

Strategic Professional – Options

Advanced Taxation – United Kingdom

Tuesday 4 September 2018



Time allowed: 3 hours 15 minutes

This question paper is divided into two sections:

Section A – BOTH questions are compulsory and MUST be attempted

Section B – BOTH questions are compulsory and MUST be attempted

Tax rates and allowances are on pages 2–6

Do NOT open this question paper until instructed by the supervisor.

This question paper must not be removed from the examination hall.

Think Ahead

ACCA

The Association of
Chartered Certified
Accountants

Paper ATX – UK

SUPPLEMENTARY INSTRUCTIONS

1. You should assume that the tax rates and allowances for the tax year 2017/18 and for the financial year to 31 March 2018 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		Normal rates	Dividend rates
Basic rate	£1 – £33,500	20%	7.5%
Higher rate	£33,501 to £150,000	40%	32.5%
Additional rate	£150,001 and over	45%	38.1%
Savings income nil rate band – Basic rate taxpayers			£1,000
– Higher rate taxpayers			£500
Dividend nil rate band			£5,000

A starting rate of 0% applies to savings income where it falls within the first £5,000 of taxable income.

Personal allowance

Personal allowance	£11,500
Transferable amount	£1,150
Income limit	£100,000

Residence status

Days in UK	Previously resident	Not previously resident
Less than 16	Automatically not resident	Automatically not resident
16 to 45	Resident if 4 UK ties (or more)	Automatically not resident
46 to 90	Resident if 3 UK ties (or more)	Resident if 4 UK ties
91 to 120	Resident if 2 UK ties (or more)	Resident if 3 UK ties (or more)
121 to 182	Resident if 1 UK tie (or more)	Resident if 2 UK ties (or more)
183 or more	Automatically resident	Automatically resident

Remittance basis charge

UK resident for	
Seven out of the last nine years	£30,000
12 out of the last 14 years	£60,000
17 out of the last 20 years	£90,000

Child benefit income tax charge

Where income is between £50,000 and £60,000, the charge is 1% of the amount of child benefit received for every £100 of income over £50,000.

Car benefit percentage

The relevant base level of CO₂ emissions is 95 grams per kilometre.

The percentage rates applying to petrol cars with CO₂ emissions up to this level are:

50 grams per kilometre or less	9%
51 grams to 75 grams per kilometre	13%
76 grams to 94 grams per kilometre	17%
95 grams per kilometre	18%

Car fuel benefit

The base figure for calculating the car fuel benefit is £22,600.

Individual savings accounts (ISAs)

The overall investment limit is £20,000.

Property income

Basic rate restriction applies to 25% of finance costs.

Pension scheme limits

Annual allowance	£40,000
Minimum allowance	£10,000
Threshold income limit	£110,000
Income limit	£150,000
Lifetime allowance	£1,000,000

The maximum contribution that can qualify for tax relief without any earnings is £3,600.

Authorised mileage allowances: cars

Up to 10,000 miles	45p
Over 10,000 miles	25p

Capital allowances: rates of allowance

Plant and machinery	
Main pool	18%
Special rate pool	8%

Motor cars

New cars with CO ₂ emissions up to 75 grams per kilometre	100%
CO ₂ emissions between 76 and 130 grams per kilometre	18%
CO ₂ emissions over 130 grams per kilometre	8%

Annual investment allowance

Rate of allowance	100%
Expenditure limit	£200,000

Cash basis accounting

Revenue limit £150,000

Cap on income tax reliefs

Unless otherwise restricted, reliefs are capped at the higher of £50,000 or 25% of income.

Corporation tax

Rate of tax	– Financial year 2017	19%
	– Financial year 2016	20%
	– Financial year 2015	20%
Profit threshold		£1,500,000

Patent box – deduction from net patent profit

Net patent profit x ((main rate – 10%)/main rate)

Value added tax (VAT)

Standard rate	20%
Registration limit	£85,000
Deregistration limit	£83,000

Inheritance tax: nil rate bands and tax rates

Nil rate band

	£	
6 April 2017 to 5 April 2018	325,000	
6 April 2016 to 5 April 2017	325,000	
6 April 2015 to 5 April 2016	325,000	
6 April 2014 to 5 April 2015	325,000	
6 April 2013 to 5 April 2014	325,000	
6 April 2012 to 5 April 2013	325,000	
6 April 2011 to 5 April 2012	325,000	
6 April 2010 to 5 April 2011	325,000	
6 April 2009 to 5 April 2010	325,000	
6 April 2008 to 5 April 2009	312,000	
6 April 2007 to 5 April 2008	300,000	
6 April 2006 to 5 April 2007	285,000	
6 April 2005 to 5 April 2006	275,000	
6 April 2004 to 5 April 2005	263,000	
6 April 2003 to 5 April 2004	255,000	
Residence nil rate band		£100,000
Rate of tax on excess over nil rate band	– Lifetime rate	20%
	– Death rate	40%

Inheritance tax: taper relief

Years before death	Percentage reduction
More than 3 but less than 4 years	20%
More than 4 but less than 5 years	40%
More than 5 but less than 6 years	60%
More than 6 but less than 7 years	80%

Capital gains tax

	Normal rates	Residential property
Lower rate	10%	18%
Higher rate	20%	28%
Annual exempt amount		£11,300
Entrepreneurs' relief – Lifetime limit		£10,000,000
– Rate of tax		10%

National insurance contributions

Class 1	Employee	£1 – £8,164 per year	Nil
		£8,165 – £45,000 per year	12%
		£45,001 and above per year	2%
Class 1	Employer	£1 – £8,164 per year	Nil
		£8,165 and above per year	13.8%
		Employment allowance	£3,000
Class 1A			13.8%
Class 2		£2.85 per week	
		Small profits threshold	£6,025
Class 4		£1 – £8,164 per year	Nil
		£8,165 – £45,000 per year	9%
		£45,001 and above per year	2%

Rates of interest (assumed)

Official rate of interest	2.5%
Rate of interest on underpaid tax	2.75%
Rate of interest on overpaid tax	0.5%

Stamp duty land tax

Non-residential properties

Up to £150,000	0%
£150,001 – £250,000	2%
£250,001 and above	5%

Residential properties (note)

Up to £125,000	0%
£125,001 – £250,000	2%
£250,001 – £925,000	5%
£925,001 – £1,500,000	10%
£1,500,001 and above	12%

Note: These rates are increased by 3% in certain circumstances including the purchase of second homes and buy-to-let properties.

Stamp duty

Shares	0.5%
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Section A – BOTH questions are compulsory and MUST be attempted

- 1 Your manager has had a meeting with Bryce, the managing director of Grand Ltd. Extracts from the email prepared by your manager following the meeting, together with a schedule of information from Bryce, are set out below.

Extract from the email from your manager – dated 3 September 2018

(a) Grand Ltd group of companies

Grand Ltd has two wholly owned subsidiaries, Colca Ltd and Sautso Ltd, and also owns shares in a number of other companies. All of the group companies are UK resident trading companies, which prepare accounts to 31 March each year. All supplies made by the group are subject to value added tax (VAT) at the standard rate. Sautso Ltd has been a member of the Grand Ltd group for many years.

Sale of Colca Ltd

Grand Ltd purchased the whole of the ordinary share capital of Colca Ltd for £800,000 on 1 November 2011. The value of Colca Ltd has fallen and the company is to be sold on 1 December 2018. Two separate offers have been received: offer A and offer B.

Offer A – in respect of a sale of the company's shares

- The purchaser will pay £730,000 for the whole of the ordinary share capital of Colca Ltd. This amount will be reduced by any tax liabilities payable by Colca Ltd arising as a result of the company being sold.

Offer B – in respect of a sale of the company's trade and assets

- The purchaser will pay £695,000 for the trade and assets of Colca Ltd.

Colca Ltd – expected asset values on 1 December 2018

	£
Oribi building	410,000
Atuel building	230,000
Items of machinery	25,000
Net current assets (at cost)	30,000
	<hr/>
	695,000
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There is further information in respect of these assets in the attached schedule from Bryce.

The value of Colca Ltd's goodwill is negligible and should be ignored for the purposes of this work.

Please prepare a memorandum for the client file.

Note: When calculating the post-tax proceeds in respect of the two offers, you should assume that tax relief at the rate of 19% will be obtained in respect of any allowable capital losses.

The memorandum should cover the following:

(i) Offer A – in respect of a sale of the company's shares

- An explanation of whether or not tax relief will be available in respect of the capital loss arising on the sale of the shares.
- An explanation of the tax implications of Colca Ltd leaving the Grand Ltd group whilst still owning the Atuel building. This explanation should not include any calculations.
- A calculation of the expected post-tax proceeds.

Extract from the email from your manager – dated 3 September 2018 (continued)

(ii) Offer B – in respect of a sale of the company’s trade and assets

- A calculation of the expected post-tax proceeds. For this purpose you should ignore any chargeable gains or allowable losses arising on the sale of the items of machinery.
- In relation to the sale of the items of machinery, an explanation as to whether or not they will result in chargeable gains or allowable capital losses and of the availability of rollover relief.
- An explanation of the companies to which Colca Ltd can transfer any capital losses arising on the assets sold.

(iii) Offer B – value added tax (VAT)

- In respect of offer B: an explanation as to whether or not Colca Ltd should charge VAT on the sale of its buildings and/or its machinery.

(b) Tax evasion and tax avoidance

Bryce and his daughter (who is a tax expert in the field of capital allowances) have drawn up a plan which they claim will enable a company to claim a tax deduction of 180% of the cost of new machinery. The plan is complicated in that it involves the creation of a new, wholly-owned subsidiary and a series of contracts involving the leasing and sub-leasing of the machinery between the two companies.

I have not looked at the plan in detail because, even if it would appear to have the intended tax effect, I am sure that it would fall within the general anti-abuse rule (GAAR).

Please prepare notes which:

- Distinguish between tax evasion and tax avoidance and state the purpose of the GAAR.
- Explain why the GAAR is likely to apply to this particular plan.

Tax manager

Schedule of information from Bryce – dated 3 September 2018

Colca Ltd – details of assets

Colca Ltd uses both the Oribi and Atuel buildings in its trade.

	Oribi building	Atuel building	Machinery
Date of purchase	1 February 2012	1 April 2016	N/A
Purchase cost	£320,000 (note 1)	£255,000 (note 2)	(note 3)
Value added tax option to tax made?	No	No	N/A

Notes

1. On 1 December 2011, Colca Ltd sold a machine for £74,000 resulting in a chargeable gain of £17,000. This gain was rolled over against the purchase of the Oribi building.
2. Colca Ltd purchased the Atuel building from Sautso Ltd for £255,000, its market value at that time. As Colca Ltd and Sautso Ltd are both 100% subsidiaries of Grand Ltd, the transfer of the building took place at no gain, no loss.

Sautso Ltd had purchased the Atuel building, new and unused, for £340,000 on 1 January 2016.
3. All of the items of machinery are moveable. The sale of the machinery will give rise to a balancing charge of £12,100.

Most of the items of machinery are worth less than their original cost. However, a small number of items are particularly specialised, such that their current market value exceeds their original cost.

Required:

(a) Prepare the memorandum as requested in the email from your manager. The following marks are available:

(i) Offer A – in respect of a sale of the company's shares. (8 marks)

(ii) Offer B – in respect of a sale of the company's trade and assets. (11 marks)

(iii) Offer B – value added tax (VAT). (7 marks)

(b) Tax evasion and tax avoidance. (5 marks)

Professional marks will be awarded for the approach taken to problem solving, the clarity of the explanations and calculations, the effectiveness with which the information is communicated, and the overall presentation and style of the memorandum and notes. (4 marks)

Note: The following indexation factors should be used, where necessary.

November 2011 to December 2018	0·128
February 2012 to December 2018	0·121
January 2016 to April 2016	0·010
January 2016 to December 2018	0·039
April 2016 to December 2018	0·029

(35 marks)

**This is a blank page.
Question 2 begins on page 11.**

- 2 Your manager has forwarded a schedule to you from Dee, a new client of your firm. The schedule and an email from your manager detailing the work he requires you to do are set out below.

Schedule from Dee – dated 4 September 2018

I am resident and domiciled in the UK. My husband, Cam, moved to the UK in January 2013 and we married in June 2014. Cam is resident in the UK but domiciled in the country of Riviera. I have a 16-year-old son, Oder, who is resident and domiciled in the UK.

My father's London house

My father died on 1 June 2018 and I inherited his London house. The house had a value for probate purposes of £390,000, but is now worth £450,000. My father purchased the house for £130,000 in 1984. I intend to sell the house as soon as possible.

Investment plan in respect of the proceeds from the sale of the London house

I plan to invest the £450,000 proceeds as follows:

- £300,000, purchase of UK shares; and
- £150,000, cash deposit in the UK.

Alternative investment plan

It has been suggested to me by a friend (who is a tax adviser) that I should consider an alternative investment plan, which would result in a lower income tax liability for me and my family.

Under my friend's suggestion I would give £150,000 of the sales proceeds from the London house to Cam, leaving me with £300,000. We would then each invest two-thirds of our respective funds in shares with the remaining third left on cash deposit.

I would like to know what the income tax saving would be if I followed my friend's advice rather than my original plan.

Gift to Oder

I am also considering making a cash gift to Oder of £20,000 out of my existing funds (i.e. not from the proceeds from the sale of the London house). Oder would place this amount on cash deposit.

Our annual income

I set out below our current annual income.

The bank interest and dividends are in respect of cash deposits and shares all of which are held within ISAs. We invest the maximum possible amount into ISAs on 1 May each year.

Oder has no income. None of us have made any previous chargeable gains.

	Dee £	Cam £
Annual income		
Employment income	170,000	18,000
Bank interest (within ISA)	1,500	1,200
Dividends (within ISA)	2,500	1,800

Tax-efficient investments

I have considered investing in enterprise investment scheme (EIS) shares but have not done so due to the high level of risk involved. However, I understand that venture capital trusts (VCTs) have a lower level of risk.

Please let me have a comparison of the income tax implications of these two forms of investment on the assumption that I will invest £50,000 in the tax year 2018/19. I do not know for how long I will want to hold these shares.

Thank you

Dee

Please prepare notes for me to use in a meeting with Dee. The notes should cover the following:

(a) Minimising income tax on investment income

When carrying out this work you should assume:

1. The shares purchased will yield a 4% return per annum and the cash deposits will yield a 1% return per annum.
2. The whole of the £450,000 will be available to invest, i.e. Dee will pay any capital gains tax due in respect of the sale of the London house out of her existing funds.
3. None of the investments will consist of either enterprise investment scheme (EIS) shares or venture capital trust (VCT) shares.

- Calculations of the income tax saving which would be achieved in a complete tax year if Dee were to follow her friend's advice and give £150,000 of the proceeds from the sale of the London house to Cam in accordance with the alternative investment plan.

To do this efficiently, you should just calculate the additional tax payable by Dee and Cam on the income generated by the inherited funds, rather than preparing complete income tax computations.

To save you some time, I have already calculated that if Dee invested the whole of the £450,000 herself, she would incur an additional income tax liability in respect of the bank interest and dividend income for a complete tax year of £3,342.

- It seems to me that the total income tax liability of Dee and Cam could be reduced further whilst still retaining the fundamentals of Dee's alternative investment plan. Dee would still give Cam £150,000 but, rather than each of them investing 2/3 of their funds in shares and leaving the remainder on cash deposit, the total investment of £300,000 in shares and £150,000 in cash deposits would be split between them in a different way.

Set out the factors which are relevant to obtaining a more income tax-efficient split of the total investment. You should only consider the income tax positions of Dee and Cam and the nature of the proposed investments. I do not require you to produce calculations of any potential tax savings.

- The matters to be considered in relation to income tax in respect of the proposed gift of £20,000 to Oder.

(b) Gift to Cam

- By reference to Cam's domicile status, explain why Dee's proposed gift of £150,000 to Cam could result in an **inheritance tax** liability and how this potential liability might be avoided.

You should note that Dee gave Cam a half interest in her home on 1 August 2014. The value of this gift was £600,000.

- Calculations in order to show the **capital gains tax** saving which would be achieved if Dee were to give Cam a one-third interest in the London house prior to its sale (as opposed to cash of £150,000 following its sale).

(c) Tax-efficient investments

- A comparison of the income tax implications for Dee of investing £50,000 in either EIS shares or VCT shares as requested.

Thank you

Tax manager

Required:

Prepare the notes as requested in the email from your manager. The following marks are available:

(a) **Minimising income tax on investment income.** (11 marks)

(b) **Gift to Cam.** (9 marks)

(c) **Tax-efficient investments.** (5 marks)

(25 marks)

Section B – BOTH questions are compulsory and MUST be attempted

- 3** Enid requires advice on the capital gains tax (CGT) and value added tax (VAT) implications of transferring her unincorporated sole trader business to a newly incorporated company, Niche Ltd. She also requires information on the tax implications of alternative ways of extracting profits from the new company.

Enid:

- Has been in business as an unincorporated sole trader for many years.
- Receives dividends from a portfolio of investments of £4,000 each year.
- Has no other source of income.
- Is a higher rate taxpayer for all relevant tax years.
- Will transfer all the assets and liabilities of her business to Niche Ltd on 1 October 2018.
- Will make no other disposals for CGT purposes in the tax year 2018/19.
- Will be the only director and shareholder of Niche Ltd.

Enid's unincorporated business:

- At 1 October 2017 Enid had trading losses brought forward of £51,000.
- In the year ending 30 September 2018, Enid's business will have a taxable trading profit of £42,000, prior to the transfer to Niche Ltd.
- Is registered for the purposes of value added tax (VAT).

The assets and liabilities to be transferred to Niche Ltd:

	Cost £	Value at 1 October 2018 £
Goodwill	0	80,000
Workshop	55,000	122,000
Inventory	8,000	8,000
Liabilities	n/a	(10,000)

Consideration to be paid by Niche Ltd:

- 1,000 £1 ordinary shares in respect of 85% of the total value of the consideration for the business.
- The remainder of the consideration will be left on loan account payable by Niche Ltd to Enid.
- Enid will withdraw cash from the loan account to pay any CGT liability arising on the transfer of the business.

Niche Ltd:

- Will pay Enid a salary of £75,000 per year, and dividends of £15,000 on 31 March each year.
- Will not be regarded as a personal service company under the provisions of the IR35 legislation.

Required:

- (a) Explain how Enid can obtain relief for the trading losses of £51,000 brought forward in her unincorporated business at 6 April 2018. (4 marks)
- (b) Explain why the transfer of Enid's business to Niche Ltd qualifies for incorporation relief, and, on the assumption that Enid does not elect to disapply this relief, calculate the balance on her loan account with Niche Ltd after deducting the cash to be withdrawn to pay any capital gains tax (CGT) due. (7 marks)
- (c) Advise Enid of the impact on the total amount of tax payable by both herself and Niche Ltd if, instead of a dividend of £15,000, she (1) receives additional salary of £15,000, or alternatively (2) withdraws £15,000 from her loan account in the tax year 2019/20.

Note: You should assume that there will be sufficient funds in Enid's loan account to permit this withdrawal. (6 marks)

- (d) Advise Enid of her administrative obligations under the value added tax (VAT) legislation, arising from the transfer of her business to Niche Ltd, and whether or not she is able to transfer the VAT registration from her unincorporated business to Niche Ltd.

Note: You should assume that the transfer of a going concern rules will apply for VAT purposes, but are NOT required to discuss these rules. (3 marks)

(20 marks)

- 4 Aqil requires advice on the capital gains tax (CGT) and inheritance tax (IHT) implications of gifting a warehouse to his daughter, Damia. He also requires advice on the tax consequences for a company, in which he is a director and shareholder, of its disposal and acquisition of certain capital assets.

Aqil and Damia:

- Are both resident and domiciled in the UK.
- Are both higher rate taxpayers in all relevant tax years.
- Both make disposals to fully use their annual exempt amount for CGT each tax year.

Aqil:

- Is a director and 55% shareholder in Spidera Ltd, a UK resident trading company.
- Will give a warehouse building to his daughter Damia on 1 October 2018.

Aqil's warehouse:

- Aqil acquired the warehouse on 1 July 2006 at a cost of £62,000.
- The warehouse has always been wholly used, rent-free by Spidera Ltd since that date.
- The current market value of the warehouse is £195,000.

Damia:

- Will use the warehouse solely in her sole trader business.
- Intends to retain and use the warehouse until she sells this business in five years' time, when the warehouse is anticipated to have increased in value.

Spidera Ltd:

- Prepares accounts to 30 June each year.
- Is owned by Aqil (55%) and Basir (45%).
- Basir is not connected to Aqil, and is neither a director nor an employee of Spidera Ltd.

Spidera Ltd – disposal of equipment:

- Spidera Ltd sold an item of fixed equipment for proceeds of £20,000 on 20 August 2018.
- The equipment had been purchased on 1 May 2012 for £65,000.
- The tax written down value of Spidera Ltd's main pool was nil at 30 June 2018.
- Rollover relief was claimed on the purchase of the equipment to defer a chargeable gain of £38,000.
- Spidera Ltd will use the after-tax proceeds from the sale of the item of fixed equipment to purchase a motorcycle which it will give to Basir.

Required:

(a) In respect of the proposed gift of the warehouse on 1 October 2018:

- Explain why capital gains tax (CGT) gift relief will be available.** (2 marks)
- Explain, with supporting calculations, the effect of making a gift relief claim in respect of the warehouse on the total CGT liabilities of Aqil and Damia.** (5 marks)
- Advise on the availability of business property relief for inheritance tax (IHT) purposes if Aqil dies before 1 October 2025.** (5 marks)

- (b) Explain, with supporting calculations, the amount of the after-tax proceeds which will be available from the sale of the fixed equipment, and the tax consequences for both Spidera Ltd and Basir of the gift of the motorcycle.** (8 marks)

(20 marks)

End of Question Paper