Professional Level – Options Module

# Advanced Taxation (United Kingdom)

Monday 6 December 2010

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 2–4**

**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.**

ACCA

**The Association of Chartered Certified Accountants**

## SUPPLEMENTARY INSTRUCTIONS

1. You should assume that the tax rates and allowances for the tax year 2009/10 and for the financial year to 31 March 2010 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 – £37,400 | 20 |
| Higher rate | £37,401 and above | 40 |

A starting rate of 10% applies to savings income where it falls within the first £2,440 of taxable income.

### Personal allowances

| | | £ |
|---|---|---|
| Personal allowance | Standard | 6,475 |
| | 65 – 74 | 9,490 |
| | 75 and over | 9,640 |
| Income limit for age related allowances | | 22,900 |

### 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 | £245,000 |
| Lifetime allowance | £1,750,000 |
| 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** | | |
| First year allowance | | 40 |
| Writing down allowance | – Main pool | 20 |
| | – Special rate pool | 10 |

The first-year allowance of 40% applies to expenditure during the period 6 April 2009 to 5 April 2010 (1 April 2009 to 31 March 2010 for limited companies).

| | |
|---|---|
| **Motor cars** | |
| $CO_2$ emissions up to 110 grams per kilometre | 100 |
| $CO_2$ emissions between 111 and 160 grams per kilometre | 20 |
| $CO_2$ emissions over 160 grams per kilometre | 10 |
| **Annual investment allowance** | |
| First £50,000 of expenditure | 100 |
| **Industrial buildings** | |
| Writing-down allowance | 2 |

## Corporation tax

| Financial year | 2007 | 2008 | 2009 |
|---|---|---|---|
| Small companies rate | 20% | 21% | 21% |
| Full rate | 30% | 28% | 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 | 1/40 | 7/400 | 7/400 |

## Marginal Relief

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

## Extended loss relief

Extended loss relief is capped at a maximum of £50,000. For limited companies it applies to loss making accounting periods ending between 24 November 2008 and 23 November 2010.

## Value added tax (VAT)

| | | |
|---|---|---|
| Standard rate | – from 1 December 2008 to 31 December 2009 | 15% |
| | – all other periods | 17·5% |
| Registration limit | | £68,000 |
| Deregistration limit | | £66,000 |

## Inheritance tax

| | % |
|---|---|
| £1 – £325,000 | Nil |
| Excess | 40 |

## Capital gains tax

| | |
|---|---|
| Rate of tax | 18% |
| Annual exemption | £10,100 |
| Entrepreneurs' relief | |
| Lifetime limit | £1,000,000 |
| Relief factor | 4/9ths |

## National insurance contributions
(not contracted out rates)

| | | | % |
|---|---|---|---|
| Class 1 | Employee | £1 – £5,715 per year | Nil |
| | | £5,716 – £43,875 per year | 11·0 |
| | | £43,876 and above per year | 1·0 |
| Class 1 | Employer | £1 – £5,715 per year | Nil |
| | | £5,716 and above per year | 12·8 |
| Class 1A | | | 12·8 |
| Class 2 | | Small earnings exception limit – £5,075 | |
| | | £2·40 per week | |
| Class 4 | | £1 – £5,715 per year | Nil |
| | | £5,716 – £43,875 per year | 8·0 |
| | | £43,876 and above per year | 1·0 |

## Rates of interest (assumed)

| | |
|---|---|
| Official rate of interest | 4·75% |
| Rate of interest on underpaid tax | 2·5% |
| Rate of interest on overpaid tax | 0% |

## Stamp duty land tax

| | % |
|---|---|
| £150,000 or less (1) | Nil |
| £150,001 – £250,000 | 1 |
| £250,001 – £500,000 | 3 |
| More than £500,000 | 4 |

(1) For residential property the nil rate band was increased to £175,000 until 31 December 2009 after which it was restricted to £125,000.

## Stamp duty

| | |
|---|---|
| Shares | 0·5% |

**Section A – BOTH questions are compulsory and MUST be attempted**

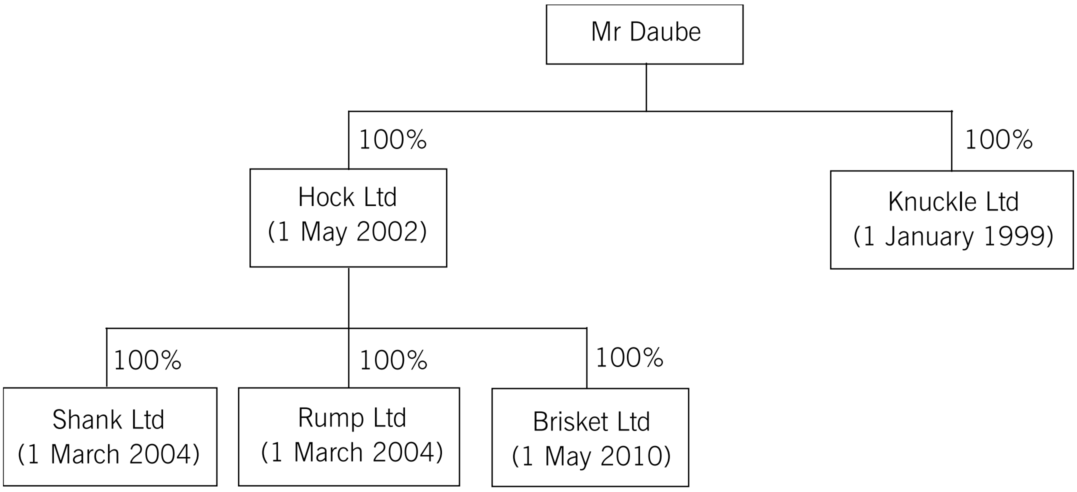
**1** Your manager has had a meeting with Mr Daube, a potential new client. The memorandum recording the matters discussed at the meeting and an extract from an e-mail from your manager detailing the tasks for you to perform are set out below.

**Memorandum recording matters discussed at meeting with Mr Daube**

| | |
|---|---|
| To | The files |
| From | Tax manager |
| Date | 3 December 2010 |
| Subject | Mr Daube – Corporate matters |

I had a meeting with Mr Daube on 2 December 2010. He wants us to advise him on the sale of Shank Ltd, one of his companies, and on the sale of a number of buildings.

Mr Daube owns the Hock Ltd group of companies and Knuckle Ltd as set out below. The dates in brackets are the dates on which the companies were purchased. Neither Mr Daube nor his companies are associated with any other companies. All five companies are UK resident trading companies with a 31 March year end. All of the companies, with the exception of Shank Ltd, are profitable.




**(i) Sale of Shank Ltd**

Shank Ltd has made trading losses for a number of years and, despite surrendering the maximum possible losses to group companies, it has trading losses to carry forward as at 31 March 2010 of £35,000. Shank Ltd is expected to make a further trading loss of £54,000 in the year ending 31 March 2011 and has no other sources of income. Mr Daube is of the opinion that the company will only become profitable following significant financial investment, which the group cannot afford, together with fundamental changes to its commercial operations. Accordingly, Hock Ltd entered into a contract on 1 November 2010 to sell the whole of the ordinary share capital of Shank Ltd to Raymond (an independent third party) on 1 February 2011 for £270,000; an amount that is considerably less than the group paid for it.

**(ii) Sales of buildings**

The following buildings are to be sold during the year ending 31 March 2011. Rollover relief will not be claimed in respect of any of the gains arising.

| | Gar building | Cray building | Monk building | Sword building |
|---|---|---|---|---|
| Owned by: | Shank Ltd | Rump Ltd | Brisket Ltd | Knuckle Ltd |
| Cost: | £210,000 | £240,000 | £380,000 | See below |
| Estimated indexation allowance factors: | 0·350 | 0·250 | 0·070 | 0·480 |
| Date of sale: | 1 January 2011 | 1 February 2011 | 1 March 2011 | 1 February 2011 |
| Purchaser: | Hock Ltd | Quail plc | Hare plc | Pheasant plc |
| Estimated proceeds: | £370,000 | £420,000 | £290,000 | £460,000 |

On 30 June 2000 Knuckle Ltd sold its original premises, the Pilot building, for £270,000 resulting in a chargeable gain of £60,000. On 1 January 2001 it purchased the Sword building for £255,000 and claimed rollover relief in respect of the gain on the Pilot building.

**Tax manager**

**E-mail from your manager**

I have just had a further conversation with Mr Daube. He informed me that:

– Brisket Ltd acquired the Monk building on 1 January 2007.
– Quail plc, Hare plc and Pheasant plc are all unrelated to Mr Daube and his companies.
– None of the companies will make any other chargeable gains or allowable losses in the year ending 31 March 2011.
– Knuckle Ltd has identified a number of potential overseas customers and expects to begin selling its products to them in 2011. At the moment, all of Knuckle Ltd's supplies are standard rated for the purposes of value added tax (VAT).

I want you to draft a report for Mr Daube dealing with the matters set out below.

**(i) Sale of Shank Ltd**

– The alternative ways in which the company's trading losses can be relieved. I want some precise detail here so please try to consider all of the possibilities and any anti-avoidance legislation that may restrict the use of the losses.
– The tax treatment of the loss arising on the sale of Shank Ltd.
– An explanation of the upper and lower limits for all of the companies for the purposes of calculating the rate of corporation tax for the year ending 31 March 2011.

**(ii) Sales of buildings**

On the assumption that all four buildings are sold as planned:

– Calculations of the chargeable gain/allowable loss arising on the sale of each of the buildings.
– The alternative ways in which any capital losses arising can be relieved. I need a detailed explanation of the options available together with any restrictions that will apply. Watch out for the Monk building because the loss will include a pre-entry element.
– The need to charge VAT on the sales of the buildings.
– The stamp duty land tax implications of the sales of the buildings.

**(iii) Potential sales by Knuckle Ltd to overseas customers**

– The VAT implications.

**Tax manager**

**Required:**

**(a) Prepare the report as set out in the e-mail from your manager. The following marks are available.**

**(i) Sale of Shank Ltd;** (12 marks)

**(ii) Sales of buildings;** (16 marks)

**(iii) Potential sales by Knuckle Ltd to overseas customers.** (4 marks)

Professional marks will be awarded in part (a) of question 1 for the appropriateness of the format of the report and the effectiveness with which the information is communicated. (2 marks)

**(b) Prepare a summary of the information required and any action that should be taken before the firm agrees to become tax advisers to Mr Daube and his companies.** (5 marks)

**(39 marks)**

**2** An extract from an e-mail from your manager regarding a meeting with a client, Sushi, together with an e-mail from Sushi are set out below.

**E-mail from your manager**

I have just had a meeting with Sushi who has been a client of the firm since she moved to the UK from the country of Zakuskia in May 1996. Sushi is 57 years old and was born in the country of Zakuskia. Her father died in 2003 and, as you will see from her e-mail, her mother died in October 2010. Her father and mother were both domiciled and resident in the country of Zakuskia throughout their lives. Zakuskian inheritance tax is charged at the rate of 24% on all land and buildings situated within the country that are owned by an individual at the time of death. There is no capital gains tax in the country of Zakuskia. There is no double tax treaty between the UK and the country of Zakuskia.

Until the death of her mother, Sushi's only assets consisted of her house in the UK, a number of investment properties also situated in the UK, and cash in UK bank accounts. Her total UK assets are worth approximately £3 million. Sushi is a higher rate taxpayer and realises taxable capital gains of more than £20,000 each year. She has made significant cash gifts to her son in the past and, therefore, does not require an explanation of the taxation of potentially exempt transfers or the accumulation principle. Sushi is resident and ordinarily resident in the UK.

I want you to write a letter to Sushi addressing the points below:

**(i) UK inheritance tax and the statue**

An explanation of:

- The UK inheritance tax implications of the death of Sushi's mother.
- Which of Sushi's assets will be subject to UK inheritance tax when she dies. This will require some careful and detailed consideration of her domicile position both now and in the future.
- The manner in which UK inheritance tax would be calculated, if due, on any land and buildings situated in the country of Zakuskia that are owned by Sushi when she dies.
- Why the gift of the statue to her son, as referred to in her e-mail, will be a potentially exempt transfer, and how this treatment could be avoided.

The statue has not increased in value since the death of Sushi's mother. Accordingly, the proposed gift of the statue to Sushi's son will not give rise to a capital gain.

**(ii) The Zakuskian income**

The Zakuskian income will be subject to tax in the UK because Sushi is UK resident. Accordingly, we need to think about whether or not Sushi should claim the remittance basis. In order to do this I want you to prepare calculations of the increase in her UK tax liability due to the Zakuskian income on the assumption that the remittance basis **is not** available and then on the assumption that it **is** available. You should assume that Sushi remits £100,000 (gross) to the UK each year in accordance with her plans.

In relation to the taxation of the Zakuskian income, the letter should include explanations of the meaning of the terms 'remittance basis' and 'remittance', and whether or not the remittance basis is available to Sushi, together with your conclusions based on your calculations but no other narrative. You should include brief footnotes to your calculations where necessary to aid understanding of the figures.

There is no need to consider the implication of capital gains on overseas assets as Sushi does not intend to dispose of any of her Zakuskian assets, apart from the statue, for the time being.

Thank you

**Tax manager**

E-mail from Sushi

| |
|---|
| My mother died on 1 October 2010 and left me the whole of her estate. I inherited the following assets.<br><br>The family home in the country of Zakuskia<br>Investment properties in the country of Zakuskia<br>Cash in Zakuskian bank accounts<br>Paintings and other works of art in the country of Zakuskia<br><br>The works of art include a statue that has been owned by my family for many years. I intend to bring the statue to the UK in December 2010 and give it to my son on his birthday on 1 July 2011. The statue was valued recently at £390,000.<br><br>The assets inherited from my mother will generate gross annual income of approximately £200,000 before tax, all of which is subject to 10% Zakuskian income tax. I intend to bring half of this income into the UK each year. The balance will remain in a bank account in Zakuskia.<br><br>I would like to meet with you to discuss these matters.<br><br>Thank you for your help.<br><br>Sushi |

**Required:**

**Prepare the letter to Sushi requested in the e-mail from your manager. The following marks are available.**

**(i) UK inheritance tax and the statue;** (12 marks)

**(ii) The Zakuskian income.** (12 marks)

Professional marks will be awarded in question 2 for the appropriateness of the format of the letter, the degree to which the calculations are approached in a logical manner, and the effectiveness with which the information is communicated. (3 marks)

**(27 marks)**

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

**3** Trifles Ltd intends to carry out a purchase of its own shares. The shareholders from whom the shares are to be purchased require advice on their tax position. Trifles Ltd also intends to loan a motorcycle to one of the shareholders.

The following information has been obtained from the shareholders in Trifles Ltd.

Trifles Ltd:
– Is an unquoted company specialising in the delivery of small, high value items.
– Was incorporated and began trading on 1 February 2003.
– Has an issued share capital of 10,000 ordinary shares subscribed for at £2 per share.
– Has four unrelated shareholders: Torte, Baklava, Victoria and Melba.
– Intends to purchase some of its own shares from Victoria and Melba.
– Victoria and Melba have been directors of the company since they acquired their shares but will resign immediately after the purchase of their shares.

The purchase by Trifles Ltd of its own shares:
– Will take place on 28 February 2011 for Victoria's shares, and on 31 March 2011 for Melba's shares at an agreed price of £30 per share.
– Will consist of the purchase of all of Victoria's shares and 450 shares from Melba.

Victoria:
– Is resident and ordinarily resident in the UK.
– Is a higher rate taxpayer who will make no other capital disposals in the tax year 2010/11.
– Has a capital loss carried forward as at 5 April 2010 of £4,300.
– Will have no link with Trifles Ltd following the purchase of her shares.
– Inherited her holding of 1,500 ordinary shares on the death of her husband, Brownie, on 1 February 2009.
– Brownie paid £16,500 for the shares on 1 February 2007.
– The probate value of the 1,500 ordinary shares was £16,000 on 1 February 2009.

Melba:
– Is resident and ordinarily resident in the UK.
– Is a higher rate taxpayer.
– Acquired her holding of 1,700 ordinary shares when Trifles Ltd was incorporated.
– Following the purchase of her shares Melba's only link with Trifles Ltd will be her remaining ordinary shareholding and the use of a motorcycle belonging to the company.

The motorcycle:
– Will be purchased by Trifles Ltd for £9,000 on 1 April 2011.
– Will be made available on loan to Melba for the whole of the tax year 2011/12.
– Melba will pay Trifles Ltd £30 per month for the use of the motorcycle.

**Required:**

**(a) Explain whether or not Victoria and/or Melba satisfy the conditions relating to period of ownership and reduction in level of shareholding such that the amount received from Trifles Ltd on the purchase of own shares may be treated as capital.** (6 marks)

**(b) Calculate Victoria's after tax proceeds from the purchase of her shares:**

**– if the amount received is treated as capital; and**
**– if the amount received is treated as income.** (6 marks)

**(c) Explain, with supporting calculations where necessary, the tax implications of the purchase and loan of the motorcycle for both Melba and Trifles Ltd.** (5 marks)

Note: ignore value added tax (VAT).

**(17 marks)**

**4** Sakura requires advice on the receipt of insurance proceeds, the sale of a painting in exchange for a boat and the implications of making an error when preparing his tax return.

The following information has been obtained from a telephone conversation with Sakura.

Sakura:
– Is a higher rate taxpayer who is resident, ordinarily resident and domiciled in the UK.
– Is finalising his tax return for the tax year 2009/10.
– Has not previously made any gifts or disposals for the purposes of capital gains tax or inheritance tax other than those set out below.
– Does not expect to make any gifts or disposals for the purposes of capital gains tax or inheritance tax in the tax years 2010/11 or 2011/12 other than those set out below.
– Has received insurance proceeds of £67,000.
– Intends to sell a painting to his son, Cashel, in exchange for a boat.

The insurance proceeds of £67,000:
– The insurance proceeds were paid to Sakura on 1 June 2010.
– The insurance proceeds relate to the destruction of an antique china figurine on 1 March 2010.
– Sakura paid £28,000 for the figurine on 1 April 2006.
– The figurine had a market value of £80,000 on 1 March 2010.
– Sakura intends to use the money to purchase a modern glass figurine for £59,000.

Exchange of painting for boat:
– Sakura intends to sell a painting with a market value of £48,000 to his son, Cashel.
– The consideration for the sale will be a boat owned by Cashel that has a market value of £25,000.
– The painting and the boat cost £22,000 and £37,000 respectively.

Sakura's tax return:
– Sakura always prepares his tax returns in an honest manner.
– However, he is aware that he could still make an honest mistake.

**Required:**

**(a) – Explain, with supporting calculations where necessary, the capital gains tax and inheritance tax implications for Sakura of the receipt of the insurance proceeds and the sale of the painting in exchange for the boat.**

**– Advise Sakura of the actions he should take in relation to his plans in order to minimise his capital gains tax liability and point out any matter(s) that would need to be resolved with HM Revenue and Customs.**

Note: you should clearly identify the tax years relevant to the disposals and the due date of payment of any minimised capital gains tax liability. (11 marks)

**(b) State, with reasons, whether there will be any capital gains tax and/or inheritance tax implications for Cashel from the disposal of the boat.** (2 marks)

**(c) Explain the manner in which a penalty would be calculated if Sakura were to make an honest mistake when completing his tax return.** (4 marks)

**(17 marks)**

**5** Robusto Ltd, a partially exempt company for the purposes of value added tax (VAT), requires advice on the cost of purchasing services from various suppliers and an explanation of the implications if the relationship between the company and the person providing the services is one of employer and employee.

The following information was obtained during a meeting with the managing director of Robusto Ltd.

Robusto Ltd – Budgeted results for the year ending 31 March 2011:

– Turnover (exclusive of VAT):

| | £ |
|---|---|
| Standard rated | 850,000 |
| Exempt | 330,000 |
| Zero rated | 120,000 |

– The irrecoverable VAT for the year will exceed the *de minimis* limits.
– Robusto Ltd is growing quickly and intends to purchase market analysis services relating to all aspects of its business.

Potential providers of market analysis services:

– There are three potential service providers: Cognac Ltd, Fonseca Inc and Pisco.
– Robusto Ltd will use the provider that results in the lowest cost to the company.
– Alternatively, Robusto Ltd will take on a new employee to carry out the market analysis.

Cognac Ltd:

– Cognac Ltd is a UK resident company wholly owned by Offley, a UK resident individual.
– Offley is the company's only employee.
– Offley would be contractually obliged to perform all of the market analysis services provided by Cognac Ltd.
– Cognac Ltd would charge a fixed fee of £28,500 plus VAT.

Fonseca Inc:

– Fonseca Inc is a company resident in the country of Parejo.
– The country of Parejo is not a member of the European Union.
– Fonseca Inc would charge a fixed fee of £29,000.

Pisco:

– Pisco is a UK resident unincorporated sole trader who is not registered for VAT.
– Pisco would charge a fixed fee of £29,500.

**Required:**

**(a) In respect of the market analysis services:**

- **explain, with the aid of supporting calculations, which service provider would result in the lowest cost to Robusto Ltd; and**
- **calculate the maximum salary that could be paid by Robusto Ltd to an employee such that the total cost would be no more than that of the cheapest service provider.** (9 marks)

**(b) On the assumption that the services are purchased from Pisco, give THREE examples of specific contractual arrangements that would assist HM Revenue and Customs in arguing that the relationship between Robusto Ltd and Pisco is that of employer and employee.** (3 marks)

**(c) On the assumption that HM Revenue and Customs could successfully argue that the relationship between Robusto Ltd and the individual carrying out the market analysis services, Offley or Pisco, is one of employer and employee:**

- **explain the tax implications for Robusto Ltd and Cognac Ltd if the services are purchased from Cognac Ltd; and**
- **explain why Robusto Ltd might prefer to offer the contract to Cognac Ltd rather than to Pisco.**

Note: you are not required to prepare any calculations for part (c) of this question or to describe in detail how any deemed salary payment would be calculated. (5 marks)

**(17 marks)**

**End of Question Paper**