

Professional Level – Options Module

Advanced Taxation (Irish)

Monday 2 June 2008

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 2–6

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 (IRL)

The ACCA logo consists of the letters 'ACCA' in a bold, white, sans-serif font, centered within a solid black rectangular background.

SUPPLEMENTARY INSTRUCTIONS

1. You should assume that the tax rates and allowances shown below, for the Finance Act 2007, will continue to apply for the foreseeable future.
2. Calculations and workings need only be made to the nearest Euro.
3. All time apportionments should be made to the nearest month.
4. All workings should be shown.

TAX RATES AND ALLOWANCES

The following rates, credits, formulae and allowances are based on the Finance Act 2007 and are to be used for all questions in this paper.

Rates of income tax 2007

	Tax €
Single/Widow(er)	
€34,000 at 20%	6,800
Balance at 41%	
Married couple (one income)	
€43,000 at 20%	8,600
Balance at 41%	
Married couple (dual income)	
€68,000 at 20%	13,600
Balance at 41%	
One parent family	
€38,000 at 20%	7,600
Balance at 41%	

Abbreviated list of personal tax credits for the income tax year 2007

	€
Single person's credit	1,760
Married couple's credit	3,520
Widowed person's credit (without dependent children)	2,310
Home carer credit (maximum)	770
Single parent credit	1,760
Dependent relative credit	80
Age credit – single/widowed	275
– married	550
Employee/PAYE credit	1,760

Rates of PRSI/levies 2007

Self-employed

PRSI	
Rate	3%
Note: No PRSI where income is below €3,174 per annum	
Health contribution	
Lower exemption limit (€480 per week)	€24,960
Rate: First €1,925 per week (€100,100 per annum)	2%
Balance	2.5%
Note: No upper limit for PRSI or health contribution	

Rates of PRSI/levies 2007

Employee – Class A1

PRSI

Upper limit €48,800

Rate 4%

The first €127 per week (non-cumulative) is exempt from PRSI

Note: No PRSI on income up to €17,628 per annum (€339 per week)

Health contribution

Lower exemption limit (€480 per week) €24,960

Rate: First €1,925 per week (€100,100 per annum) 2%

Balance 2.5%

Note: No upper limit for health contribution

Rates of PRSI/levies 2007

Employer (for employees – Class A1)

PRSI

Rate: 10.75%

For salaries less than €18,512 (€356 per week) the rate is 8.5% per annum

Note: No upper limit for employer's contribution

Retirement annuities

Age	Percentage of net relevant earnings
	%
Up to 30 years	15
30 years but less than 40 years	20
40 years but less than 50 years	25
50 years but less than 55 years	30
55 years but less than 60 years	35
60 years and over	40

Cap on earnings of €262,382

Corporation tax

Standard rate 12.5%

Higher rate 25%

Manufacturing rate 10%

Capital gains tax

Rate 20%

Annual exemption €1,270

Rural/Urban renewal allowances

Industrial and commercial buildings	Rate
Owner occupier	%
Free depreciation	50
or	
Initial allowance	50
Annual allowance	4
Maximum	100
Lessor	
Initial allowance	50
Annual allowance	4
Maximum	100
Residential property	
Owner occupier	
Construction	5% per annum (10 years)
Refurbishment	10% per annum (10 years)
Lessor (Section 23 relief)	
Construction	100
Conversion	100
Refurbishment	100

Motor cars – limits on capital costs

1 January 2007 onwards

	€
Capital allowances	24,000
Leasing charges	24,000
Running cost	No limit

Motor cars – benefit-in-kind rates

Lower limit miles	Upper limit miles	Percentage of original market value of car %
15,000 or less		30
15,001	20,000	24
20,001	25,000	18
25,001	30,000	12
30,001	upwards	6

Indexation factors for capital gains tax

Year expenditure incurred	Multipliers for disposals in year ending 31 December 2004 <i>et seq</i>
1974-75	7.528
1975-76	6.080
1976-77	5.238
1977-78	4.490
1978-79	4.148
1979-80	3.742
1980-81	3.240
1981-82	2.678
1982-83	2.253
1983-84	2.003
1984-85	1.819
1985-86	1.713
1986-87	1.637
1987-88	1.583
1988-89	1.553
1989-90	1.503
1990-91	1.442
1991-92	1.406
1992-93	1.356
1993-94	1.331
1994-95	1.309
1995-96	1.277
1996-97	1.251
1997-98	1.232
1998-99	1.212
1999-2000	1.193
2000-2001	1.144
2001	1.087
2002	1.049
2003 <i>et seq</i>	1.000

Capital acquisition tax – 2007

Class threshold	€
Class 1: Child or minor child of deceased child (or inheritance taken by parent):	496,824
Class 2: Lineal ancestor (other than inheritance taken by parent) Lineal descendant (other than a child or a minor child of a deceased child) Brother, sister, child of brother or sister	49,682
Class 3: Any other person	24,841
Rate	20%

Rates of stamp duty

Non-residential property

Value	Rate
	%
Up to €10,000	0
€10,001 – €20,000	1
€20,001 – €30,000	2
€30,001 – €40,000	3
€40,001 – €70,000	4
€70,001 – €80,000	5
€80,001 – €100,000	6
€100,001 – €120,000	7
€120,001 – €150,000	8
Over €150,000	9

Residential property

Owner occupiers and investors

Value	%
Up to €127,000	0
€127,001 – €190,500	3
€190,501 – €254,000	4
€254,001 – €317,500	5
€317,501 – €381,000	6
€381,001 – €635,000	7.5
Over €635,000	9

First time buyers who are owner occupiers of new or second hand residential property are exempt.

Note: where applicable VAT should be excluded from the chargeable consideration.

Stocks and marketable securities 1%

Section A – BOTH questions are compulsory and MUST be attempted

- 1 Winifred Williams is a public relations consultant. She has been a partner in HJWPR & Co since 1 May 2000. The firm has three partners: Herman Howard, Jennifer Jones and Winifred Williams. Profits are shared equally between the partners. The recent and projected profits of the partnership are as follows:

	€
Year ended 30 April	
2007	330,000
2008	360,000
2009 (projected)	390,000
2010 (projected)	450,000
2011 (projected)	520,000

The firm operates from an office which is owned by the partners in equal shares. It is used exclusively by the firm. It cost €450,000 when purchased on 1 May 2000. Its current estimated market value is €750,000. This is expected to increase to €900,000 by the time Winifred retires.

Winifred reached the age of 57 on 31 December 2007. She plans to retire at the age of 60 and she now wants to put in place preparations to retire from the partnership no later than 30 April 2011. To this end she has asked you to write to her setting out her options and advising on any action that you would recommend she should take during the course of the next three years.

She has provided you with the following additional information:

- She is Irish domiciled, resident and ordinarily resident.
- She is single and has no dependants.
- She has been making the maximum permissible contributions to a retirement annuity scheme for the past several years. She intends to continue doing so until her retirement. These contributions have been made on the tax return filing date each year and claims have been made to have the relief allowed against the relevant earnings of the previous year.
- The other partners will buy out her share of the firm on her retirement. The price is to be calculated as the sum of:
 - $\frac{1}{3}$ of the market value of the premises; and
 - $3\frac{1}{2}$ times her average annual profit share for the three years ending with her retirement.

Required:

Write a letter to Winifred Williams advising on the actions which she might take in preparation for her retirement. Your letter should deal with the following and include supporting computations as appropriate:

- (a) **Whether she would maximise her tax savings by retiring on her 60th birthday, i.e. on 31 December 2010 or by waiting until 30 April 2011.** (12 marks)
- (b) **How she might ensure that she maximises the tax relief for her contributions to her retirement annuity scheme before she retires.** (7 marks)
- (c) **The capital gains tax issues that arise in connection with the sale of her share of the partnership goodwill and premises.** (10 marks)
- (d) **A recommendation as to the most advantageous date for her retirement, giving reasons.** (2 marks)

Appropriateness of the format and presentation of the letter and the effectiveness with which the information is communicated. (3 marks)

(34 marks)

2 Martin and Geraldine McGovern are an Irish resident married couple. They each own 50% of the share capital in M & G Manufacturing Ltd. They are full-time working directors of the company which is engaged in the manufacture of industrial components. The company pays corporation tax at 12¹/₂% on its profits.

The directors wish to implement a significant capital investment programme over the next 12 months. This will involve the acquisition of a new factory for use by the company. They are in negotiation with a property developer who intends to commence construction, within the next month, of a building which will be suitable for this purpose. The costings are as follows:

	€
Site acquisition	250,000
Construction costs	1,200,000
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	1,450,000
VAT	195,750
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	1,645,750
Stamp duty	130,500
Legal and other costs related to site acquisition	25,000
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	1,801,250
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Fit out	250,000
VAT	33,750
	<hr/>
	283,750
	<hr/>
Total projected outlay	2,085,000

The factory will not be located in a tax designated area.

The McGovern's have sought your advice on how they might best structure the acquisition of the building from a tax perspective. They have provided you with the following additional information:

- The company rents the factory from which it currently operates at an annual rent of €100,000. In the event that they proceed with the investment programme the company will move its entire operation to the new building and the lease of the existing building will be terminated.
- The company has surplus cash on deposit of €650,000 which can be used towards the cost of financing the project.
- The McGovern's have personal liquid cash resources of €450,000. They are also owed €250,000 by M & G Manufacturing Ltd.
- The bank is prepared to advance up to 75% of the site, construction and fit out costs (net of VAT), but excluding stamp duty, legal and other costs. This will be by way of a 15-year commercial mortgage at an interest rate of 6.25% per annum. Monthly repayments, including capital and interest, will amount to €857 per month for each €100,000 borrowed.
- The market rent for the completed factory is anticipated to be €125,000 per annum.
- You may assume that the McGovern's will be subject to income tax, PRSI and levies at 46% on any net rental income and can achieve savings at this rate by setting excess Schedule D Case V capital allowances against other income, subject to the usual restrictions.

Required:

Prepare a report to the Directors of M&G Manufacturing Ltd in which you:

(a) Address the financing and taxation implications of the proposed investment programme if:

(i) The McGoverns acquire the new factory in a personal capacity and lease it to M&G Manufacturing Ltd;
(13 marks)

(ii) M&G Manufacturing Ltd acquires the new factory. (7 marks)

(b) Recommend the most appropriate structure to be adopted. (10 marks)

Your report should consider the relevant income tax, corporation tax and VAT issues and include appropriate computations to illustrate your findings. You may confine your workings to the first year of operation of the new factory.

Appropriateness of the format and presentation of the report and the effectiveness with which the information is communicated. (2 marks)

(32 marks)

Section B – TWO questions ONLY to be attempted

3 Omega Ltd is an Irish resident and incorporated company which operates a retail convenience store. The share capital comprises 1,000 ordinary shares of €1 each, all of which are beneficially owned by John Smith.

The following information has been extracted from the accounts of the company for the year ended 31 December 2007.

	Notes	€
Turnover		2,540,000
Cost of sales		<u>(1,650,000)</u>
Gross profit		890,000
Overheads	(1)	<u>(550,000)</u>
Operating profit		340,000
Other income	(2)	<u>229,750</u>
Net profit before taxation		<u>569,750</u>

Notes:

(1) Overheads include:

Director's salary	(a)	83,550
Rent	(b)	67,500
Depreciation		25,000

(a) The director's salary was paid to John Smith.

(b) The rent is in respect of a shop premises which is owned jointly by John Smith and his wife, Mary. The premises are newly constructed and are situated in an urban renewal tax designated area. The property was jointly acquired by John and Mary Smith in February 2007 at a cost of €650,000. The company occupied the property in April 2007 under a 21-year lease which was granted to it by the Smiths at a rent of €90,000 per annum. The amount of qualifying expenditure for capital allowances purposes has been certified at €552,500.

(2) Other income comprises:

	€
Bank interest – gross	54,648
Irish dividend income	49,340
Profit on the disposal of shop premises	<u>125,762</u>
	<u>229,750</u>

Following the move to new premises in April 2007 the company disposed of the shop premises from which it had previously operated. The profit on disposal was calculated as follows:

	€	€
Proceeds		1,250,000
Legal and other costs		<u>(56,250)</u>
		1,193,750
Purchase price: 2003	750,000	
Legal costs, stamp duty etc	86,250	
Refurbishment: 2004	<u>231,738</u>	<u>(1,067,988)</u>
		<u>125,762</u>

The following information is available about the personal circumstances of John and Mary Smith.

(1) John Smith has no other income apart from that derived from Omega Ltd.

(2) Mary Smith is an engineer. She works part-time as a self-employed consultant. Her earnings for the year 2007 were €25,000.

(3) The acquisition of the new shop premises was funded by a mortgage. The interest incurred in the period April to December 2007 amounted to €32,500.

Required:

(a) **Compute the corporation tax and close company surcharge payable by Omega Ltd for the year ended 31 December 2007.** (7 marks)

(b) **Compute the income tax, PRSI and levies payable by John and Mary Smith for the year of assessment 2007.** (6 marks)

(c) **In light of the results of the computations at (a) and (b) identify two methods by which the overall tax borne by Omega Ltd and the Smiths might be reduced.** (4 marks)

(17 marks)

4 TEC Services Ltd is an Irish incorporated and resident company which is engaged in the provision of architectural and planning services. The share capital of the company, which was issued, on formation of the company at its nominal value of €1, is owned as follows:

	Number of €1 ordinary shares
Emmet Galvin	750
Joseph Conway	250
	<hr/>
	1,000
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Both shareholders are also full-time working directors of the company. They are both aged 45 and were founder shareholders when the company was formed in January 2002.

While the company has been relatively successful in its first six years of operation, the directors are of the view that the continued success of the business can be best assured if the general manager, Eamon Hynes, becomes a shareholder and director. They, therefore, wish to offer Eamon Hynes a directorship and the opportunity to subscribe for 10% of the ordinary share capital in the company.

The company is currently valued at €330,000 and a minority stake of 10% is estimated to have a value of €26,000. Eamon Hynes will have to borrow the subscription monies and he can afford to pay only €20,000. The directors are prepared to acquiesce in the issue of the shares for this price.

They have sought your advice on the taxation issues which arise from this proposal. All of the individuals concerned pay tax at the higher rate.

Required:

(a) **In the event that the company were to issue shares to the value of €26,000 to Eamon Hynes in return for a subscription of €20,000, set out the taxation implications for:**

(i) **Eamon Hynes;** (4 marks)

(ii) **Emmett Galvin; and** (5 marks)

(iii) **Joseph Conway.** (1 mark)

(b) **Explain how the company might assist Eamon Hynes in funding his subscription for the shares at their full market value and identify the tax implications arising therefrom.** (7 marks)

Note: you should include computations of all the tax liabilities identified in both parts of the question.

(17 marks)

5 Alfred Larkin is aged 59. He has lived in Ireland since September 2004 when he started working for the Dublin branch of the National Bank of Oceanica. Alfred was born in the country of Oceanica, where he is domiciled, and he plans to return there when he retires in June 2014.

The following information relates to Alfred's income for the year ended 31 December 2007:

1. He was paid a salary of €75,000 by the Dublin branch of the National Bank of Oceanica, from which PAYE of €15,000 was deducted.
2. He is provided with a company car which cost €58,000 in 2005. During 2007 he drove 19,000 miles of which 20% were for business purposes. All the running costs of the car, including petrol, are paid for by the bank.
3. The bank pays €1,500 per annum for his membership of a golf club which is used to meet customers of the bank.
4. He has an interest free loan of €190,000 from the bank, which was used to purchase his private residence in Dublin. This cost €415,000 in October 2004 and is currently worth €675,000.

The following additional information is available in respect of the year ended 31 December 2007:

- (1) Alfred owns a house and land situated in Oceanica which is rented out for €20,000 per annum. Income tax at the rate of 30% is payable on this rental income in Oceanica. Alfred remits all this income to Ireland each year.
- (2) In October 2007 he sold a plot of land attached to the house in Oceanica for €90,000. All of the proceeds from the disposal were remitted to Ireland. The house and land were purchased in March 1993 for €50,000. The house has never been Alfred's principal private residence and the house and remaining land were worth €420,000 after the sale.
- (3) Alfred owns 100,000 ordinary shares of €1 each in Alpha Inc, a public company quoted on the New York Stock Exchange. Alpha Inc paid a dividend of 8 cents per share during 2007. Alfred deposited this dividend in his account at the head office of the National Bank of Oceanica. Alfred had inherited the shares on the death of an uncle in September 2001 when they were worth €45,000. The holding is now worth €100,000.
- (4) Alfred owns 20,000 ordinary shares of €1 each in Delta Ltd, an unquoted Irish resident trading company with an issued share capital of 250,000 shares. Alfred has sat on the board of Delta Ltd as a non-executive director since June 2005. This post is unpaid, and Delta Ltd has not paid a dividend in recent years. Alfred's shareholding is worth €65,000. He acquired his shares by way of subscription at par in December 2004.
- (5) Alfred has bank deposits of €65,000 with the National Bank of Oceanica, of which €45,000 is held at the Dublin branch, and €20,000 at the head office in Oceanica. Interest has been credited to these accounts during 2007 as follows:

	€
Dublin branch	1,350
Head office	425

The above figures are both stated net of tax which, in the case of the head office account, is at the rate of 15%. All of the interest arising on the deposit at the head office has been remitted to Ireland.

- (6) In December 2007 Alfred sold a set of paintings for €8,000. The paintings, which had been kept at his residence in Oceanica, were purchased in March 1996 for €2,800. Alfred deposited the proceeds from the disposal in his bank account in Oceanica.

Under the Oceanicaese tax system, capital gains are not subject to taxation. There is no double taxation treaty between Ireland and Oceanica.

Alfred has been a widower for over 10 years, and intends to leave all of his assets to his children under the terms of his Will. He has three adult children, all of whom are resident in Oceanica.

Required:

(a) Calculate Alfred's Irish income tax and capital gains tax liabilities for the year of assessment 2007. (10 marks)

(b) Advise Alfred on the liability his children would have to Irish inheritance tax were he to die before returning to Oceanica in June 2014, clearly distinguishing between the assets which may or may not be subject to inheritance tax.

Note: you are not required to prepare computations for this part. (7 marks)

(17 marks)

End of Question Paper