Professional Level – Options Module

Advanced Taxation (United Kingdom)

September/December 2017 – Sample Questions

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 – TWO questions ONLY to be attempted

Tax rates and allowances are on pages 2–5

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

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

Paper P6 (UK)

Think Ahead ACCA

The Association of Chartered Certified Accountants

SUPPLEMENTARY INSTRUCTIONS

1. You should assume that the tax rates and allowances for the tax year 2016/17 and for the financial year to 31 March 2017 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 – £32,000	20%	7·5%
Higher rate	£32,001 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	£11,000
Transferable amount	£1,100
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 CO_2 emissions is 95 grams per kilometre.

The percentage rates applying to petrol cars with CO_2 emissions up to this level are:

50 grams per kilometre or less	7%
51 grams to 75 grams per kilometre	11%
76 grams to 94 grams per kilometre	15%
95 grams per kilometre	16%

Car fuel benefit

The base figure for calculating the car fuel benefit is £22,200.

Individual savings accounts (ISAs)

The overall investment limit is £15,240.

Pension scheme limits

Annual allowance	– 2014/15 to 2016/17	£40,000
	– 2013/14	£50,000
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

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	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	£83,000
Deregistration limit	£81,000

Inheritance tax: nil rate bands and tax rates

	£	
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	
6 April 2002 to 5 April 2003	250,000	
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	£11,100
Entrepreneurs' relief – Lifetime limit	£10,000,000
– Rate of tax	10%

National insurance contributions

Class 1	Employee	£1 – £8,060 per year	Nil
		£8,061 – £43,000 per year	12%
		£43,001 and above per year	2%
Class 1	Employer	£1 – £8,112 per year	Nil
		£8,113 and above per year	13·8%
		Employment allowance	£3,000
Class 1A			13·8%
Class 2		£2·80 per week	
		Small profits threshold	£5,965
Class 4		£1 – £8,060 per year	Nil
		£8,061 – £43,000 per year	9%
		£43,001 and above per year	2%

Rates of interest (assumed)

Official rate of interest	3%
Rate of interest on underpaid tax	3%
Rate of interest on overpaid tax	0·5%

Stamp duty land tax

Non-residential properties

£150,000 or less	0%
£150,001 – £250,000	2%
£250,001 and above	5%

Residential properties (note)

£125,000 or less	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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Question 1 begins on page 7.

Section A – BOTH questions are compulsory and MUST be attempted

1 Your manager has sent you a memorandum in relation to the Harrow Tan Ltd group. An extract from the memorandum and a schedule of group information prepared by Corella, the group finance director, are set out below.

Memorandum from your manager – dated 7 September 2017

Background

– We are advising Corella, the group finance director, on a number of matters. I've attached a schedule from Corella, which sets out much of the relevant information.

– Corella was only recently appointed the Harrow Tan Ltd group finance director. She has had very little experience of practical tax since qualifying as an accountant in 1994. I have carried out a brief review of Corella's schedule and concluded that it is mathematically correct but that we cannot rely on its tax technical content.

– All five group companies are UK resident trading companies which prepare accounts to 31 December each year.

Sale of shares in Rocha Ltd

Harrow Tan Ltd acquired the whole of the ordinary share capital of Rocha Ltd (100,000 shares) on 1 December 2016 for £8,900,000.

On 1 January 2017, Seckel Ltd (owned 80% by Harrow Tan Ltd) sold a commercial building to Rocha Ltd for £800,000, its market value on that date. The group claimed exemption from stamp duty land tax in respect of this transaction. Seckel Ltd had purchased the building on 1 May 1998 at a cost of £330,000.

However, the results of Rocha Ltd for the year ending 31 December 2017 are now expected to be significantly worse than originally budgeted and an agreement was signed on 31 July 2017 for Harrow Tan Ltd to sell 60,000 Rocha Ltd ordinary shares for £10,300,000. It is planned that the sale of these shares will take place on 1 October 2017, although the sale could be delayed by up to three months if necessary.

Tosca Ltd – promotion of new product

Tosca Ltd manufactures high quality glass bowls. It accounts for value added tax (VAT) using the annual accounting scheme.

Tosca Ltd has developed a new product, which is expected to increase the company's annual turnover from £1,200,000 to £2,000,000. The new product is to be marketed to the company's customers, all of whom are UK based retailers, via promotional evenings in various parts of the UK.

At the promotional evenings the retailers will be provided with a meal. They will also be given a sample of the new product costing approximately £90, and a pen costing £40.

Please prepare notes for us to use in a meeting with Corella, which EXPLAIN the following matters:

(i) Sale of shares in Rocha Ltd

– The error(s) and omission(s) in part A of Corella's schedule together with any tax saving opportunities or other matters, including stamp duty land tax, which are not addressed in part A of her schedule. Please include a corrected calculation of the taxable gain on the sale on the assumption that it occurs on 1 October 2017.

– Take some time to think about this. From my brief review I think there may be three or four issues which need to be brought to Corella's attention.

(ii) Group relief – year ending 31 December 2017

– By reference to the information in part B of Corella's schedule, the maximum amount of Seckel Ltd's trading loss which can be surrendered to each of the other companies in the Harrow Tan Ltd group.

(iii) Rollover relief

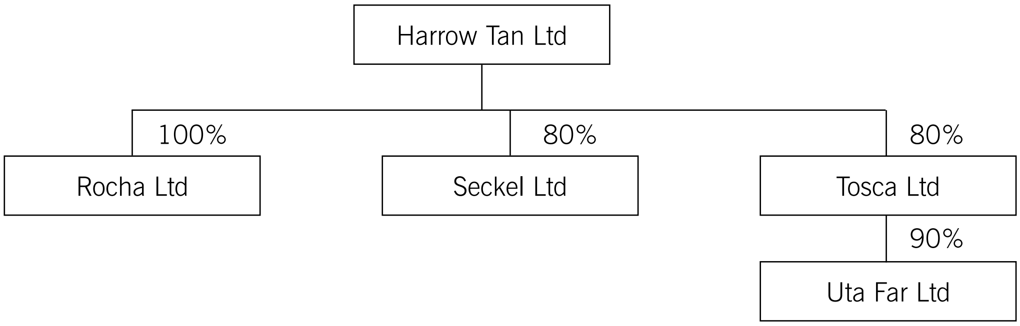
– The rollover relief potentially available to the group and the accuracy of part C of Corella's schedule.

Memorandum from your manager – dated 7 September 2017 (continued)

(iv) Tosca Ltd – promotion of new product

- The VAT implications of:
  - the expected increase in the turnover of Tosca Ltd; and
  - the entertainment and gifts at the promotional evenings.

Schedule of group information – from Corella, the group finance director



A: Taxable gain on the sale of shares in Rocha Ltd

	£
Sale proceeds	10,300,000
Less: Cost (£8,900,000 x 60%)	(5,340,000)
Indexation allowance (£5,340,000 x 0·015)	(80,100)
Chargeable gain	4,879,900
Rollover relief (analysed below)	(1,350,000)
Taxable gain	3,529,900

B: Budgeted results for the year ending 31 December 2017

	Harrow Tan Ltd	Rocha Ltd	Seckel Ltd	Tosca Ltd	Uta Far Ltd
	£	£	£	£	£
Trading profit/(loss)	40,000	60,000	(180,000)	70,000	600,000
Chargeable gains	Note 1	–	–	–	Note 2

Notes:

1. Disposal of shares in Rocha Ltd.
2. Uta Far Ltd sold a building used in its business on 1 May 2017 for £1,800,000. This resulted in a chargeable gain of £85,000.

C: Harrow Tan Ltd – Acquisitions in the year ending 31 December 2017 qualifying for rollover relief

	£
New factory, to be used in carrying on the company's business, consisting of:	
Land	410,000
Building	370,000
Total cost of factory	780,000
Machinery	430,000
Patents and trademarks	140,000
Total qualifying additions	1,350,000

Required:

Prepare the meeting notes as requested by your manager. The following marks are available:

(i) Sale of shares in Rocha Ltd.

Note: The following indexation factors should be used where applicable:

December 2016 to month of sale	0·015	
May 1998 to January 2017	0·621	
May 1998 to October 2017	0·650	(12 marks)

(ii) Group relief – year ending 31 December 2017. (6 marks)

(iii) Rollover relief. (7 marks)

(iv) Tosca Ltd – promotion of new product. (6 marks)

Professional marks will be awarded for the ability to follow instructions, the clarity of the explanations and calculations, the effectiveness with which the information is communicated, and the overall presentation. (4 marks)

(35 marks)

2 Your manager has had a meeting with Florina and Kanzi who are clients of your firm. Florina's father, Winston, also attended the meeting. The notes prepared following the meeting and an email from your manager setting out the work he requires you to do are set out below.

Meeting with Florina, Kanzi and Winston on 6 September 2017

The meeting was attended by Florina and Kanzi (who have been living together since 1999 but are not married) and Winston (Florina's father).

All three individuals are resident and domiciled in the UK. They have no sources of income or chargeable gains other than those referred to below.

Florina

Florina is a director of and shareholder in Flight Hip Ltd. She earns an annual salary of £50,000 and receives a dividend of £20,000 from the company every year. She received total taxable benefits of £25,000 from the company in the tax year 2016/17. Flight Hip Ltd is not a close company.

Florina's benefits include a company car together with free petrol for both business and private use. The car's benefit percentage by reference to its CO_2 emissions is 26%. Florina drives 19,000 miles per year of which 2,000 miles are in the performance of her employment duties. The total cost of all of the petrol used by Florina in the tax year 2016/17 was £3,000.

Florina's only other income consists of dividends of £1,500 received in June every year from Landing Properties Ltd. Landing Properties Ltd is an unquoted UK resident company, unrelated to Flight Hip Ltd.

Florina purchased 4,000 shares (a holding of less than 1%) in Landing Properties Ltd for £8,000 on 1 August 2001. She is considering selling these shares to Padarn, an unconnected individual, for their market value of £40,000. This would result in a capital gains tax liability of £4,180. I suggested that it may be possible to reduce the tax due by making a gift of some of the shares to Kanzi, who would then sell them to Padarn, and I agreed to provide Florina with further details.

Kanzi

Kanzi is an artist. His annual taxable trading income is approximately £14,000.

Although Kanzi is not employed by Flight Hip Ltd, the company provides him with a car and free petrol. The car's benefit percentage by reference to its CO_2 emissions is 23%. Kanzi drives 5,000 miles per year; the total cost of the petrol used by Kanzi in the tax year 2016/17 was £800.

Kanzi should be treated as a member of Florina's household for the purposes of the employment income legislation.

Winston

Winston is in very poor health and is not expected to live for more than 12 months. It is estimated that Winston's total chargeable estate is currently worth £1,400,000. The values of his assets are not expected to change between now and his death.

Winston intends to make a donation of £150,000 to a registered UK charity. This donation will be either a lifetime gift or a legacy from his estate on death.

Winston's current will leaves the whole of his estate to Florina and his two other children.

Winston's only previous lifetime gift was a chargeable transfer, after the deduction of exemptions, of £200,000 to a trust on 1 June 2015.

Winston wants to carry out some sophisticated tax-planning in order to reduce the inheritance tax which will be payable in respect of his death estate.

Email from your manager – dated 7 September 2017

Please carry out the following work.

(a) Florina and Kanzi

Florina's remuneration from Flight Hip Ltd

Calculate the total tax saving which could be achieved by Florina and Flight Hip Ltd if, in the tax year 2017/18, the company were to make a single lump sum payment of £20,000 into a personal pension fund for Florina instead of paying her a dividend of £20,000. These calculations should take account of the tax which Florina will pay when she eventually withdraws the £20,000 from the pension fund.

You should assume that:

(1) there will be no further contributions into the fund in future years; and
(2) Florina will be a basic rate taxpayer when she makes a withdrawal from the fund.

Provision of free petrol

By comparing the income tax due in respect of the petrol with the value of the petrol received, determine whether Florina and Kanzi would be better off if:

– Florina were to reimburse Flight Hip Ltd for the cost of the petrol used by her for private purposes; and/or
– Flight Hip Ltd were to stop providing Kanzi with free petrol.

Sale of shares in Landing Properties Ltd

Explain whether or not gift relief would be available in respect of a gift of shares in Landing Properties Ltd from Florina to Kanzi.

On the assumption that gift relief **would** be available, calculate, with supporting explanations, the number of shares which Florina should give to Kanzi, prior to the eventual sale of the shares to Padarn, and the maximum reduction in the total capital gains tax payable which could be achieved.

(b) Winston's charitable donation

Prepare calculations, with supporting explanations, to show, by reference to inheritance tax only, whether it is more tax-efficient for Winston to make the charitable donation now or via his will. You should ignore the possibility of any further inheritance tax planning taking place.

(c) Becoming Winston's tax adviser

Winston wants to appoint us to replace his existing tax advisers.

Explain any difficulties which we may have complying with the fundamental principles of professional ethics in relation to acting for Winston and suggest appropriate safeguards.

Tax manager

Required:

Carry out the work requested in the email from your manager. The following marks are available:

(a) Florina and Kanzi.

Note: The following mark allocation is provided as guidance for this requirement:

Florina's remuneration from Flight Hip Ltd	4·5 marks
Provision of free petrol	4 marks
Sale of shares in Landing Properties Ltd	5·5 marks

(14 marks)

(b) Winston's charitable donation. (6 marks)

(c) Becoming Winston's tax adviser. (5 marks)

(25 marks)

Section B – TWO questions ONLY to be attempted

3 Luiza, the finance director of Damiana plc, requires advice on the corporation tax treatment of the company's expenditure on research and development (R&D) and the consequences of the late filing of its recent corporation tax returns. Luiza also wishes to know the tax implications for her of two alternative ways of acquiring shares in Damiana plc.

Damiana plc:
– Is a UK resident quoted trading company.

Damiana plc – R&D expenditure:
– Damiana plc is a large company for the purpose of tax relief for R&D expenditure.
– During the year ending 31 March 2018, Damiana plc will incur expenditure on qualifying R&D of £169,000.
– Damiana plc will have taxable total profits, before any deduction in respect of R&D expenditure, of £1,675,000 in the year ending 31 March 2018.

Damiana plc – late filing of corporation tax returns:
– Damiana plc prepared accounts for the 18-month period ended 31 March 2016.
– The corporation tax returns for this period were filed on 15 July 2017.
– All previous corporation tax returns have been filed on time.

Luiza:
– Is employed as the finance director of Damiana plc, earning a gross annual salary of £165,000.
– Has no other source of taxable income.
– Has been offered two alternative ways to acquire ordinary shares in Damiana plc.
– In either case she will sell these shares on 10 November 2020 when their market value is expected to be £32·70 per share.
– Uses her annual exempt amount for capital gains tax purposes each year.

Acquisition of Damiana plc shares – alternative 1:
– Damiana plc will transfer 5,000 ordinary shares (a 1% holding) to Luiza on 1 November 2017 for which Luiza will pay £1 per share.
– The market value of these shares on 1 November 2017 is expected to be £24·50 per share.
– Damiana plc does not expect to pay a dividend in the foreseeable future.

Acquisition of Damiana plc shares – alternative 2:
– Damiana plc will grant options over 5,000 ordinary shares to Luiza on 1 November 2017 under its newly established enterprise management incentive (EMI) scheme.
– The exercise price of these options will be £23·00 per share.
– Luiza will exercise the options on 2 November 2020.

Required:

(a) Explain, with supporting calculations, the tax relief available for the research and development (R&D) expenditure incurred by Damiana plc in the year ending 31 March 2018, and the amount of corporation tax which will be saved as a result of claiming this relief. (5 marks)

(b) Identify the accounting periods for which corporation tax returns were required from Damiana plc in respect of the 18-month period ended 31 March 2016. State the due date(s) for filing the returns in each case, and the implications for Damiana plc in respect of their late filing. (3 marks)

(c) Explain the tax implications for Luiza if she acquires 5,000 ordinary shares in Damiana plc alternatively, (1) by means of a transfer on 1 November 2017, or (2) as a result of exercising the share options on 2 November 2020. On the assumption that she sells the shares as planned on 10 November 2020, calculate Luiza's net increase in wealth under each alternative. (12 marks)

(20 marks)

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Question 4 begins on page 14.

4 Meg is an unincorporated sole trader. She requires advice regarding a planned change of accounting date, bringing her husband into the business, either as an employee or as a partner, and the value added tax (VAT) implications of purchasing supplies from an overseas supplier.

Meg:

– Is 60 years old and is married to Laurie.
– Owns an unincorporated sole trader business, MT Travel.
– Has rental income of £8,600 each year in addition to any profits from MT Travel.

MT Travel:

– Was set up by Meg on 1 January 2012.
– Has had accounts prepared to 31 December annually.
– Generated overlap profits of £7,400 on commencement.
– Meg will change its accounting date to 31 March by preparing accounts for the 15 months ending 31 March 2018.

MT Travel – recent and forecast tax-adjusted trading profits:

	£
Year ended 31 December 2016	17,000
15 months ending 31 March 2018	9,000

MT Travel – the future:

– From 1 April 2018, Meg's husband, Laurie, will start to participate in the business.
– Meg will either:
  (1) employ Laurie part-time, paying him an annual salary of £12,000, the commercial rate for the work he will perform; or
  (2) admit Laurie into the business as a partner, sharing profits and losses in the ratio 75% to Meg, and 25% to Laurie.
– The business is expected to generate a tax-adjusted trading loss in the tax year 2018/19 of £20,000, before making any payment to Laurie.
– The business is expected to become profitable again in the tax year 2019/20 and thereafter, but profits are not expected to exceed £30,000 per year for the foreseeable future.

Laurie:

– Is 63 years old.
– Was employed for many years by Hagg Ltd, earning gross annual remuneration of £60,000, until 31 March 2017.
– Has received annual dividends of £18,000 for many years. This is currently his only source of taxable income.

MT Travel – VAT:

– MT Travel is registered for the purposes of VAT.
– MT Travel currently buys standard-rated marketing services from a UK supplier, who is VAT registered.
– MT Travel can buy the same services from a supplier located in an overseas country, which is not in the EU, where the rate of VAT is 12%.

Required:

(a) (i) Calculate the taxable trading profit of MT Travel for each of the tax years 2016/17 and 2017/18 before considering relief for the anticipated trading loss of the tax year 2018/19. (3 marks)

(ii) Identify and explain ONE practical tax disadvantage of MT Travel having a 31 March year end, rather than a 31 December year end. (2 marks)

(b) (i) Calculate the allowable trading loss available to each of Meg and Laurie for the tax year 2018/19 if Laurie becomes an employee, or, alternatively, a partner in MT Travel on 1 April 2018. (3 marks)

(ii) Advise Meg and Laurie of the alternative ways in which their respective trading losses as calculated in (b)(i) could be used depending on whether Laurie is taken on as an employee or as a partner, and state the rate at which income tax would be saved in each case. (8 marks)

(c) Explain the value added tax (VAT) effect of MT Travel purchasing the services from the overseas supplier, rather than the UK supplier. (4 marks)

(20 marks)

5 Adam would like advice on the capital gains tax and inheritance tax implications of being given Eastwick Farm by his mother, Sabrina, and on recent changes in tax law which affect his investment planning.

Sabrina:

– Is UK resident and domiciled.
– Has made one previous lifetime gift of £350,000 into a discretionary trust for her grandchildren on 1 September 2017.
– Inherited Eastwick Farm from her husband, Sam, on his death on 1 July 2016.
– Has managed the farm since this date.

Sam:

– Owned and farmed Eastwick Farm for many years prior to his death on 1 July 2016.
– Had made lifetime gifts which used the whole of his nil rate band for inheritance tax purposes.

Sabrina – proposal to gift Eastwick Farm to Adam:

– Sabrina plans to retire from running the farm on 31 December 2017.
– She has been informed by a financial adviser that she could gift the farm to Adam when she retires without paying any capital gains tax or inheritance tax.
– She has decided to gift the farm to Adam on 1 January 2018.

Eastwick Farm – valuation of land and buildings:

	1 July 2016	1 January 2018 (estimated)
	£	£
Agricultural value	385,000	396,000
Market value	502,000	544,000

Adam:

– Is UK resident and domiciled.
– Is 42 years old.
– Is an additional rate taxpayer, with adjusted income (for the purpose of calculating Adam's annual allowance for pension contributions) of £200,000 per year, which he expects to continue for the foreseeable future.
– Uses his annual exempt amount for capital gains tax purposes each year.
– Is in full-time employment and will lease Eastwick Farm to a tenant farmer.

Adam – investments:

– Adam has regularly contributed £40,000 into a personal pension scheme to use his annual allowance.
– Adam has invested the maximum amount each year in an individual savings account (ISA).

Adam – thoughts on investments:

– 'I have been advised that my annual allowance for pension contributions was reduced to £15,000 for the tax year 2016/17, so I have incurred an additional tax charge. Please can you explain this reduction in my annual allowance?'
– 'Is there now any point in investing in either a cash or a stocks and shares ISA as savings income and dividends are now exempt from tax anyway up to £5,000 per year?'

Required:

(a) (i) **Explain the capital gains tax and inheritance tax implications for Sabrina of the planned gift of Eastwick Farm to Adam on 1 January 2018, and the reasons why the financial adviser has determined that neither tax may be payable by her as a consequence of this gift.**

Note: Detailed calculations are NOT required for this part. (3 marks)

(ii) **Explain, with supporting calculations, Adam's potential capital gains tax liability on a future sale of Eastwick Farm and the inheritance tax implications for him of being gifted the farm by Sabrina on 1 January 2018 if, as he intends, he leases the farm to a tenant farmer, and Sabrina dies before 1 January 2025.** (11 marks)

(b) **Comment on the thoughts expressed by Adam in relation to his personal pension contributions and investment in individual savings accounts (ISAs).** (6 marks)

(20 marks)

End of Question Paper