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# Answers

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1 Joe

Notes for meeting

For The files  
Client VNL Ltd – liquidation  
Joe – establishment of new business  
Prepared by Tax senior  
Date 1 June 2021

(a) Liquidation of VNL Ltd

(i) Sale of intangible fixed assets

	Goodwill £	Brand £	£
Sale proceeds on 31 July 2021	75,000	47,000	122,000
Cost	(95,000)		
Tax written down value (£36,000 – £5,760)		(30,240)	
(Loss)/profit	<u>(20,000)</u>	<u>16,760</u>	
Corporation tax at 19% on profit			(3,184)
Loss relieved against total profits at 19%			<u>3,800</u>
Post tax proceeds			<u>122,616</u>

**Tutorial note:** *The loss on the sale of the goodwill is a non-trading debit. This loss can be offset against the total income and gains of the current accounting period.*

(ii) Timing of payments to shareholders

**Prior to the appointment of the liquidator**

A payment made to the shareholders prior to the appointment of the liquidator will be subject to income tax as a dividend in the normal way.

The first £2,000 of an individual's dividend income in a tax year from all shareholdings is taxed at 0%. The excess over £2,000 will be taxed as a shareholder's top slice of income.

Any amount which falls into a shareholder's basic rate band will be subject to income tax at 7.5%. The balance of the dividend will be subject to income tax at 32.5%.

**After the appointment of the liquidator**

Once the liquidator has been appointed, amounts paid to shareholders will represent proceeds in respect of a part disposal of their shares for the purposes of capital gains tax (CGT).

Any amount of the chargeable gain which is not covered by the shareholder's annual exempt amount of £12,300 will be subject to CGT.

Where the disposal of the shares qualifies for business asset disposal relief, the whole of any chargeable gain (within the lifetime limit of £1,000,000) will be subject to CGT at 10% irrespective of whether the shareholders are basic rate or higher rate taxpayers.

As VNL Ltd is a trading company, business asset disposal relief will be available where:

- the shareholder had owned at least 5% of the company's ordinary share capital and been an officer or employee of the company for a period of at least two years prior to the cessation of VNL Ltd's trade, and
- the shares are disposed of within three years of the cessation of VNL Ltd's trade.

Where business asset disposal relief is not available, the chargeable gain will be taxed after calculating tax on income, by reference to the income tax bands.

Any amount of the chargeable gain which falls into a shareholder's basic rate band will be subject to CGT at 10%. The balance of the chargeable gain will be subject to CGT at 20%.

**(b) Unincorporated business**

**(i) Accounting date**

**Taxable trading profits in the first two tax years**

	<b>March</b>	<b>July (W)</b>
	<b>£</b>	<b>£</b>
Tax year: 2021/22	24,500	30,278
2022/23	97,000	79,750
<b>Total</b>	<u>121,500</u>	<u>110,028</u>

- Joe's total taxable trading profits for the first two tax years would be lower if he were to adopt a 31 July accounting date.
- A 31 July accounting date results in a higher amount of taxable trading profits in the tax year 2021/22 and a lower amount in the tax year 2022/23.
  - As a result, Joe's income tax liability for the tax year 2021/22 would be higher than it would be with a 31 March accounting date.
  - However, depending on his other sources of income, Joe may be able to use more of his basic rate band in 2021/22 whilst having a lower amount subject to income tax at 40% in the following tax year.

**Tutorial note:** Credit was also awarded for relevant comments regarding the impact of the change of accounting date on overlap profits.

**Advantages of adopting a 31 July accounting date**

- After the first tax year, there will be a greater time period between earning profits and paying the tax due in respect of them.
- There will be a greater time period between knowing the amount of taxable profits and the end of the tax year. This time period can be used to plan Joe's affairs, for example, in respect of pensions.

**Working**

	<b>£</b>
<b>Trading profit</b>	
Period ending 31 July 2022	
1 November 2021 to 31 December 2021 (£4,000 x 2)	8,000
1 January 2022 to 31 March 2022 (£5,500 x 3)	16,500
1 April 2022 to 31 July 2022 (£7,500 x 4)	30,000
	<u>54,500</u>
Year ending 31 July 2023	
1 August 2022 to 31 August 2022	7,500
1 September 2022 to 31 July 2023 (£8,500 x 11)	93,500
	<u>101,000</u>
<b>Taxable trading profit</b>	
2021/22 – 1 November 2021 to 5 April 2022 (£54,500 x 5/9)	30,278
2022/23 – 1 November 2021 to 31 October 2022 (£54,500 + (£101,000 x 3/12))	79,750
	<u>110,028</u>

**(ii) Costs already incurred and the business premises**

**Tax deduction when calculating taxable trading profit**

**– Consultancy services**

The cost of the consultancy services will be treated as an allowable expense incurred on 1 November 2021, i.e. the day Joe begins trading. This is because the expenditure will have been incurred in the seven years prior to the commencement of trade and would be allowable if it had been incurred after trading commenced.

**– Computer equipment**

Capital allowances in the form of the 100% annual investment allowance will be available in respect of the cost of the computer equipment as it was purchased for the purposes of carrying on Joe's new trade.

This will result in a tax deduction equal to the whole of the cost when calculating the trading profit for Joe's first trading period.

- **Premises**

That part of the cost of the premises which relates to integral features or plant and machinery will qualify for plant and machinery capital allowances.

The balance of the cost of the premises will not qualify for any allowances. In particular, it will not qualify for structures and buildings allowance because the building was constructed prior to 29 October 2018.

**Recovery of input tax for the purposes of value added tax (VAT)**

- **Consultancy services**

Joe will be able to recover input VAT in respect of services provided to him for business purposes in the six months prior to registering for VAT.

Accordingly, because Joe first incurred these costs more than six months ago, he should consider registering for VAT as soon as possible in order to recover as much of the input tax relating to the consultancy services as he can.

- **Computer equipment**

Joe will be able to recover the input tax in respect of the computer equipment provided he registers for VAT by 30 April 2025 (i.e. within four years of purchasing the equipment). This is on the assumption that he still owns the equipment when he registers.

- **Premises**

The amount of input tax which Joe can recover will depend on whether or not he opts to tax the building for the purposes of VAT.

- If he opts to tax the building, he will be able to recover all of the input tax.
- Otherwise, he will only be able to recover two-thirds of it.

This is because the granting of the lease will be an exempt supply unless an option to tax is made in respect of the building.

The building will not be subject to the capital goods scheme because its VAT exclusive cost will be less than £250,000.

## 2 Fiona

### (a) Becoming Fiona's tax advisers

The actions we should carry out before we become Fiona's tax advisers:

- We must give consideration to the fundamental principles of professional ethics, for example, integrity and professional competence and due care. This requires us to consider whether becoming tax advisers to Fiona would create any threats to compliance with these principles.

If any such threats are identified, we should not accept the appointment unless the threats can be reduced to an acceptable level via the implementation of safeguards.

Fiona's move to the UK will significantly affect her tax affairs, and we must be sure that we are able to deal with the technical aspects of these matters.

- We must assure ourselves that Fiona is not involved in any form of money laundering.
- We should obtain permission from Fiona to contact her existing tax advisers in order to ensure that there is nothing in the past which would preclude us from accepting the appointment on ethical grounds.
- We should issue a letter of engagement setting out the terms of our agreement with Fiona and our agreed responsibilities.

**(b) Gifts to Elena and Hugo**

**(i) Inheritance tax (IHT) payable in respect of Fiona's gift on 1 May 2020**

	£	£
Gift to Elena on 1 May 2020		430,000
Less: Annual exemption 2020/21		<u>(3,000)</u>
		427,000
Nil rate band	325,000	
Less: Chargeable transfers in the previous seven years		
1 July 2015 chargeable lifetime transfer (CLT)	(74,000)	
1 September 2019 potentially exempt transfer (PET)	<u>(204,000)</u>	
		(47,000)
Amount chargeable to IHT		<u>380,000</u>
IHT (£380,000 x 40%)		<u>152,000</u>

**Tutorial note:** *The gift was of a UK asset, such that it was subject to UK IHT even though Fiona was domiciled in Parella at the time it was made. This calculation assumes a date of death of 30 April 2023, as required in the email from the manager. This would be within three years of the gift on 1 May 2020, such that no taper relief would be available.*

**(ii) Proposed gift to Hugo**

**Capital gains tax (CGT)**

**Aber House**

- Aber House is situated in Parella. Accordingly, tax relief will not be available in the UK in respect of the capital loss resulting from a gift of this house unless it is made after Fiona becomes UK resident.

However, because Fiona and Hugo are connected persons, the loss would only be available for relief against gains on future disposals to Hugo.

**Bleb House**

- On a gift of Bleb House, a gain of £85,000 would be subject to UK CGT regardless of whether or not Fiona is resident in the UK at the time of the gift.
- This is because, since 6 April 2015, residential properties situated in the UK have been subject to CGT regardless of the resident status of the person making the disposal.

**IHT**

**Aber House**

- Aber House is situated in Parella. Accordingly, a gift of this house will not be subject to IHT unless Fiona is domiciled or deemed domiciled in the UK for IHT purposes.
- It has already been determined that once Fiona is UK resident, she will be deemed domiciled in the UK for the purposes of income tax and CGT. However, she will not be deemed domiciled for the purposes of IHT because she was not resident for either of the two tax years prior to 2021/22.
- Accordingly, Aber House would be excluded property for the purposes of IHT regardless of when in the next three months the gift is made.

**Bleb House**

- Bleb House is situated in the UK. Accordingly, a gift of this house will be within the charge to UK IHT regardless of Fiona's domicile status.

**Conclusion**

- Fiona should give Aber House to Hugo after she has moved to the UK.  
This would create the possibility of obtaining relief for the capital loss and would not have any IHT implications.

**(c) Taxation of overseas income**

**Availability of the remittance basis**

- The remittance basis is available where an individual is UK resident but not UK domiciled.
- Where an individual is UK resident and deemed domiciled in the UK, the remittance basis is only available if unremitted overseas income and gains in a tax year is less than £2,000.

In these circumstances, the remittance basis applies automatically.

- Accordingly, for the tax year 2022/23, the amount of Fiona's taxable overseas income will be automatically calculated on the remittance basis. This is because her only unremitted overseas income will be her Parellian bank interest of £1,200.

- Fiona will not be subject to the remittance basis charge because she will qualify for the remittance basis automatically.

#### Fiona – income tax liability for the tax year 2022/23

	£	Working £
Property income:		
Properties in the UK	26,000	26,000
Properties in Parella	31,000	N/A
Interest income:		
UK bank interest	1,700	1,700
Parellian bank interest (unremitted)	–	–
Total income	58,700	27,700
Less: Personal allowance	(12,500)	(12,500)
Taxable income	<u>46,200</u>	<u>15,200</u>
Property income		
£37,500/£13,500 x 20%	7,500	2,700
£7,000 x 40%	2,800	–
Interest income		
£500/£1,000 x 0%	0	0
£1,200 x 40%/£700 x 20%	480	140
	<u>10,780</u>	<u>2,840</u>
Double tax relief, the lower of:		
UK tax on overseas income		
£10,780 – £2,840 (W) = £7,940		
Parellian tax suffered		
£31,000 x 18% = £5,580	<u>(5,580)</u>	
Income tax liability	<u>5,200</u>	

**Tutorial note:** *The personal allowance will be given because the remittance basis is available automatically.*

### 3 Samphire Ltd and Kelp Ltd

#### (a) (i) Alternative 1: Gift of a computer to Nori

The transfer of the computer to Nori will not result in a balancing charge on the main pool, as the proceeds will be £nil.

The transfer of the computer will also be a disposal of a chattel by Samphire Ltd, but this will be an exempt disposal as both cost and deemed proceeds are less than £6,000.

As Nori is a director of Samphire Ltd, the gift of the computer will give rise to a taxable benefit of £1,500, i.e. the market value of the computer at the date of the gift. Accordingly, there will be a Class 1A national insurance contributions (NIC) liability for Samphire Ltd of £207 (£1,500 x 13.8%). Corporation tax relief of £39 (£207 x 19%) will be available in respect of this.

Therefore the total additional taxes payable in respect of this alternative for Samphire Ltd are £168 (£207 – £39).

#### (ii) Alternative 2: Make a loan to Nori

Samphire Ltd is a close company. Accordingly, on making a loan to Nori, a participator, it must make a payment of notional tax of £488 (£1,500 x 32.5%) to HM Revenue and Customs (HMRC). This payment will be due by 1 January 2024. Following the write off of the loan (on 6 April 2024), HMRC will repay all the notional tax to Samphire Ltd (by 1 January 2026).

Writing off the loan is treated as a distribution, so there will be no corporation tax implications for Samphire Ltd.

Although the loan is interest-free, it will not give rise to a taxable benefit for Nori. This is because the total amount of the loan will not exceed £10,000 at any time. Accordingly, Samphire Ltd will not have any liability to Class 1A NIC.

However, a liability to Class 1 NIC will arise on writing off the loan on 6 April 2024, as Nori is also an employee of the company. Accordingly, Samphire Ltd will have a Class 1 NIC liability of £207 (£1,500 x 13.8%) and corporation tax relief in respect of this of £39 (£207 x 19%).

Therefore the total additional taxes payable in respect of this alternative for Samphire Ltd is also £168 (£207 – £39).

**(b) (i) Gain on the sale of the lease**

	£
Proceeds	206,000
Less: Cost (£165,000 x 96·593/99·289)	(160,520)
Unindexed gain	45,480
Less: Indexation allowance: (0·070 x £160,520)	(11,236)
Chargeable gain	34,244

**(ii) Gain remaining chargeable after claiming the maximum amount of rollover relief.**

Kelp Ltd owned the lease on Factory 1 for six years from 1 November 2015 to 1 November 2021. However, it did not occupy the building for trading purposes during the last six months of ownership from 1 May 2021 to 1 November 2021. Accordingly, only £31,390 (£34,244 x 5·5/6) of the gain is eligible for rollover relief.

In order to relieve the whole of this eligible gain, Kelp Ltd must reinvest £188,833 (£206,000 x 5·5/6) in qualifying business assets within the four-year period commencing one year before the disposal of Factory 1.

The factory acquired from Samphire Ltd (Factory 2) is a qualifying business asset, acquired within the year prior to the disposal of Factory 1. Kelp Ltd and Samphire Ltd are not in a gains group, as they are owned by an individual, not a company. Accordingly, the price paid by Kelp Ltd of £138,000 is its relevant acquisition cost. As Kelp Ltd will use Factory 2 wholly for trading purposes, the full amount of £138,000 is the qualifying cost for rollover relief purposes.

The warehouse to be acquired by Kelp Ltd is also a qualifying business asset, and it will be acquired within the three years following the disposal of Factory 1. However, as only 70% of the warehouse will be used by Kelp Ltd in its trade, only £54,600 (£78,000 x 70%) of its cost will be a qualifying acquisition for rollover relief purposes.

Accordingly, £192,600 (£138,000 + £54,600) has been reinvested in qualifying business assets. As this exceeds £188,833, the whole of the eligible gain of £31,390 can be deferred, leaving an immediately chargeable gain of £2,854 (£34,244 – £31,390).

**4 Yacon Ltd and Daikon**

**(a) Company share option plan (CSOP)**

**Ability to select employees**

In a CSOP, Yacon Ltd would be free to select employees as it wishes to participate in the scheme.

**Value of options granted**

Yacon Ltd can choose to award options to purchase a different number of shares to each member of a CSOP. There is no annual maximum amount, but an employee can only be granted options over shares up to a total value of £30,000, as at the date of the grant.

**Holding period required and tax implications for employees**

There are no tax implications for employees on the grant of the options, or on their exercise after five years as the exercise will be between three and ten years of being granted.

**Share incentive plan (SIP)**

**Ability to select employees**

Under the rules for a SIP, all employees must be offered the opportunity to participate in the plan. Yacon Ltd can specify a minimum period of employment in order to qualify, but this cannot exceed 18 months.

**Value of free shares given**

Yacon Ltd can give each employee free shares up to the value of £3,600 each tax year, such that the proposal to offer shares with a value of up to £3,000 to each employee each year will be acceptable. The free shares must be offered on similar terms to all employees, such that different amounts of shares can be offered to different employees, depending on their meeting certain objective criteria, such as length of service or performance targets.

**Holding period required and tax implications for employees**

There are no tax implications for employees when the free shares are put into the plan.

As the free shares will be held in the plan for five years, there will be no income tax liability when they are withdrawn from the plan.

**(b) Daikon – reliefs available on the sale of his house**

**Private residence relief (PRR):**

	Exempt years	Chargeable years
1 July 2013 to 31 December 2013 Absent – no prior occupation		0.5
1 January 2014 to 30 June 2015    Occupied	1.5	
1 July 2015 to 31 December 2016 Absent but deemed occupation as employed overseas	1.5	
1 January 2017 to 31 March 2017    Occupied	0.25	
1 April 2017 to 31 March 2021    Occupied (4 years x 75%)	3	1
1 April 2021 to 31 December 2021 Last 9 months treated as 100% occupation	0.75	
	<u>7</u>	<u>1.5</u>

PRR is £119,412 (£145,000 x 7/8.5).

**Letting relief**

The additional amount of the gain which will be exempt under letting relief is the lowest of:

- (1) The amount of the gain which is exempt under the PRR exemption (£119,412).
- (2) The gain attributable to the letting £17,059 (£145,000 x 1/8.5).
- (3) £40,000.

Letting relief is therefore £17,059.

**(c) Inheritance tax implications of Jicama's gift of the apartment**

The gift of the apartment on 5 June 2019 was a potentially exempt transfer (PET), valued at the market value of the apartment on that date. The gift was also a gift with reservation of benefit, due to the condition imposed by Jicama that she would continue to live there.

However, the reservation of benefit was lifted on 12 March 2021, when Jicama went to live with her sister. This created a further PET, which would be valued at the market value of the apartment on that date.

If Jicama dies in December 2024, this is within seven years of the date of the original gift, so both the original PET and the later deemed PET become chargeable. Taper relief would be available to reduce the liability to inheritance tax in both cases. To avoid a double tax charge, only the PET which results in a higher tax charge overall will actually be chargeable.

		<i>Available</i>	<i>Maximum</i>
<b>1</b>	<b>Joe</b>		
<b>(a)</b>	<b>(i)</b> Loss on sale of goodwill	1	
	Profit on sale of brand	1	
	Post tax proceeds	2	
		<u>4</u>	4
	<b>(ii)</b> Prior to appointment	4	
	After appointment	6	
		<u>10</u>	7
<b>(b)</b>	<b>(i)</b> Taxable profits		
	Trading profit	3	
	Taxable trading profit	3	
	Comments	2	
	Advantages	2	
		<u>10</u>	8
	<b>(ii)</b> Income tax		
	Consultancy services	1.5	
	Computer equipment and premises	4	
	Value added tax		
	Consultancy services	2	
	Computer equipment	2.5	
	Premises	4	
		<u>14</u>	12
	Problem solving	1	
	Clarity of explanations and calculations	1	
	Effectiveness of communication	1	
	Overall presentation and style	1	
		<u>4</u>	4
	<b>Total</b>		<u><b>35</b></u>

	<i>Available</i>	<i>Maximum</i>
<b>2 Fiona</b>		
<b>(a)</b> Fundamental principles	3	
Other matters	3	
	<u>6</u>	5
<b>(b) (i)</b> Calculation of inheritance tax	<u>3</u>	3
<b>(ii)</b> Capital gains tax		
Aber House	2	
Bleb House	1.5	
Inheritance tax		
Aber House	3	
Bleb House	1	
Conclusion	2	
	<u>9.5</u>	7
<b>(c)</b> Remittance basis	4	
Calculation of income tax liability		
Liability before double tax relief	3.5	
Double tax relief	3.5	
	<u>11</u>	10
<b>Total</b>		<u>25</u>
<b>3 Samphire Ltd and Kelp Ltd</b>		
<b>(a) (i)</b> Tax implications of transfer	1.5	
Class 1A national insurance contributions (NIC)	2	
Tax cost	1	
	<u>4.5</u>	4
<b>(ii)</b> Loan to participator	4.5	
NIC implications	3	
Tax cost	1	
	<u>8.5</u>	6
<b>(b) (i)</b> Calculation of chargeable gain	<u>3</u>	3
<b>(ii)</b> Gain eligible for rollover relief	1.5	
Reinvestment required	2	
Qualifying expenditure – factory 2	2	
– warehouse	1.5	
Conclusion	1	
	<u>8</u>	7
<b>Total</b>		<u>20</u>

	<i>Available</i>	<i>Maximum</i>
<b>4</b> Yacon Ltd and Daikon		
(a) Company share option plan	4	
Share incentive plan	5	
	<u>9</u>	8
(b) Private residence relief	5.5	
Letting relief	2.5	
	<u>8</u>	7
(c) Original gift 5 June 2019	2	
Reservation lifted	2	
Death in December 2024	3	
	<u>7</u>	5
<b>Total</b>		<u><b>20</b></u>