# **Answers**

1 Paragraphs for inclusion in a letter to Sirene

#### (i) The Chase deal

Automatic Ltd and Falcon Ltd will be associated companies for the purposes of determining the rate of corporation tax payable regardless of whether Falcon Ltd is owned by you personally or by Automatic Ltd. This is because, in both situations, you will have effective control of both companies. Accordingly, the limits used to determine the rate of tax payable by Automatic Ltd (and Falcon Ltd) will be divided by two.

From a corporation tax point of view it would be advantageous for Falcon Ltd to be owned by Automatic Ltd so that the two companies form a group. This would enable the full gain made by Automatic Ltd on the sale of the storage building to be rolled over against the administrative head office purchased by Falcon Ltd from Chase Ltd as shown in the amended budgeted corporation tax computation below. The rollover relief claim would reduce Falcon Ltd's base cost of the property purchased from Chase Ltd by the amount of the gain.

There are further potential advantages to the two companies being in a group including:

- no gains or losses will arise on any future transfers of assets between the two companies;
- a capital loss made by one of the companies can effectively be relieved against a chargeable gain made by the other;
   and
- if either of the companies were to make a trading loss in the future, the loss could be relieved against the taxable profits of the other group company.

There is a disadvantage in forming a group of companies in relation to capital allowances. The annual investment allowance will be split between the two companies if they are members of a group but would be available in full to each of them (unless they share premises or carry on similar activities) if you were to own them personally.

You are correct in thinking that there is no relief against trading profits for the cost of the administrative head office.

# (ii) Degrouping charges

A degrouping charge can only arise on the purchase of a company's shares. Accordingly, no such charge can arise in respect of the Chase deal. I set out below the circumstances that will give rise to a degrouping charge on the purchase of the shares of Target Ltd, a hypothetical company.

- Target Ltd must be leaving its existing capital gains group.
- An asset must have been transferred to Target Ltd at no gain, no loss from a company within its capital gains group.
- The no gain, no loss transfer must have occurred within the six years prior to the purchase of Target Ltd.
- Target Ltd must still own the asset at the time you acquire Target Ltd.

The degrouping charge would be calculated as follows:

		£
Market	value of the asset at the time of the no gain, no loss transfer	Χ
Less:	Original cost to the group	(X)
	Indexation allowance from the date of the original purchase to the date of the	
	no gain, no loss transfer	(X)
Degrou	iping charge in Target Ltd	XX

The charge is taxable in the accounting period in which Target Ltd is purchased, i.e. leaves the original group.

#### (iii) VAT (Value added tax)

VAT must be charged on the sale of a trade and assets unless it qualifies as a transfer of a going concern. A transfer of a going concern is outside the scope of VAT such that no VAT should be charged.

For the sale of the trade and assets of Chase Ltd to be regarded as a transfer of a going concern the following conditions must be satisfied.

- The trade and assets purchased from Chase Ltd must be a going concern.
- Falcon Ltd must use the assets to carry on the same kind of business as that carried on by Chase Ltd.
- Falcon Ltd must be VAT registered or be required to be VAT registered as a result of the purchase (based on the turnover
  of the purchased business in the previous 12 months).
- There should be no significant break in trading before or after the purchase of the business.

Even if the transfer satisfies the above conditions, Chase Ltd is required to charge VAT on the administrative head office if it has opted to tax the building in the past or if the building is less than three years old at the date of sale. The requirement to charge VAT in these circumstances is, however, removed if Falcon Ltd opts to tax the building at the time of purchase.

#### (iv) Automatic Ltd – Amended budgeted corporation tax computation for the year ending 31 March 2010

	udgeted profits chargeable to corporation tax e gain relieved by rollover relief	£ 280,000 (34,000)
Amended	budgeted profits chargeable to corporation tax (note 1)	246,000
Corporatio Less:	n tax at 28% (W) marginal relief (£750,000 – £248,400 (W)) x £246,000/£248,400) x 7/400	68,880 (8,693)
Less:	relief in respect of corporate venturing scheme shares (£19,000 x 20%) (note 2)	60,187 (3,800)
		56,387

#### Notes

- 1. It is correct to exclude the dividends received from Rye Ltd when calculating Automatic Ltd's profits chargeable to corporation tax. However, as noted above, once Falcon Ltd has purchased the trade and assets of Chase Ltd, there will be two associated companies. As a result of this, Automatic Ltd will be a marginal company and the dividends received from Rye Ltd will be relevant when calculating marginal relief.
- 2. It appears that the investment in Rye Ltd satisfies the conditions of the corporate venturing scheme. This relief will be withdrawn if Automatic Ltd sells the shares within three years of acquiring them.

#### Working

'Profits'

	£
Profits chargeable to corporation tax	246,000
Franked investment income (£2,160 x 100/90)	2,400
'Profits'	248,400

'Profits' are between the limits of £150,000 (£300,000/2) and £750,000 (£1,500,000/2) such that the company is marginal.

#### 2 (a) Memorandum

To The files
From Tax assistant
Date 7 December 2009

Subject Grifter

# (i) Property in Shadowsia

The income tax due on the rental income is calculated below.

£
5,808
792
6,600
2,640
(792)
1,848
9,240
9,240
18,480

The death of Grifter's uncle within seven years of giving him the property in Shadowsia results in an inheritance tax liability as set out below.

	£
Value of property	94,000
Gifts in February 2004 use annual exemption	
Potentially exempt transfer	94,000
Less: relief for fall in value (£94,000 – £48,000)	(46,000)
	48,000
Gifts in February 2004 use nil rate band	-
	48,000
Inheritance tax at 40%	19,200
Taper relief (£19,200 x 60% (5-6 years))	(11,520)
Inheritance tax payable	7,680

Grifter can choose to pay the inheritance tax in ten equal annual instalments starting on 31 May 2010 if he wishes because it has arisen in respect of land and buildings. However, interest on overdue tax will be charged from that date on the whole amount outstanding. Any outstanding inheritance tax liability would become payable if Grifter were to sell the property. In (ii) below, when calculating the amount by which Grifter could reduce his mortgage, I have accounted for the whole of the inheritance tax liability.

#### The tax refund

Grifter's tax affairs should be reviewed in order to determine whether there is any explanation for the refund. If the tax refund has been made to him in error, he should repay it immediately. He may be committing a civil and/or a criminal offence if he fails to do so.

If Grifter does not return the refund, we would have to consider ceasing to act as his advisers. In these circumstances we are required to notify the tax authorities that we no longer act for him, although we should not provide any reason for our action. We should also consider the need to submit a money laundering report to the Serious Organised Crime Agency as the retention of the refund may amount to a crime.

#### (ii) Reduction in mortgage

Sell the cars

£
279,000
(22,320)
256,680
=
(18,480)
(7,680)
(14,600)
215,920

The tax treatment of the proposed sale of the cars

The tax implications of the proposed sale of the cars depend on whether Grifter is regarded as trading or not. If he is regarded as trading, the profit on each of the cars would be subject to income tax. If he is not regarded as trading, the profit on the sale of each car would be a capital profit. These capital profits would not be subject to tax because cars are exempt from capital gains tax.

It is my view that the profits from the sale of the cars would be treated as capital profits. This conclusion is based on reference to the 'badges of trade' which are used to determine whether or not a trade is being carried on. The particular factors which have led me to this conclusion are:

- Cars are not a category of asset that is purchased solely with the intention of realising a profit. They can also be purchased to be used and enjoyed.
- The cars were purchased to be used (and have been so used) rather than to be resold at a profit.
- The proposed sale of the cars is not one of a series of disposals.
- The cars have been owned for considerable periods of time.

# Sell the house

	£
Net proceeds from sale of house (£1,200,000 – £6,400)	1,193,600
Less: capital gains tax payable (W1)	(51,074)
other amounts payable as per (i) $(£18,480 + £7,680 + £14,600)$	(40,760)
payment to reduce mortgage (see above)	(215,920)
Amount available to purchase house	885,846
Less: professional fees in respect of purchase	(4,000)
	881,846
Less: stamp duty land tax at 4% (£881,846 x 4/104)	(33,917)
Maximum capital cost of house	847,929
Marabin na	

#### Workings

#### 1 Capital gains tax on the sale of the house

£
1,200,000
(6,400)
1,193,600
(500,000)
693,600
(409,855)
283,745
51,074

#### 2 Principal private residence exemption

	Exempt	Chargeable	Total
1 March 1999 to 31 August 2003 – Absent	-		
(Period of absence with no prior period of occupation)	_	54	54
1 September 2003 to 28 February 2010 – Period of occupation	78	_	78
	78	54	132

# (b) Briefing note

#### The remittance basis

#### Who is entitled to be taxed on the remittance basis?

Individuals who are:

- not ordinarily resident; and/or
- non UK domiciled.

#### Is a claim required?

The remittance basis applies automatically to individuals with unremitted overseas income and gains of less than £2,000 in a tax year.

Other individuals are required to submit a claim for the remittance basis to apply in a tax year.

#### How does the remittance basis affect an individual's UK tax liability?

Income tax

- UK resident individuals are normally taxed on the whole of their worldwide income.
- Under the remittance basis, such individuals will only be subject to tax on foreign income if it is remitted to the UK.
- Remitted income is taxed as non-savings income at 20%/40%.

#### Capital gains tax

- Individuals who are resident or ordinarily resident in the UK are normally subject to capital gains tax on their worldwide assets
- Under the remittance basis, individuals who are not domiciled in the UK will only be subject to tax in respect of gains on overseas assets if the gains are remitted to the UK.
- An individual who has claimed the remittance basis must make an election in order for capital losses in respect of overseas assets to be allowable. The election must be made in respect of the first year in which the remittance basis is claimed and applies to all future years.

An individual who claims the remittance basis will not be entitled to:

- the income tax personal allowance:
- the capital gains tax annual exemption.

The remittance basis charge:

- must be paid by an individual who claims the remittance basis and who has been UK resident for at least seven of the nine years prior to the year of claim;
- is a charge of £30,000 on unremitted income and gains for every year in which the individual wishes the remittance basis to apply.

#### 3 Ava

#### (a) Late submission of the 2007/08 income tax return

The latest date for submission of the 2007/08 income tax return was 31 January 2009 provided it was filed online.

A penalty of £200 will be levied because the return will be submitted more than six months but less than 12 months late. This penalty will be restricted to a maximum of the tax outstanding for the year.

A penalty equal to 10% of the outstanding income tax will be levied because the tax will be paid more than six months after 31 January 2009, the date on which it was due.

The penalties in respect of both the late submission of the return and the late payment of the outstanding income tax will be set aside by the Commissioners if they are satisfied that Burt's illness is a reasonable excuse for the late reporting.

Interest will be charged on the outstanding income tax from 31 January 2009 until 14 December 2009 at an annual rate of 7.5%.

#### (b) (i) The availability of agricultural property relief and business property relief

Hayworth Farm is agricultural property situated in the UK and therefore qualifies for agricultural property relief. The relief is given on the agricultural value of the property rather than its market value. 100% relief is available because the lease of the farm was granted after 1 September 1995.

Because the farm is farmed by tenants, it must have been owned by Ava and farmed by the tenants for at least seven years prior to the gift. Ava is able to satisfy this condition because she inherited the farm from her husband and therefore his period of ownership, of more than seven years, can be added to hers.

Business property relief is not available in respect of the gift of the farm as it has always been held as an investment and not as a business asset.

# (ii) Tax payable in respect of the gift of Hayworth Farm

Capital gains tax

		£
Deemed proceeds at market value		650,000
Less:	cost (probate value)	(494,000)
Gain		156,000
Less:	annual exemption (assumed to be available)	(9,600)
Taxable gain		146,400
Capital gains tax at 18%		26,352

The capital gains tax will be payable on 31 January 2011.

Inheritance tax

Market value as at 1 February 2010 Agricultural property relief (£445,000 x 100%) Less: 2009/10 annual exemption	£	£ 650,000 (445,000) (3,000)
Potentially exempt transfer Nil rate band		202,000
Ava's nil rate band Less: gift on 1 December 2008 (£238,000 – £6,000)	312,000 (232,000)	
	010.000	(80,000)
Burt's nil rate band available to Ava  Less: legacy to sister	312,000 (280,000)	
		(32,000)
Amount chargeable to inheritance tax		90,000
Inheritance tax at 40% Taper relief (£36,000 x 20% (3–4 years))		36,000 (7,200)
Inheritance tax payable		28,800

The inheritance tax will be payable on 31 July 2014 (six months after the end of the month of death).

The claim to transfer Burt's unused nil rate band to Ava must be made by 31 January 2016 (two years from the end of the month of Ava's death).

Assumption: Ava's nephew still owns the farm on 1 January 2014 or has died prior to that date whilst owning it.

#### 4 Fedora and Smoke Ltd

# (a) Repayment of loan

Smoke Ltd is a close company (as it is controlled by Fedora), that has made a loan to a participator (Fedora). Accordingly, Smoke Ltd will have paid HM Revenue and Customs £4,600 (25% x £18,400) on 1 January 2005. HM Revenue and Customs will repay the £4,600 to the company nine months after the end of the accounting period in which the loan is repaid.

The loan also gives rise to an annual employment income benefit for Fedora of £1,150 (£18,400 x 6·25%). This benefit will no longer be charged to income tax once the loan is repaid, saving Fedora £460 (£1,150 x 40%) each year. In addition, Smoke Ltd will no longer have to pay class 1A national insurance contributions in respect of the loan benefit. This will save the company £116 (£1,150 x  $12\cdot8\%$  x 79%).

#### (b) Annual net effect of Smoke Ltd employing Wanda

	Cost £	Saving £
Fedora Reduction in income tax liability (£20,000 x 40%)		8,000
Reduction in national insurance liability (£20,000 x 1%)		200
Wanda Increase in income tax liability (W1) National insurance liability ((£20,000 – £5,435) x 11%)	2,887 1,602	
Smoke Ltd Employer national insurance contributions		
Reduction in salary to Fedora (£20,000 x 12·8%)	1.004	2,560
Salary to Wanda ((£20,000 – £5,435) x 12·8%)	1,864	(520)
Corporation tax effect (£1,864/£2,560 x 21%)	(391)	(538)
	5,962	10,222
Annual net saving (£10,222 – £5,962)		4,260

# Working

#### 1 Wanda – Increase in income tax liability

20,000
470
(6,035)
14,435
2,887

Note: as a non-taxpayer, Wanda will have been receiving the bank interest gross.

#### (c) The sale of the land

Taxable gain arising on the sale of the land

		£
Proce	22,000	
Less:	cost (£174,000 x £22,000/(£22,000 + £491,000))	(7,462)
	indexation allowance (£7,462 x 0·545 ((214·4 – 138·8)/138·8))	(4,067)
Gain		10,471
Rollov	ver relief:	
	Proceeds not spent = £3,000 (£22,000 - £19,000)	
	Relief available (£10,471 – £3,000)	(7,471)
Taxab	3,000	
Taxab		

#### The relief available

Rollover relief is available in respect of the gain because it has arisen on the disposal of a qualifying asset (land) that has been used for business purposes. The gain can be rolled over if qualifying assets are purchased for use in the business in the four-year period commencing 1 February 2009. Plant and machinery only qualifies for rollover relief if it is fixed rather than moveable.

On the assumption that the engineering machinery is fixed, and that Smoke Ltd will not purchase any other qualifying assets during the four-year period, the gain that will be charged will be equal to the amount of the proceeds from the sale of the land that has not been used to purchase qualifying assets, i.e. £3,000, with the balance of the gain of £7,471 (£10,471 – £3,000) being deferred.

Machinery has a statutory useful life of less than 50 years and is therefore a depreciating asset for the purposes of rollover relief. Accordingly, the deferred gain of £7,471 will become chargeable on the earliest of the following:

- the date on which the machinery is sold;
- the date on which the machinery is no longer used in the business; and
- ten years from the date on which the machinery is purchased, i.e. in March 2020.

#### 5 Ellroy

# (a) (i) The difference in Ellroy's total tax liability depending on his choice of year end

	2009/10 £	2010/11 £	2011/12 £
March year end: Six months ending 31 March 2010 Year ending 31 March 2011 (£87,200 – £32,000) Year ending 31 March 2012	13,100	55,200	74,400
September year end: 1 October 2009 to 5 April 2010 (£24,700 (W1) x 6/12) Year ending 30 September 2010 (W1) Year ending 30 September 2011 (W1)	12,350	24,700	80,800
Increase/(fall) in profit due to adopting a September year end	(750)	(30,500)	6,400
Income tax and class 4 national insurance contributions at $41\%$	(307)	(12,505)	2,624
Reduction in total tax liability over the three years			10,188

Note: The income tax and class 4 national insurance contributions on the change in the level of profits will be at 40% and 1% respectively due to the level of Ellroy's partnership income.

#### Working

# 1 Tax adjusted profits – 30 September year end

Year ending 30 September 2010	£
Adjusted trading profit	
Six months ending 31 March 2010	13,100
Six months ending 30 September 2010 (£87,200 x 6/12)	43,600
Less: capital allowances (AIA)	(32,000)
	24,700
Year ending 30 September 2011	
Adjusted trading profit	
Six months ending 31 March 2011 (£87,200 x 6/12)	43,600
Six months ending 30 September 2011 (£74,400 x 6/12)	37,200
	80,800

#### (ii) The effect on Ellroy's total taxable profits of changing his year end

With a 31 March year end, Ellroy's basis period for the tax year 2012/13 will be the year ending 31 March 2013.

If Ellroy were to change his year end to 30 September and prepare accounts for the six months ending 30 September 2012, he would have a six-month trading period ending in the tax year 2012/13. His basis period for 2012/13 would be the year ending 30 September 2012, such that the profits for the six months ending 31 March 2012 would be taxed again in 2012/13 having already been taxed in 2011/12. The profits taxed twice would be classified as overlap profits and would be relieved when the trade ceases or, potentially, on a future change of accounting date.

Accordingly, by changing his year end, in the tax year 2012/13 Ellroy would be taxed on the profits arising in the six months ending 31 March 2012 rather than those arising in the six months ending 31 March 2013. If Ellroy's profits are rising, the change in accounting date will reduce his taxable profits for 2012/13. If Ellroy's profits are falling, the change in accounting date will cause his taxable profits for 2012/13 to increase.

Ellroy would need to notify HM Revenue and Customs of the change in accounting date by 31 January 2014 in order for the change to be valid in 2012/13.

# (b) Maximum flat rate percentage

The annual VAT payable by the business when calculated in the normal way is set out below.

	L
Output tax (£100,000 x 17·5%)	17,500
Input tax (£21,000 x 17·5%)	(3,675)
Payable to HMRC	13,825

Under the flat rate scheme a business continues to charge its customers output tax in the normal way but pays a fixed percentage of its VAT inclusive turnover to HMRC rather than calculating output tax minus input tax.

The VAT due under the flat rate scheme in respect of Ellroy's business would be £117,500 (£100,000 x  $1\cdot175$ ) multiplied by the flat rate percentage.

The percentage necessary to result in VAT payable of £13,825 is 11·766% (£13,825/£117,500).

Accordingly, the scheme will be financially beneficial if the flat rate percentage for Ellroy's business is no more than 11.5%.

Tutorial note

Flat rate scheme percentages increase in increments of either a half or a whole percentage point. Accordingly, the scheme would be financially beneficial if the relevant percentage is 11.5% but not if it is 12%.

# Professional Level – Options Module, Paper P6 (UK) Advanced Taxation (United Kingdom)

# December 2009 Marking Scheme

			Ma Available	rks Maximum	
1	(i)	Associated companies and the tax rate limits	2		
		The advantages and disadvantages of forming a group	0		
		Rollover relief Other advantages and disadvantages (1 mark each)	2		
		Tax relief in respect of the cost of the administrative head office	3 1		
		tan rener in respect of the seat of the sammed and a most ember	8	6	
				0	
	(ii)	No degrouping charge on the Chase deal	1		
		Circumstances giving rise to a degrouping charge	3 3		
		Calculation of degrouping charge			
		Taxable period	0.5		
			7.5	6	
	(iii)	Charge VAT unless transfer of a going concern	1.5		
		Conditions (1 mark each, maximum 3 marks)	3		
		Land and buildings	2.5		
			7	5	
	(iv)	Rollover relief	1		
		Corporation tax liability pre relief for investment in Rye Ltd	2 1		
		Relief for investment in Rye Ltd			
		Relevant explanations	2.5		
			6.5	6	
		Effectiveness of communication	1		
			6.5 1 1	_1_	
		Total		24	

				Ma Available	irks Maximum
2	(2)	(i)	Amount payable in respect of rental income	Available	Maxilliulli
_	(a)	(1)	Taxable rental income	1.5	
			Tax, interest and penalties due	2.5	
			Inheritance tax on property in Shadowsia	3	
			Instalment option	3	
			Tax refund	5	
				 15	1.0
					12
		(ii)	Sell the cars		
		` ,	Net sales proceeds	1	
			Treatment of profit on sale of cars		
			Trading or capital	3	
			Badges of trade	4	
			Other adjustments	1.5	
			Sell the house		
			Gain before principal private residence exemption	1	
			Principal private residence exemption	2	
			Capital gains tax	0.5	
			Other adjustments	1	
			Stamp duty land tax		
				16	14
			ropriate style and presentation	1	
			ctiveness of communication	1	
		Log	ical structure		
				3	3
	(b)	Who	o is entitled to be taxed on the remittance basis?	2	
	(2)		necessary to claim the remittance basis?	1.5	
			v does claiming the remittance basis affect an individual's UK tax liability?		
			Income tax	3	
			Capital gains tax	3.5	
			Remittance basis charge	2	
				12	9
		Tota	I		38
		.0.0	•		

			Available	Maximum
3	(a)	Submission date for income tax return	1	
		Penalty for late submission	1	
		Surcharge on overdue tax Reasonable excuse	1 1	
		Interest on overdue tax	1	
		microst on orotage tax	<u></u> 5	4
				4
	(b)	(i) Agricultural property relief		
		Location	0.5	
		Amount of relief	1	
		Qualifying period	2	
		Business property relief		
			4.5	4
		(ii) Capital gains tax		
		Amount payable	2	
		Due date	1	
		Inheritance tax	2	
		Transfer less agricultural property relief and annual exemption Nil rate bands	2 3	
		Inheritance tax payable	1·5	
		Due date	1	
		Date of claim to transfer unused nil rate band	1	
		Assumption	1	
			12.5	11
		Total		19
		iotai		
4	(a)	Close company loan to participator	1	
		Payment made to HMRC will be repaid	1.5	
		Annual benefit will cease	3	
			5.5	4
	(b)	Fedora	0.5	
		Income tax	0·5 0·5	
		National insurance Wanda	0.2	
		Income tax	2	
		National insurance	1	
		Smoke Ltd		
		National insurance	1.5	
		Corporation tax	1	
		Annual net saving	0.5	
				7
	(c)	Calculation of gain before rollover relief	2	
	(0)	Calculation of gain after rollover relief	1	
		Land is a qualifying business asset	1	
		Qualifying period	1	
		Fixed plant and machinery is a qualifying asset	1	
		Assumptions	1	
		Plant and machinery is a depreciating asset	1	
		Taxation of deferred gain	1.5	
			9.5	8
		Total		19

Marks

				Ma	ırks
_			T 6	Available	Maximum
5	(a)	(i)	Taxable profits with a 31 March year end 30 September year end	2	
			Tax adjusted profits for the trading periods	2.5	
			Assessable profits	2	
			Effect on total tax and national insurance liability		
				2 2 8·5	8
		(ii)	Basis periods	1.5	
			Profits taxed twice	2	
			Effect on taxable profits	2.5	
			Requirement to notify HMRC	1	
				7	6
	(b)	VAT	payable in the normal way	1.5	
		Bas	is of flat rate scheme	2	
		Cald	culation of maximum percentage	2	
		Con	clusion	0.5	
				_6_	_5
		Tota	ıl		19