 2012 are £160,000.

The sale will be carried out in one of two ways:

- (i) a sale by Flame plc of the whole of the ordinary share capital of Inferno Ltd for £1 million; or
- (ii) a sale by Inferno Ltd of its trade and assets for their market value.

Gordon needs to know the tax cost for the Flame plc group of each of these options to help him in his negotiations.

Inferno Ltd owns the following assets.

	Note	Cost £	Current market value £
Equipment	1, 3	100,000	60,000
Milling machine	2, 3	95,000	80,000
Goodwill	4	Nil	530,000
Building – business premises	5	300,000	490,000

**Notes**

- 1. No item of equipment will be sold for more than cost.
- 2. The milling machine is an item of fixed plant and machinery that was purchased on 1 June 2009. Inferno Ltd claimed rollover relief in respect of the purchase of this machine to defer a chargeable gain of £8,500 made on 1 May 2008.
- 3. Capital allowances have been claimed in respect of the equipment and the milling machine. The tax written down value of the main pool of Inferno Ltd as at 1 April 2012 was zero. There have been no additions or disposals since that date.
- 4. The goodwill has been generated internally by Inferno Ltd since it began trading on 1 May 2003.
- 5. Inferno Ltd purchased the building from Flame plc on 15 March 2008 for its market value at that time of £300,000. Flame plc had purchased the building on 1 January 2004 for £240,000.

**Flame plc – employee share scheme**

Gordon is planning to introduce a share option scheme in order to reward the senior managers of Flame plc.

**Bon Ltd – the grant of a lease**

Part of the trading premises of Bon Ltd, a subsidiary of Flame plc, is surplus to requirements. Bon Ltd intends to grant a lease to an independent third-party company in respect of that part of its premises.

**Bon Ltd – refund of corporation tax**

Bon Ltd received a refund of corporation tax from HM Revenue and Customs on 1 June 2012. The company has not been able to identify any reason for this refund.

Email from your manager

(a) I want you to draft a report to the Group Finance Director that addresses the following:

(i) Flame plc – sale of Inferno Ltd

The tax cost of each of the two possible ways of carrying out the sale. Please note that I have already considered the availability of the substantial shareholding exemption and concluded that it will not be available in respect of the sale of Inferno Ltd because the Flame plc group is not a trading group.

The report should include concise explanations of matters where the calculations are not self-explanatory.

(ii) Flame plc – employee share scheme

- The tax advantages for the employees of introducing an approved company share option plan (CSOP) as opposed to an unapproved share option scheme.
- Why a CSOP would be a suitable approved scheme for Gordon to choose.
- The restrictions within the CSOP rules in respect of the following:
  - The number of share options that can be granted to each employee.
  - The price at which the shares can be sold to the employees.

(iii) Bon Ltd – the grant of a lease

The value added tax (VAT) implications for the lessee if Bon Ltd were to opt to tax the building prior to granting the lease.

(b) Bon Ltd – refund of corporation tax

Prepare a summary of the actions that we should take and any matters of which Bon Ltd should be aware in respect of the refund of corporation tax.

Tax manager

Required:

(a) Draft the report to the Group Finance Director requested in the email from your manager. The following marks are available.

(i) Flame plc – sale of Inferno Ltd;

Notes for part (a)(i):

- 1 For guidance, approximately equal marks are available for calculations and explanations.
- 2 The following indexation factors should be used, where necessary.

January 2004 to March 2008	0.158	
January 2004 to January 2013	0.338 (assumed)	
March 2008 to January 2013	0.155 (assumed)	(15 marks)

(ii) Flame plc – employee share scheme; (8 marks)

(iii) Bon Ltd – the grant of a lease. (3 marks)

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

(b) Prepare the summary requested in the email from your manager. (5 marks)

**(35 marks)**

- 2 Your manager has received a letter from Dana, a new client of your firm. Extracts from the letter and from an email from your manager are set out below.

**Extract from the letter from Dana**

**Relief available in respect of a trading loss**

I resigned from my job on 31 December 2009, having earned an annual salary of £40,000 for the previous three years. I spent the whole of 2010 planning my new business and began trading on 1 January 2011. The business was profitable initially but I made a loss in the year ended 30 September 2012.

The results of the business have been:

Period ended 30 September 2011 – a profit of £14,900.

Year ended 30 September 2012 – a loss of £30,000.

I own a number of rental properties that are let on long-term tenancies. On 1 February 2012, I sold one of these properties for £310,000. I paid £250,000 for this property on 1 December 2010.

My taxable property business profits in recent tax years have been:

	£
2008/09	15,375
2009/10	15,175
2010/11	26,475
2011/12	33,475
2012/13 (estimated)	44,075

Please let me know how much tax I can save by relieving my trading loss for the year ended 30 September 2012.

**Transfer of a rental property to a trust on 1 September 2012**

On 1 September 2012, I transferred a rental property worth £270,000 to a trust for the benefit of my brother's children. I assume that there will be no tax liabilities for me or the trustees in respect of this gift. I also transferred a rental property to a trust in December 2007 and I am sure that no tax was paid in respect of that gift. I have never made any other gifts apart from gifts of cash to members of my family; none of these gifts exceeded £2,000.

**Email from your manager**

Dana is unmarried and has no children. She is resident, ordinarily resident and domiciled in the UK.

I have just spoken to Dana and she has provided me with the following additional information.

- Dana received a bonus of £2,000 from her employer when she left her job in December 2009. The bonus was to thank her for all of the work she had done over the years.
- The results Dana has provided in respect of her unincorporated business have been adjusted for tax purposes but do not take account of expenditure she incurred during 2010. During that year, Dana spent £1,400 on petrol as she travelled around the UK visiting potential customers.

Dana had no income or capital gains in the tax years concerned other than those referred to in her letter and in the additional information set out above.

**Work required:**

Please prepare the following for me for my next meeting with Dana.

**(a) Relief available in respect of the trading loss**

A reasoned explanation, with supporting calculations, of the most tax efficient manner in which Dana's trading loss can be relieved, together with a calculation of the total tax relief obtained by following the most tax efficient strategy. I want you to consider all of the ways in which Dana could relieve the loss with the exception of carry forward for relief in the future. You should assume that gift relief will be claimed in respect of the transfer of the rental property to the trust on 1 September 2012 when carrying out this work.



Your explanation should include:

- a brief summary of the other reliefs available for relieving the loss, together with your reasons for rejecting them; and
- the implications of the additional information provided by Dana.

**(b) Transfer of the rental property to the trust on 1 September 2012**

**(i) Capital gains tax**

An explanation as to whether or not gift relief is available in respect of the transfer of the rental property on 1 September 2012 and, on the assumption that it is available, the action required in order to submit a valid claim.

**(ii) Inheritance tax**

In relation to Dana's gifts prior to 1 September 2012:

- a list of the precise information we need to request from Dana in order to enable us to determine whether the gifts to her family members were exempt and to calculate the inheritance tax due on the transfer to the trust on 1 September 2012; and
- an explanation of why the information is required.

Tax manager

**Required:**

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

**(a) Relief available in respect of the trading loss.**

In respect of part (a) of this question you should:

- 1 Ignore national insurance contributions.
- 2 Assume that the tax rates and allowances for the tax year 2011/12 apply to all years. (18 marks)

**(b) Transfer of the rental property to the trust on 1 September 2012.**

- (i) Capital gains tax;** (2 marks)
- (ii) Inheritance tax.** (5 marks)

**(25 marks)**

**Section B – TWO questions ONLY to be attempted**

**3** Banger Ltd and Candle Ltd are two unrelated companies.

The management of Banger Ltd requires advice on the implications for one of the company's shareholders of the use of a motor car owned by the company and the proposed liquidation of the company.

The management of Candle Ltd has asked for a calculation of the company's corporation tax liability. Candle Ltd is a close investment-holding company.

**(a) Banger Ltd:**

- Banger Ltd is a UK resident trading company.
- 65% of the company's share capital is owned by its managing director, Katherine.
- The remaining shares are owned by a number of individuals who do not work for the company.

**Motor car provided to minority shareholder throughout the year ended 31 March 2012:**

- Banger Ltd paid £17,400 for the motor car, which had a list price when new of £22,900.
- The car has a petrol engine and has CO<sub>2</sub> emissions of 142 grams per kilometre.

**Liquidation of Banger Ltd:**

- It is intended that a liquidator will be appointed on 31 January 2013 to wind up the company.

**Distributions of company assets to shareholders being considered by Banger Ltd:**

- A total distribution of £280,000 in cash to the shareholders prior to 31 January 2013.
- The distribution of a building with a market value of £720,000 to Katherine after 31 January 2013.

**Required:**

- (i) Explain, with supporting calculations, the amount of the minority shareholder's taxable income in respect of the use of the motor car;** (3 marks)
- (ii) Explain in detail the tax implications for Banger Ltd, the minority shareholders and Katherine of the distributions that the company is considering.** (7 marks)

**(b) Candle Ltd:**

- Is a UK resident close investment-holding company with no associated companies.

**The results of Candle Ltd for the year ended 31 March 2012:**

	£
Interest receivable	41,100
Chargeable gains realised in the country of Sisaria, net of 23% Sisarian tax	14,630
Chargeable gains realised in the UK, excluding the sale of shares in Rockette plc	83,700
Fees charged by a financial institution in respect of an issue of debentures	14,000
Interest payable on debentures	52,900
General expenses of management	38,300

**Sale of shares in Rockette plc on 1 January 2012:**

- Candle Ltd purchased a 2.2% holding of the shares in Rockette plc for £31,400 in 1998.
- Piro plc acquired 100% of the ordinary share capital of Rockette plc on 1 January 2012.
- Candle Ltd received shares in Piro plc worth £147,100 and cash of £7,200 in exchange for its shares in Rockette plc.
- Piro plc's acquisition of Rockette plc was a commercial transaction and was not part of a scheme to avoid tax.
- The relevant indexation factor is 0.510.

**Required:**

**Calculate the corporation tax liability of Candle Ltd for the year ended 31 March 2012, giving explanations of your treatment of the disposal of the shares in Rockette plc and the rate of corporation tax payable. You should assume that Candle Ltd will claim all reliefs available to reduce its tax liability and you should state any further assumptions you consider necessary.** (10 marks)

**(20 marks)**

4 Ash requires a calculation of his capital gains tax liability for the tax year 2011/12, together with advice in connection with entrepreneurs' relief, registration for the purposes of value added tax (VAT) and the payment of income tax.

**Ash:**

- Is resident and ordinarily resident in the UK.
- Had taxable income of £29,000 in the tax year 2011/12.
- Was the owner and managing director of Lava Ltd until 1 May 2011, when he resigned and sold the company.
- Is a partner in the Vulcan Partnership.

**Ash – disposals of capital assets in the tax year 2011/12:**

- The sale of the shares in Lava Ltd resulted in a capital gain of £235,000, which qualified for entrepreneurs' relief.
- Ash assigned a 37-year lease on a property for £110,000 on 1 May 2011.
- Ash sold two acres of land on 1 October 2011 for £30,000.
- Ash sold quoted shares and made a capital loss of £17,400 on 1 November 2011.

**The lease:**

- The lease was previously assigned to Ash for £31,800 when it had 46 years remaining.
- The property has always been used by Lava Ltd for trading purposes.
- Lava Ltd paid Ash rent, equivalent to 40% of the market rate, in respect of the use of the property.

**The sale of the two acres of land:**

- Ash purchased eight acres of land for £27,400 on 1 June 2004.
- Ash sold six acres of the land for £42,000 on 1 August 2007.
- The remaining two acres of land were worth £18,000 on 1 August 2007.

**Vulcan Partnership (Vulcan):**

- Has a 31 March year end.
- Has monthly turnover of:

Standard-rated supplies	£300
Exempt supplies	£100
Zero-rated supplies	£5,500
- Its turnover is expected to increase slightly in 2013.
- None of its customers is registered for the purposes of VAT.
- Ash expects to receive less profit from Vulcan for the tax year 2012/13 than he did in 2011/12.

**Required:**

- (a) (i) **State the conditions that must be satisfied for Ash's assignment of the lease to be an associated disposal for the purposes of entrepreneurs' relief;** (3 marks)
- (ii) **Calculate Ash's capital gains tax liability for the tax year 2011/12 on the assumption that the assignment of the lease does qualify as an associated disposal and that entrepreneurs' relief will be claimed where possible.**

Note: The following lease percentages should be used, where necessary.

37 years	93.497	
46 years	98.490	(7 marks)

- (b) **Discuss in detail whether the Vulcan Partnership may be required to register for value added tax (VAT) and the advantages and disadvantages for the business of registration.** (7 marks)
- (c) **Set out the matters that Ash should consider when deciding whether or not to make a claim to reduce the payment on account of income tax due on 31 January 2013.** (3 marks)

**(20 marks)**

- 5 Cuthbert requires advice on the tax implications of the payment of capital gains tax by instalments and an error he has made in an income tax return. He has also requested calculations in respect of the inheritance tax payable on the death of his uncle, Pugh.

**Cuthbert:**

- Is resident, ordinarily resident and domiciled in the UK.
- Intends to give a building to his brother on 1 March 2013.
- Made an error in his income tax return for the tax year 2010/11.

**Cuthbert – proposed gift of a building to his brother on 1 March 2013:**

- The building is currently let to long-term tenants and has a market value of £460,000.

**Cuthbert – error in his income tax return for the tax year 2010/11:**

- HM Revenue and Customs have written to Cuthbert in respect of his income tax return.
- HM Revenue and Customs are claiming that Cuthbert has under-declared his UK property income.

**Pugh – valuation of assets owned at death on 1 February 2012:**

	£
Home in the UK	720,000
Vintage motor cars located in the country of Camberia	490,000
Quoted shares (holdings of less than 1%) registered in Camberia	330,000
Cash held in bank accounts in the UK	45,000

**Pugh – UK inheritance tax liability:**

- Was calculated on the basis that Pugh was domiciled in the country of Camberia and that he had made no lifetime gifts.
- Was paid on time.

**Pugh – information discovered after the payment of the UK inheritance tax:**

- Pugh had been domiciled in the UK since 1 January 2003.
- Pugh had made a gift of UK quoted shares (all holdings of less than 1%) to a trust on 10 June 2007.
- The quoted shares were worth £320,000 and Pugh paid the UK inheritance tax due.

**The system of inheritance tax in the country of Camberia:**

- There is no nil rate band and the rate of inheritance tax is 25%.
- Inheritance tax is only charged on the value of land and buildings and quoted shares owned at the time of death and located in Camberia.
- There is no double tax treaty between the UK and Camberia.

**Required:**

- (a) Explain whether or not the capital gains tax due on the proposed gift of the building could be paid by instalments and the matters that Cuthbert would need to be aware of in respect of this method of payment. (6 marks)
- (b) Explain how any penalty would be calculated if it is determined that Cuthbert made a careless error when completing his 2010/11 tax return. (4 marks)
- (c) Calculate the UK inheritance tax liability in respect of Pugh's estate following the discovery of the additional information, together with the interest on overdue tax that will be payable if the inheritance tax is paid on 1 January 2013. (10 marks)

**(20 marks)**

**End of Question Paper**