Strategic Professional – Options

Advanced Taxation – United Kingdom (ATX – UK)

September/December 2019 – Sample Questions

ATX UK ACCA

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 2–5

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

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

ATX – 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 2018/19 and for the financial year to 31 March 2019 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 – £34,500	20%	7·5%
Higher rate	£34,501 – £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	£2,000

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

Personal allowance

Personal allowance	£11,850
Transferable amount	£1,190
Income limit	£100,000

Where adjusted net income is £123,700 or more, the personal allowance is reduced to zero.

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

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	13%
51 grams to 75 grams per kilometre	16%
76 grams to 94 grams per kilometre	19%
95 grams per kilometre	20%

Car fuel benefit

The base figure for calculating the car fuel benefit is £23,400.

Individual savings accounts (ISAs)

The overall investment limit is £20,000.

Property income

Basic rate restriction applies to 50% of finance costs relating to residential properties.

Pension scheme limits

Annual allowance	£40,000
Minimum allowance	£10,000
Threshold income limit	£110,000
Income limit	£150,000
Lifetime allowance	£1,030,000

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

Approved 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 50 grams per kilometre	100%
CO_2 emissions between 51 and 110 grams per kilometre	18%
CO_2 emissions over 110 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 2018	19%
	– Financial year 2017	19%
	– Financial year 2016	20%
Profit threshold		£1,500,000

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 2018 to 5 April 2019	325,000
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

Residence nil rate band		£125,000
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	£11,700
Entrepreneurs' relief and investors' relief:	
– Lifetime limit	£10,000,000
– Rate of tax	10%

National insurance contributions

Class 1	Employee	£1 – £8,424 per year	Nil
		£8,425 – £46,350 per year	12%
		£46,351 and above per year	2%
Class 1	Employer	£1 – £8,424 per year	Nil
		£8,425 and above per year	13·8%
		Employment allowance	£3,000
Class 1A			13·8%
Class 2		£2·95 per week	
		Small profits threshold	£6,205
Class 4		£1 – £8,424 per year	Nil
		£8,425 – £46,350 per year	9%
		£46,351 and above per year	2%

Rates of interest (assumed)

Official rate of interest	2·5%
Rate of interest on underpaid tax	3·00%
Rate of interest on overpaid tax	0·5%

Standard penalties for errors

Taxpayer behaviour	Maximum penalty	Minimum penalty – unprompted disclosure	Minimum penalty – prompted disclosure
Deliberate and concealed	100%	30%	50%
Deliberate but not concealed	70%	20%	35%
Careless	30%	0%	15%

Stamp duty land tax on non-residential properties

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

Stamp duty

Shares	0·5%

Section A – BOTH questions are compulsory and MUST be attempted

1 Your manager has received a letter from Nelson, a potential new client, in relation to his unincorporated business. Extracts from the letter, and from an email from your manager detailing the work he requires you to do, are set out below.

Extracts from the letter from Nelson – dated 2 December 2019

Background

I was employed from 1 May 2014 until I was made redundant on 28 February 2018. My gross annual salary was £80,000.

Just over a year later, on 1 June 2019, I began trading as an unincorporated business preparing accounts to 30 April each year. My tax adviser advised me to trade as an unincorporated business because it was expected that I would make a tax adjusted trading loss for my first trading period ending on 30 April 2020. However, due to the speed with which the business has grown, the forecast for this period now shows a budgeted tax adjusted trading profit of £77,550.

Transfer of my business to NQA Ltd

In the future, I expect sales to be generated mainly from overseas customers, possibly via companies incorporated and trading outside the UK. In view of this, it has become clear to me that I need to be operating the business through a limited company.

Accordingly, I intend to incorporate my business by transferring its trade and assets to a new unquoted company, NQA Ltd, in exchange for ordinary shares. I will own the whole of the ordinary share capital of NQA Ltd and, for the time being, I will be its only director and employee. This incorporation will take place on 1 May 2020.

I will realise chargeable gains of £45,000 in respect of the goodwill of the business and £30,000 in respect of the Arch building (which I use as my business premises). I understand from our discussions that these gains will not be subject to capital gains tax due to the relief available when a business is transferred to a company in exchange for shares.

Other information

– Since 1 March 2018, I have had no source of income other than my unincorporated business.
– In the tax year 2020/21, I will not make any disposals for the purposes of capital gains tax other than the sale of my business to NQA Ltd.

Advice required

1. I am trying to determine whether or not I should have been advised to begin trading through a limited company from 1 June 2019 rather than as an unincorporated business.

   I would like to know if I will pay more tax as a result of the advice I was given. I would also like to understand the relevance of the expected trading loss in the first trading period together with any other reasons my existing tax adviser might have had for advising me to begin trading as an unincorporated business rather than through a limited company.
2. Ideally, I would prefer to retain personal ownership of the Arch building when I incorporate my business, rather than transfer it to NQA Ltd. However, this will depend on how it affects my capital gains tax position.
3. Once NQA Ltd has begun trading, I would like to be able to borrow any excess funds in the company for my personal use. I would then repay the loan as and when I can afford to. I appreciate there may be an employment income benefit in respect of this.
4. One of my customers has gone into liquidation, and I do not expect to be able to recover any part of the outstanding debt.
   – Does this mean that the value added tax (VAT) which I have already paid to HM Revenue and Customs (HMRC) in respect of this sale is lost?
   – Am I correct in thinking that, if I had used the cash accounting scheme for VAT, I would not have had this particular problem, and that my cash flow generally would have benefited?

Extract from the email from your manager – dated 3 December 2019

Please prepare a memorandum for the client file consisting of the work set out below.

(a) Becoming tax advisers to Nelson

Explain the information we require, the matters we should consider and the actions we should take before we agree to become Nelson's tax advisers.

(b) Trading through a limited company rather than as an unincorporated business

Total taxes payable

The total taxes payable by Nelson for the tax year 2019/20 in respect of his budgeted tax adjusted trading profit will be £20,589. Prepare calculations to determine whether or not a lower amount would have been payable if Nelson had commenced trading through a limited company rather than as an unincorporated business.

You should assume:

– the company's accounting period ends on 31 March 2020;

– the company's MONTHLY trading profit for this accounting period is £7,050. This figure is before deducting the cost of Nelson's monthly salary;

– the company pays Nelson a gross salary of £1,200 per month and a dividend equal to its post-tax profits.

Reasons for advice given by existing tax adviser

Explain why the expectation that Nelson's business would make a tax adjusted trading loss would have been an important consideration when deciding on whether he should begin trading as an unincorporated business or through a limited company. You should refer to Nelson's first two tax years of trading.

State any other reasons why Nelson's existing tax adviser may have advised him to commence trading as an unincorporated business rather than through a limited company.

(c) Other matters

– Explain the capital gains tax (CGT) implications for Nelson of retaining personal ownership of the Arch building when he incorporates his business. You ARE NOT REQUIRED to consider CGT gift relief.

– Explain the tax implications for NQA Ltd of Nelson borrowing excess funds from the company and the subsequent repayment of those funds. You ARE NOT REQUIRED to explain any matters relating to employment income benefits in respect of this arrangement.

– Provide explanations in response to the two questions raised by Nelson in respect of value added tax (VAT).

Tax manager

Required:

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

(a) Becoming tax advisers to Nelson. (5 marks)

(b) Trading through a limited company rather than as an unincorporated business.

For guidance, there are 7·5 marks for the calculations and 6·5 marks for the reasons for the advice given. (14 marks)

(c) Other matters. (12 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. (4 marks)

(35 marks)

2 Your manager has forwarded an email to you from Emma, a client of your firm, which details the work you are required to do. Extracts from that email, and from an email from your manager which provides further information, are set out below.

Extracts from the email from Emma – dated 2 December 2019

As I approach my 75th birthday, I have decided to make some significant changes to my personal and financial affairs.

(a) Rental income in the country of Falgar

I have not been happy since I moved to Falgar. Consequently, I have decided to return to the UK on 1 May 2020. However, I will keep my house in Falgar, so that I can return to it at some future time. In the meantime, from 1 May 2020 I will rent it out.

My understanding of the UK tax position in relation to this rental income is as follows:

– provided I do not bring the rental income into the UK, it will not be subject to UK income tax;

– if I do bring the income into the UK, I will then have to pay UK income tax upon it.

Please explain whether or not my understanding is correct.

(b) Gift of shares in Vyc Ltd

Our family company, Vyc Ltd, has had another excellent year and its value continues to increase. On 1 July 2020, I will give my son, Edward, 10,000 ordinary shares in the company. Edward has spent most of the last few years travelling in Asia and I am hoping that this gift of shares will persuade him to return to the UK.

I appreciate there may be a UK inheritance tax (IHT) liability if I die within seven years of this gift.

– Please explain the circumstances which would result in the maximum IHT liability on this gift and provide me with a calculation of the amount which would then be due.

– Also, please explain whether I am right to assume that capital gains tax gift relief will be available in respect of this gift.

(c) Sale of industrial property in Manchester, England

I am going to sell my industrial property in Manchester, which I have owned as an investment since 1 December 2015. I could sell it now, in which case I would realise a chargeable gain of £330,000. Alternatively, if I wait until I am back in the UK, I would be able to increase the selling price by £60,000.

– I plan to sell the property now, for the lower price, as I believe this will mean that no UK capital gains tax will be due. Please explain whether or not this is the best thing to do from a tax perspective.

Extracts from the email from your manager – dated 3 December 2019

Emma

Emma is 74 years old and married to Bill. The couple have two adult children: a son, Edward, and a daughter, Lily. Emma has always been domiciled in the country of Falgar. She was resident in the UK from 6 April 1996 until she and Bill moved to Falgar on 1 February 2017. On her return to the UK on 1 May 2020, Emma will resume UK residency.

When carrying out this work, you should assume that Emma is a higher rate taxpayer.

Taxation in Falgar

– Income tax is charged at 26% on all income arising in Falgar.

– There is no capital gains tax or inheritance tax.

– There is no double tax treaty between the UK and Falgar.

Extracts from the email from your manager – dated 3 December 2019 (continued)

Vyc Ltd

Vyc Ltd is an unquoted manufacturing company, which is registered in the UK. It does not own any assets other than those which are used in its trade.

The shareholders in Vyc Ltd are set out below. The shareholdings have not changed for many years.

	Number of shares
Emma	35,000
Bill (Emma's husband)	19,000
Lily (Emma's daughter)	10,000
Charlotte (Emma's sister)	20,000
Louis (Charlotte's husband)	16,000
	100,000

You should use the following values for an ordinary share in Vyc Ltd when carrying out this work.

Shareholding	Value per share £
Up to 25%	10
26% to 50%	13
51% to 74%	19
More than 75%	22

On 1 October 2015, Emma made a cash gift to her daughter, Lily. This resulted in a transfer of value after deduction of exemptions of £280,000. This is the only gift Emma has made. When explaining the maximum inheritance tax (IHT) liability, you should focus on the date on which Emma's future death may occur and the availability of business property relief.

Please provide the explanations requested by Emma in respect of:

(a) Rental income in the country of Falgar.

(b) Gift of shares in Vyc Ltd.

(c) Sale of industrial property in Manchester, England.

Tax manager

Required:

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

(a) Rental income in the country of Falgar. (4 marks)

(b) Gift of shares in Vyc Ltd. (13 marks)

(c) Sale of industrial property in Manchester, England. (8 marks)

(25 marks)

Section B – BOTH questions are compulsory and MUST be attempted

3 The finance director of Kitz Ltd has requested advice on the tax implications of selling shares in a subsidiary company, making a loan to another subsidiary company, and selling an intangible fixed asset.

Kitz Ltd:
- Kitz Ltd owns 100% of the ordinary shares in Feld Ltd.
- Kitz Ltd and Feld Ltd are UK resident trading companies.
- Both companies prepare accounts to 31 March annually.
- Neither company is a small or medium-sized enterprise (SME) for the purpose of transfer pricing.

Kitz Ltd – sale of 7,500 ordinary shares (a 75% holding) in Mayr Ltd on 1 July 2019:
- Mayr Ltd is a UK resident trading company.
- The shares, which represent the whole of Kitz Ltd's shareholding, were sold to an unconnected purchaser for £790,000.
- Kitz Ltd had acquired these shares on 1 March 2012 for £455,000.
- Kitz Ltd had sold a warehouse to Mayr Ltd on 8 April 2014 for its market value on that date of £165,000.
- Kitz Ltd had purchased the warehouse on 12 May 2012 for £129,000.
- Mayr Ltd still owned the warehouse on 1 July 2019.

Kitz Ltd – loan to Feld Ltd:
- Kitz Ltd will make a loan of £450,000 to Feld Ltd on 1 April 2020.
- Feld Ltd will use the loan to purchase goodwill and office premises for use in its business, and 70% of the ordinary share capital of Durn Ltd.
- The cost of these acquisitions is as follows:

	£
Goodwill	68,000
Office premises	137,000
70% shareholding in Durn Ltd	245,000

- Kitz Ltd will charge interest at the rate of 7% per year on this loan.
- Feld Ltd has been offered a loan of £450,000 from a bank at an interest rate of 10% per annum.
- In the year ending 31 March 2021, Feld Ltd will have a trading profit of £587,000 and interest receivable of £48,100.

Kitz Ltd – proposed sale of a patent:
- Kitz Ltd will sell a patent to Durn Ltd on 3 May 2020 for £72,000.
- Kitz Ltd purchased the patent for £60,000 on 3 May 2015.
- The tax written down value of the patent on 3 May 2020 will be £30,000.
- Kitz Ltd has always used the patent in its business.

Required:

(a) Explain the chargeable gains implications for Kitz Ltd arising from the sale of its shares in Mayr Ltd on 1 July 2019.

Note: No calculations are required for part (a). (6 marks)

(b) Explain, with brief supporting calculations, the corporation tax implications for both Kitz Ltd and Feld Ltd in respect of the interest charged on the loan by Kitz Ltd to Feld Ltd for the year ending 31 March 2021. (7 marks)

(c) (i) Explain the corporation tax implications for Kitz Ltd of the sale of the patent to Durn Ltd on 3 May 2020, assuming Kitz Ltd does not make a claim for intangible fixed asset rollover relief. (3 marks)

(ii) Explain why rollover relief for intangible fixed assets will be available in respect of the sale of the patent to Durn Ltd, and, on the assumption the maximum rollover relief is claimed, calculate the impact of the claim on Kitz Ltd's corporation tax liability for the year ending 31 March 2021. (4 marks)

(20 marks)

4 Your client, Rosa, has requested advice in relation to the consequences of her daughter, Siena, becoming either an employee or a partner in her unincorporated business, the options available to her to relieve a trading loss incurred by the business, and the value added tax (VAT) implications of selling a retail unit.

Rosa:

- Is 62 years old and is widowed.
- Has one daughter, Siena.
- Owns an unincorporated business, RS Trading, which she has run for many years.
- Currently has no employees in her business.
- Will bring her daughter, Siena, into the business either as an employee or a partner, on 1 April 2020.
- Has a budgeted income tax liability of £23,160, and a budgeted capital gains tax liability of £22,484 for the tax year 2019/20.

Siena:

- Will have no source of taxable income in the tax year 2020/21, other than from RS Trading.

RS Trading:

- Has an accounting date of 31 March each year.
- Has a budgeted tax adjusted trading profit of £27,000 for the year ending 31 March 2020.
- Has a budgeted trading loss of £62,000, before any payment to Siena, for the year ending 31 March 2021.
- Is registered for VAT and makes only standard rated supplies.

RS Trading – future plans:

- Siena will become either an employee or a partner in RS Trading on 1 April 2020.
- If Siena becomes an employee, she will receive an annual salary of £22,000 which is a commercial rate for the duties she will perform.
- Alternatively, if Siena becomes a partner, the profit sharing arrangements from 1 April 2020 will be:

	Rosa	**Siena**
Annual salary	£0	£12,000
Profit sharing ratio	80%	20%

Rosa – investment properties:

- Rosa will receive net rental income of £60,000 from a portfolio of residential properties and a retail unit in the tax year 2019/20.
- Rosa sold all the residential properties on 30 November 2019, realising total chargeable gains of £92,000.

Disposal of the retail unit:

- Rosa will sell the retail unit, which is currently being rented to tenants up to 5 April 2020, for its market value of £280,000 on 6 April 2020.
- Rosa had bought the retail unit when it was newly constructed, on 1 May 2013, for £290,000 plus VAT at 20%.
- Rosa used the retail unit in her business until 30 April 2017, since when she has let it to unconnected tenants.
- The retail unit is subject to the capital goods scheme for VAT.
- Rosa has not opted to tax the retail unit for VAT purposes.

Required:

(a) Advise Rosa of the difference in the total amount of income tax and national insurance contributions (NICs) payable by her and Siena for the tax year 2020/21, if Siena is taken on as (i) a partner, or (ii) an employee by RS Trading on 1 April 2020. (9 marks)

(b) Assuming Siena is employed by RS Trading from 1 April 2020, identify and explain the relief(s) available to Rosa to relieve her trading loss of the year ending 31 March 2021, and calculate the maximum tax saving available to her as a result of claiming such relief(s) in the tax year 2019/20.

Note: You should NOT consider the possibility of Rosa carrying all, or any part, of the loss forward for relief for part (b). (7 marks)

(c) Explain the value added tax (VAT) implications of the disposal of the retail unit on 6 April 2020, and calculate the final VAT adjustment under the capital goods scheme. (4 marks)

(20 marks)

End of Question Paper