Professional Level – Options Module

Advanced Taxation (United Kingdom)

Monday 7 December 2009

Paper P6 (UK)

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 3–5.

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

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The question paper begins on page 3.

SUPPLEMENTARY INSTRUCTIONS

1. You should assume that the tax rates and allowances for the tax year 2008/09 and for the financial year to 31 March 2009 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

		%
Basic rate	£1 – £34,800	20
Higher rate	£34,801 and above	40

A starting rate of 10% applies to savings income where it falls within the first £2,320 of taxable income.

Personal allowances

		£
Personal allowance	Standard	6,035
	65 – 74	9,030
	75 and over	9,180
Income limit for age related allowances		21,800

Car benefit percentage

The base level of CO_2 emissions is 135 grams per kilometre. A lower rate of 10% applies to petrol cars with CO_2 emissions of 120 grams per kilometre or less.

Car fuel benefit

The base figure for calculating the car fuel benefit is £16,900.

Pension scheme limits

Annual allowance	£235,000
Lifetime allowance	£1,650,000
The maximum contribution that can qualify for tax relief without evidence of earnings	£3,600

Authorised mileage allowances: cars

Up to 10,000 miles	40p
Over 10,000 miles	25p

Capital allowances

Plant and machinery

Annual investment allowance	£50,000
Writing down allowance	
Main pool	20%
Special rate pool	10%

First year allowance

– Low emission motor cars (CO_2 emissions of less than 110 grams per kilometre)	100%

Industrial buildings

Writing-down allowance	3%

Corporation tax

Financial year	2006	2007	2008
Small companies rate	19%	20%	21%
Full rate	30%	30%	28%
	£	£	£
Small companies rate lower limit	300,000	300,000	300,000
Small companies rate upper limit	1,500,000	1,500,000	1,500,000
Marginal relief fraction	11/400	1/40	7/400

Marginal relief

(M – P) x I/P x Marginal relief fraction

Value added tax (VAT)

Standard rate	17·5%
Registration limit	£67,000
Deregistration limit	£65,000

Inheritance tax

	%
£1 – £312,000	Nil
Excess	40

Capital gains tax

Rate of tax	18%
Annual exemption	£9,600
Entrepreneurs' relief	
Lifetime limit	£1,000,000
Relief factor	4/9ths

National insurance contributions (not contracted out rates)

			%
Class 1	Employee	£1 – £5,435 per year	Nil
		£5,436 – £40,040 per year	11·0
		£40,041 and above per year	1·0
Class 1	Employer	£1 – £5,435 per year	Nil
		£5,436 and above per year	12·8
Class 1A			12·8
Class 2		Small earnings exception limit – £4,825	
		£2·30 per week	
Class 4		£1 – £5,435 per year	Nil
		£5,436 – £40,040 per year	8·0
		£40,041 and above per year	1·0

Rates of interest

Official rate of interest	6·25% (assumed)
Rate of interest on underpaid tax	7·5% (assumed)
Rate of interest on overpaid tax	3·0% (assumed)

Stamp duty land tax

	Rate
Relevant consideration	
£150,000 or less (1)	Nil
£150,001 – £250,000	1%
£250,001 – £500,000	3%
£500,000 or more	4%

(1) For residential property, the nil rate band is extended to £175,000.

Stamp duty

Shares	0·5%

Section A – BOTH questions are compulsory and MUST be attempted

1 An extract from an e-mail from your manager is set out below.

> I have forwarded to you an e-mail I received from Sirene yesterday.
>
> Automatic Ltd, the manufacturing company that Sirene incorporated in 2007, is doing well and she is now finalising the purchase of the trade and assets of Chase Ltd, another profitable company. This acquisition, referred to by Sirene as the 'Chase deal', will be carried out in January 2010 by a new company, Falcon Ltd, which she will incorporate for this purpose. There are likely to be further acquisitions of shares and/or businesses in the future.
>
> I want you to write paragraphs, for inclusion in a letter that I will write later this week, addressing each of the matters raised in Sirene's e-mail. Please include an amended calculation of the budgeted corporation tax payable by Automatic Ltd for the year ending 31 March 2010 together with brief explanations where necessary. This calculation should begin with Sirene's figure for profits chargeable to corporation tax of £280,000 and incorporate any adjustments that need to be made.
>
> Sirene is reasonably knowledgeable about corporation tax and I am happy to assume that her figures for the income and the capital gain are correct. However, I believe that it would be advantageous for Falcon Ltd to be owned by Automatic Ltd rather than Sirene. Accordingly, please include the corporation tax advantages (and any disadvantages) of Automatic Ltd owning Falcon Ltd and amend the budgeted corporation tax computation on the assumption that the deal is structured in this manner and that all beneficial claims are made.
>
> **Thank you**
>
> **Bogard**

An extract from the e-mail from Sirene is set out below.

> **The Chase deal**
>
> I have decided to set up a new company, Falcon Ltd, because I want to keep the Chase business separate from Automatic Ltd. I will own the whole of Falcon Ltd personally (just as I do Automatic Ltd) so that the Chase deal does not affect the rate of corporation tax paid by Automatic Ltd. Please confirm that this approach is effective from a corporation tax point of view.
>
> As part of the deal, Falcon Ltd will pay Chase Ltd £320,000 for the purchase of the building it uses for its administrative head office. Am I correct in thinking that this cost will not give rise to tax deductions from trading income?
>
> **Degrouping charges**
>
> It is my understanding that on the purchase of a company or a business it is possible for certain assets to be regarded as having been sold such that chargeable gains, often called degrouping charges, arise. However, I'm not sure how to determine whether or not the Chase deal, or any future deals, will result in such a charge. Please let me have a summary of the circumstances giving rise to such a charge and an explanation of how the charge is calculated.
>
> **VAT (Value added tax)**
>
> The management of Chase Ltd have told me that they must charge VAT on the sale of the building, machinery and equipment. Are they correct?
>
> **Automatic Ltd – budgeted corporation tax computation for the year ending 31 March 2010**

	£
Tax adjusted trading profit	240,000
Chargeable gain (note 1)	34,000
Bank interest	6,000
Profits chargeable to corporation tax (note 2)	280,000
Corporation tax at 21% (note 3)	58,800

Notes

1. The chargeable gain will arise on the sale of a small building in March 2010 for £138,000. Automatic Ltd uses the building for storage purposes and will rent storage space in the future. I do not anticipate the company buying any assets qualifying for rollover relief within the qualifying period.
2. Automatic Ltd subscribed for 12,000 shares (a 6% shareholding) in Rye Ltd in September 2009 for £19,000. Rye Ltd is a very small unquoted engineering company that is run by two brothers who own 60% of its ordinary share capital. The remainder of its share capital is owned by a number of unrelated individuals, none of whom is connected with Automatic Ltd. Automatic Ltd has subsequently received a dividend of £2,160 in respect of these shares. I have excluded these dividends when calculating the taxable profits of Automatic Ltd. Please confirm that this treatment is correct.
3. Automatic Ltd has no associated companies.

Required:

Prepare the paragraphs for inclusion in your manager's letter as requested in his e-mail, together with the amended corporation tax computation. The following marks are available.

(i) The Chase deal; (6 marks)

(ii) Degrouping charges; (6 marks)

(iii) VAT (value added tax); (5 marks)

(iv) Automatic Ltd – amended budgeted corporation tax computation, together with brief explanations, for the year ending 31 March 2010. (6 marks)

A professional mark will be awarded in question 1 for the effectiveness with which the information is communicated. (1 mark)

(24 marks)

2 An extract from an e-mail from your manager detailing two tasks for you to perform is set out below.

(a) You will find a letter on your desk from a new client, Grifter, who is a self-employed information technology consultant. I need you to write a memorandum for the files addressing the matters regarding Grifter set out below. You should include a brief explanation of any tax liabilities that can be deferred but, other than this, keep any narrative to a minimum unless I have specifically asked for it.

(i) Property in the country of Shadowsia

Calculate the income tax on the rental income in respect of the property in Shadowsia on the basis that Grifter is a higher rate taxpayer for all of the relevant years. Grifter has asked us to assume that there will be interest and penalties payable equal to 100% of the tax due. There is no double tax treaty between the UK and the country of Shadowsia.

Unfortunately, Grifter's uncle died in November of this year so you will need to include a calculation of Grifter's inheritance tax liability, after any available reliefs, on the gift of the property. Grifter has informed me that his uncle was domiciled in the UK and that, due to gifts made in February 2004, there is no annual exemption or nil rate band available in respect of the gift. There was no inheritance tax liability in Shadowsia in respect of the property.

You should also include your assessment of Grifter's view of the tax repayment he has received.

(ii) Reduction in mortgage

Calculate the amount by which Grifter could reduce his mortgage if he were to sell the cars. This will be the after tax proceeds from the sale of the cars less any amounts due under (i) above.

Please include a detailed explanation of your tax treatment of the sale of the cars based on our knowledge of Grifter's circumstances. I understand from Grifter that he has not previously sold any cars from his collection.

Calculate the maximum price that Grifter could pay for a new house if he were to sell his existing house. Assume that his existing house will be sold on 28 February 2010 for £1,200,000 and that there will be professional fees of £6,400.

In calculating the amount available to buy a new house you should assume that Grifter will reduce his mortgage by the same amount as the figure you have computed in respect of the sale of the cars and that there will be professional fees in respect of the purchase of the new house of £4,000.

When carrying out these calculations you should assume that Grifter's capital gains tax annual exemption is not available.

(b) I want you to write a briefing note on the remittance basis of taxation for individuals in respect of both investment income and capital gains. The note will be sent to all of our staff to provide them with a summary of the basic rules so that they will know when there is a need to consider the matter in more detail. I suggest you use the following headings:

- Who is entitled to be taxed on the remittance basis?
- Is a claim required?
- How does the remittance basis affect an individual's UK tax liability?

Thanks

Bob

The letter from Grifter is set out below.

1 Dark Lane
London

Mr B Mitchum
M & M Co
London

1 December 2009

Dear Mr Mitchum

I shall be grateful if you will advise me on the following matters.

Property in the country of Shadowsia

On 1 April 2004 my uncle gave me a small investment property in the country of Shadowsia. The property is only worth £48,000 now but was worth £94,000 at the time of the gift. Rental income in respect of the property of £484 per month has been paid into my UK bank account since I acquired the property.

My understanding has always been that, because I am not domiciled in the UK, the rental income was not taxable in the UK and so I have not reported it on my income tax returns. However, I now realise from talking to you that I should have paid UK tax on the income (despite 12% Shadowsian tax being deducted from the payments made to me). Accordingly, please let me know how much in total I owe to the tax authorities in respect of this income up to and including the tax year 2008/09.

Hopefully the amount payable in respect of the rental income will be less than the tax refund of £14,600 that I received earlier this year. I'm quite sure that HM Revenue and Customs did not owe me this money but, whilst I'm happy to admit to my mistake over the rental income, I don't see any need to point out their mistakes. I have already spent the tax refund so I will need to use the funds generated by the sale of my cars or my house to pay any liabilities due in respect of the rental income.

Reduction in mortgage

I have not had a particularly successful year in 2009 and I have decided to repay some of my mortgage (current balance of approximately £350,000) in order to reduce my outgoings. I am considering two options.

1. Sell three of my cars and use the net proceeds to reduce my mortgage.
2. Sell my house and buy a smaller one with a smaller mortgage. I would want to reduce my mortgage by the same amount as in option 1, so the two options are comparable.

My preference would be option 2 provided I could still afford a house of a sufficient size in a suitable location.

1. My cars

I have a collection of four cars that I drive regularly and race against other collectors. I would be very sad to have to sell any of them although, despite doing most of the repairs and maintenance myself, it is a very expensive hobby.

I set out below the details of the three cars that would be sold. I would have to pay a fee of 8% of the selling price to the auction house.

	Mercedes	Bugatti	Porsche
Date of purchase	1 June 1997	1 March 1999	1 October 2003
Cost	£42,000	£89,000	£77,000
Current valuation	£84,000	£127,000	£68,000

2. My house

I bought the house on 1 March 1999 for £500,000. However, I did not move into it until 1 September 2003 as I'd also bought a boat and I was sailing around the Mediterranean Sea. I've been told that I should be able to sell the house for £1,200,000.

Yours sincerely

Grifter

Required:

(a) **Prepare the memorandum requested by your manager in his e-mail. Marks are available for the sections of the memorandum as follows:**

(i) **Property in the country of Shadowsia;** (12 marks)

(ii) **Reduction in mortgage.** (14 marks)

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

(b) **Prepare the briefing note on the remittance basis of taxation for individuals as requested by your manager in his e-mail.** (9 marks)

(38 marks)

Section B – TWO questions ONLY to be attempted

3 Ava has not yet submitted her income tax return for the tax year 2007/08. She also requires advice on the capital gains tax and inheritance tax implications of making a gift of a farm to her nephew.

The following information has been obtained from a letter from Ava and from her client file.

Ava's personal circumstances:

– Ava is 84 years old.
– Ava's husband, Burt, died on 1 November 2009 after a long and serious illness.
– Ava has no children.

Ava's income tax reporting:

– Burt had always looked after Ava's tax affairs as well as his own.
– Ava has recently realised that her income tax return for the tax year 2007/08 has not been submitted.
– The notice to file the income tax return for the tax year 2007/08 was sent to Ava on 1 May 2008.

Burt's will and lifetime gifts:

– Burt made no transfers for the purposes of inheritance tax during his lifetime.
– Burt left quoted shares worth £280,000 to his sister.
– Burt left 'Hayworth', a small farm, and the residue of his estate to Ava.
– Consequently, his chargeable death estate was less than his nil rate band.

Ava's lifetime gifts:

– Ava made a gift of quoted company shares (all minority holdings) worth £238,000 to her niece on 1 December 2008.
– Ava intends to gift Hayworth Farm to her nephew on 1 February 2010.
– Capital gains tax gift relief will not be claimed in respect of the intended gift.

Hayworth Farm:

– Is situated in the UK.
– Was purchased by Burt on 1 January 2000 for £330,000.
– Was leased to tenant farmers on 1 January 2000 and was never farmed by Burt.
– Will continue to be leased to and farmed by the tenant farmers in the future.

Hayworth Farm – Valuations of farm buildings and surrounding land:

–	1 November 2009	1 February 2010
	£	£
Market value	494,000	650,000
Agricultural value	300,000	445,000

– It can be assumed that both values will increase by 5% per year from 1 February 2010.

Required:

(a) State by when Ava's 2007/08 income tax return should have been submitted and list the consequences of submitting the return, together with Ava's outstanding income tax liability, on 15 December 2009.

Note: you are not required to prepare calculations for part (a) of this question. (4 marks)

(b) (i) Provide a reasoned explanation for the availability or non-availability of agricultural property relief and business property relief in respect of the intended gift of Hayworth Farm by Ava; (4 marks)

(ii) Calculate the capital gains tax and the inheritance tax payable in respect of the gift of Hayworth Farm on the assumption that Ava dies on 1 January 2014. State the due dates for the payment of the tax liabilities (on the assumption that they are not paid in instalments), the date on which any beneficial claim(s) need to be submitted and any assumptions made. (11 marks)

(19 marks)

4 Fedora wants to improve the overall financial position of his family and his company, Smoke Ltd. He is considering three possibilities: repaying a loan to the company, employing his wife, Wanda, in the business, and selling a piece of land owned by the company.

The following information has been obtained from a telephone conversation with Fedora and from client files.

Fedora:

– Fedora's only income is his annual salary of £80,000 from Smoke Ltd together with annual taxable benefits of £6,600.
– Fedora is aged 49.

Smoke Ltd:

– Is wholly owned by Fedora.
– Manufactures precision engineering tools.
– Has a year end of 31 March and pays corporation tax at the small companies rate.

Fedora's plans:

– Repay an interest-free loan of £18,400 made to him by Smoke Ltd in February 2004.
– Smoke Ltd to employ Wanda.
– Smoke Ltd to sell part of the land surrounding its factory.

Smoke Ltd to employ Wanda:

– Wanda would carry out duties currently performed by Fedora and would be paid an annual salary of £20,000.
– Wanda's salary would represent an arm's length price for the work that she would perform.
– Fedora's salary would be reduced by £20,000 to reflect the reduction in the level of his duties.
– Wanda's only income is bank interest of £470 per year. She has notified the bank that she is a non-taxpayer.
– Wanda is aged 43.

Smoke Ltd to sell land:

– The land is currently used by Smoke Ltd for parking vehicles.
– The land was purchased together with the factory on 1 April 1992 for £174,000.
– The land would be sold on 1 February 2010 for £22,000.
– The value of the factory together with the remaining unsold land on 1 February 2010 will be £491,000.
– Smoke Ltd will use £19,000 of the sales proceeds to acquire engineering machinery in March 2010.

Required:

(a) Explain, with the aid of supporting calculations, the tax implications for both Fedora and Smoke Ltd of the proposed repayment by Fedora of the loan from Smoke Ltd. (4 marks)

(b) Calculate the annual net effect on the total of the tax liabilities of Fedora, Wanda and Smoke Ltd of Smoke Ltd employing Wanda under the arrangements set out above. (7 marks)

(c) Calculate the taxable gain arising on the sale of the land in the year ending 31 March 2010 on the assumption that any beneficial claim available is made. Explain in detail the beneficial claim available, state the amount of the gain relieved and the manner in which any deferred part of the gain will be charged in the future. (8 marks)

Note: The following figures from the Retail Prices Index should be used.

April 1992	138·8
February 2010	214·4 (assumed)

(19 marks)

5 Ellroy started an unincorporated business on 1 October 2009. He requires advice on his choice of accounting date, a possible change of accounting date and the use of the flat rate scheme for the purposes of VAT (value added tax).

The following information has been obtained from telephone conversations with Ellroy.

Ellroy:

– Is 47 years old.
– Is considering either a 31 March or a 30 September year end in 2010 and future years for his new business.
– Receives a share of profits from a partnership of more than £40,000 per year.

The budgeted trading profits of the business:

– It should be assumed that the profits set out below will accrue evenly in each trading period.
– The profits before deduction of capital allowances but after all other tax adjustments have been made are:

	£
Six months ending 31 March 2010	13,100
Year ending 31 March 2011	87,200
Year ending 31 March 2012	74,400

– Ellroy's only capital expenditure will be the purchase of three vans at a total cost of £32,000 in June 2010.

The VAT position of the business:

– The budgeted annual turnover and expenses of the fully established business are:

		£
Turnover (all standard rated)		100,000
Expenses:	standard rated	21,000
	zero rated	3,000
	outside the scope of VAT	5,000

– All the figures exclude VAT.

Required:

(a) (i) Calculate the difference in the total income tax and national insurance that will be payable by Ellroy for the first three tax years of the business depending on whether he adopts a 31 March or 30 September year end; (8 marks)

(ii) Explain the tax implications, including the effect on Ellroy's taxable profits for 2012/13 if, having initially adopted a 31 March year end, he were to change his accounting date and prepare accounts for the six months ending 30 September 2012. You should consider the possibility of both rising and falling levels of profitability. (6 marks)

(b) Explain, by reference to the budgeted annual turnover and expenses of the fully established business and with the aid of supporting calculations, the maximum flat rate percentage that can apply to Ellroy's business such that it would be financially beneficial for him to join the flat rate scheme. (5 marks)

Note: you should ignore the 1% discount for the first 12 months of registration.

(19 marks)

End of Question Paper