
Answers

1 Corey

Memorandum

For The files
Client Corey
Subject Personal tax matters
Prepared by Tax senior
Date 3 March 2020

(a) Corey's UK residence status for the tax year 2019/20

Although Corey works overseas, he will spend more than 90 days in the UK during the tax year. Accordingly, he will not be an automatic non-UK resident.

Corey will not be an automatic UK resident because he will not:

- be in the UK for 183 days or more in the tax year; or
- have his only home in the UK; or
- work full-time in the UK.

Because Corey's status cannot be determined automatically, it will be determined by the number of ties he has with the UK. Because he was not UK resident in any of the three tax years prior to 2019/20, and he will have been in the UK for between 91 and 120 days in the tax year 2019/20, he will be UK resident if he satisfies three or more UK ties.

The ties to be considered are:

| | Satisfied? |
|--|------------|
| – In the UK for more than 90 days in either or both of the tax years 2017/18 and 2018/19 | Yes |
| – Spouse/civil partner or children under 18 who are resident in the UK | Yes |
| – Working in the UK for 40 days or more | No |
| – Accommodation available in the UK for a continuous period of more than 90 days | Yes |

It can be seen from this that Corey will satisfy three of the UK ties, such that he will be UK resident in the tax year 2019/20.

As a UK resident, Corey will be subject to UK income tax on his overseas income in addition to his UK income. He will be able to deduct any tax suffered in Medora up to a maximum of the UK tax on his overseas income.

(b) Corey's disposals of assets in the tax years 2018/19 and 2019/20

Disposals in the tax year 2018/19

For the purposes of UK capital gains tax (CGT), Corey will be regarded as only temporarily non-UK resident whilst living in Medora. This is because:

- he was absent from the UK for less than five years; and
- having always lived in the UK prior to moving to Medora, he was UK resident for at least four of the seven tax years immediately prior to the tax year of departure.

As a temporary non-UK resident, Corey will be subject to UK CGT on any assets sold whilst he was living overseas, which he owned at the date of his departure from the UK. Any such gains or losses are subject to CGT in 2019/20, the tax year in which Corey returned to the UK.

- The statue was both bought and sold while Corey was living in Medora. Accordingly, the capital loss on the sale is not available for relief in the UK.
- The gain resulting from the takeover of SQ plc will be subject to tax in 2019/20, and not in the year of the takeover.

CGT liability for the tax year 2019/20

| | Residential property £ | Other gains £ |
|----------------------------|---------------------------|------------------|
| Chargeable gains: | | |
| Shares in SQ plc (W1) | | 5,769 |
| House in Medora | 33,900 | |
| Shares in TW plc (W3) | | 1,878 |
| Less: annual exempt amount | (11,700) | |
| Taxable gains | <u>22,200</u> | <u>7,647</u> |
| Basic rate band | | 34,500 |
| Gross taxable income | 38,400 | |
| Less: personal allowance | <u>(11,850)</u> | |
| | | <u>(26,550)</u> |
| Basic rate band remaining | | <u>7,950</u> |

CGT

| | |
|-----------------------|--------------|
| Residential property: | |
| £7,950 x 18% | 1,431 |
| £14,250 x 28% | 3,990 |
| Other gains: | |
| £7,647 x 20% | <u>1,529</u> |
| CGT liability | <u>6,950</u> |

Tutorial note: The order in which the gains are subject to CGT makes no difference to the final liability, i.e. calculating CGT on the 'other gains' and then on the residential property will result in the same tax liability.

Workings

1. Disposal of 2,000 shares in SQ plc on 1 February 2019

| | |
|------------------|--------------|
| | £ |
| Proceeds in cash | 12,000 |
| Less: cost (W2) | (6,231) |
| Chargeable gain | <u>5,769</u> |

2. Allocation of cost of shares in SQ plc following takeover by TW plc

| | Consideration £ | | Cost £ |
|----------------------------------|--------------------|---------------------------|---------------|
| Shares in TW plc (4,000 x £3.50) | 14,000 | £13,500 x £14,000/£26,000 | 7,269 |
| Cash | 12,000 | £13,500 x £12,000/£26,000 | 6,231 |
| Total | <u>26,000</u> | | <u>13,500</u> |

3. Gift of 700 shares in TW plc on 1 December 2019

| | |
|--|--------------|
| | £ |
| Proceeds at market value (700 x £4.50) | 3,150 |
| Less: cost (700/4,000 x £7,269 (W2)) | (1,272) |
| Chargeable gain | <u>1,878</u> |

(c) Lifetime gifts of paintings by Emer

The advantages of making a lifetime gift are:

- As the gifts would be potentially exempt transfers (PETs), no inheritance tax (IHT) will be charged if Emer survives the gift by a minimum of seven years.
- If Emer dies before the expiration of seven years but after at least three years have elapsed, any IHT due will be reduced by taper relief. The relief is 20% of the tax if she survives the gift by three years with a further 20% relief for each additional year.
- The value of a lifetime gift is determined at the time of the gift rather than at the date of death. Accordingly, one of the benefits of making a lifetime gift of the portrait is that, if the gift becomes chargeable, IHT will be charged on the value at the time of the gift rather than the value as at the date of death (which is expected to be higher).

The watercolour is expected to fall in value. However, if its value at the time of death is lower than it was at the time of the gift, fall in value relief would be available (provided Corey still owns the painting or has sold it at arms' length). As a

result of this relief being available, the value of the painting at the time of death would be used to calculate any IHT due. The relief would only affect the IHT due on the watercolour; when calculating the IHT on subsequent gifts and on the death estate, the value of the watercolour at the time of the gift, i.e. the higher amount, would be used.

In view of the above, it is likely that both paintings should be the subject of a lifetime gift.

(d) Refund of income tax

- We should review Corey’s tax returns in order to determine whether or not there is a valid reason for the refund.
- If we conclude that the refund was made as a result of an error on the part of HM Revenue and Customs (HMRC), we should tell Corey to repay the money immediately. We should inform him that failing to return the money in these circumstances may well be a civil and/or a criminal offence.
- HMRC should be informed of their error as soon as possible, as this will minimise any interest and penalties which may otherwise become payable. We should inform HMRC if our letter of engagement authorises us to do so. Alternatively, we should advise Corey to do so.
- If Corey is unwilling to return the money, we would have to consider ceasing to act as his tax adviser. We would then have to notify HMRC that we no longer act for him, although we would not provide them with any reason for our action.
- Finally, we should consider whether or not it is necessary to make a report under the money laundering rules.

2 Mita

(a) Sale of 4,000 shares in Porth Ltd on 1 May 2020

Mita – capital gains tax (CGT) liability

| | £ | £ |
|---|-----------------|---------------------|
| Proceeds at market value | | 260,000 |
| <i>Less: cost</i> | | |
| Market value of assets sold to Porth Ltd | 120,000 | |
| <i>Less: incorporation relief</i> | <u>(37,400)</u> | |
| | <u>82,600</u> | |
| £82,600 x 4,000/10,000 | | <u>(33,040)</u> |
| | | 226,960 |
| <i>Less: gift relief (balancing figure)</i> | | <u>(60,000)</u> |
| Gain chargeable (£200,000 – £33,040) | | <u>166,960</u> |
| CGT at 10% (entrepreneurs’ relief) | | <u>16,696</u> |

(b) Quod Ltd

Tax deduction available in respect of the scientific research costs

- The equipment and computer hardware will qualify for a 100% capital allowance as capital expenditure incurred for the purpose of research and development.

Accordingly, the total cost incurred of £102,000 will be deductible for the purposes of corporation tax.

- As Quod Ltd will be a small enterprise for research and development purposes, certain categories of revenue expenditure which are directly related to research and development activities will qualify for an additional 130% deduction when calculating the company’s taxable trading income.

This additional deduction is not available in respect of the capital expenditure or the rental costs.

Only 65% of amounts paid to external contractors qualify for this additional deduction.

- Tax deduction available:

| | £ | £ |
|--|----------------|----------------|
| Total research costs | 102,000 | 102,000 |
| <i>Less:</i> | | |
| Equipment and computer hardware (capital) | (27,500) | |
| Rent | (17,400) | |
| Staff costs (£7,000 x 35% (100% – 65%)) | <u>(2,450)</u> | |
| Amount qualifying for additional deduction | <u>54,650</u> | |
| Additional deduction (£54,650 x 130%) | | <u>71,045</u> |
| Tax deduction available | | <u>173,045</u> |

Tax treatment of the purchase of the Cloque brand

- The amount of £1,000 charged to the statement of profit or loss in respect of this expenditure would be allowable for the purposes of calculating taxable trading profit.
- Alternatively, for the purpose of calculating the company's taxable trading profit, Quod Ltd could elect to write off £1,400 (£35,000 x 4%) per year, which would clearly be beneficial.

Amended tax adjusted trading loss for the year ending 31 March 2021

| | |
|---|------------------|
| | £ |
| Budgeted tax adjusted trading loss | (44,000) |
| Additional deduction in respect of research costs | (71,045) |
| Amortisation of Cloque brand (£1,400 (£35,000 x 4%) – £1,000) | (400) |
| Amended tax adjusted trading loss | <u>(115,445)</u> |

Amount of trading loss available for use by Porth Ltd

- Porth Ltd will not be able to use the trading loss of Quod Ltd unless Quod Ltd is a consortium company. Quod Ltd will be a consortium company if at least 75% of its ordinary share capital is owned by companies, each of which own at least 5% but less than 75%.
- Accordingly, for consortium relief to be available, BJB Ltd must own the 30% holding rather than Mr Berm.
- The maximum amount which could be surrendered to Porth Ltd as consortium relief is £69,267 (£115,445 x 60%), reflecting Porth Ltd's holding of 60% of the ordinary share capital of Quod Ltd.

Value added tax (VAT) implications of purchasing advice from the overseas supplier

- The provision of this advice will be a business to business (B2B) service. It will be treated as supplied in the UK, because that is where Quod Ltd is established.
- Quod Ltd will be required to pay VAT at the UK standard rate of 20% to HM Revenue and Customs (HMRC) under the 'reverse charge' principle. The rate of VAT in the overseas country is irrelevant.
- The input VAT can be reclaimed on this expense in the same way as any other input tax incurred by the company.
- Accordingly, Quod Ltd's VAT position will be the same as if the services had been purchased from the UK supplier.

(c) Ryb Ltd

UK corporation tax on the profits of Ryb Ltd

Ryb Ltd is subject to UK corporation tax on the profits of its permanent establishment (PE) in Tirona because a PE is not a separate legal entity and UK resident companies are subject to corporation tax on their worldwide income.

| | |
|--|-----------------|
| | £ |
| UK corporation tax (£75,000 x 19%) | 14,250 |
| Less: unilateral double tax relief (£75,000 x 14%) | <u>(10,500)</u> |
| UK corporation tax liability | <u>3,750</u> |

Election to exempt the profits of the PE from UK tax

- The advantage of making such an election would be that the profits made in Tirona would not be subject to UK corporation tax.
Based on the current rates of corporation tax in the two countries, this would save corporation tax at the rate of 5% (19% – 14%).
- However, it should be recognised that there would be no relief in the UK in the event of any losses being incurred in the trade in Tirona in the future.
- Once made, the election is irrevocable and would apply to all future overseas permanent establishments of Ryb Ltd.
Accordingly, there would be no relief in the UK for any losses incurred in any new overseas trades operated by Ryb Ltd.

3 Tomas and Ines

(a) Tax treatment of the sale of sporting memorabilia

As Tomas is carrying on a trade of selling sporting memorabilia, the following liabilities will arise:

| | £ |
|---|------------|
| Income tax | |
| Tomas' trading income is covered by his personal allowance | 0 |
| No tax will arise on the dividends, as they are covered by the dividend nil rate band | 0 |
| National insurance contributions (NIC) | |
| Class 2: £2.95 x 52 | 153 |
| Class 4: (£11,500 – £8,424) x 9% | <u>277</u> |
| Total tax payable | <u>430</u> |

If the sales were treated as capital disposals, there would be no capital gains tax to pay as the memorabilia are chattels, with cost and proceeds both less than £6,000.

So the difference in the total tax which will be payable by Tomas for 2019/20 is an increase of £430.

(b) Basis periods if Tomas adopts a 31 March, or a 30 April year end, and tax advantages of adopting a 30 April year end

The tax year 2020/21 will be Tomas' second tax year from commencement of trading.

(1) If Tomas adopts a 31 March year end, his basis period will be the 12 months ending 31 March 2021.

(2) If Tomas adopts a 30 April year end, his basis period will be the 12 months ending 30 April 2020.

Advantages of adopting a 30 April year end are as follows:

- The income tax liability for the tax year 2020/21 will be due for payment by 31 January 2022. Adopting a 30 April year end maximises the interval between earning profits and paying the tax on those profits.
- A 30 April year end is financially beneficial for Tomas as the profits of his business are expected to rise each year. So a basis period of 30 April 2020, rather than 31 March 2021, will result in an earlier period of profit, and therefore a lower level of profits, being taxed.
- 30 April 2020 is near the start of the tax year 2020/21, whereas 31 March 2021 is at the end. So, with a 30 April year end, the taxable profit for 2020/21 will be known much earlier, which means there is more time for planning in respect of, for example, the amounts of payments on account, or pension contributions.

Tutorial note: *Although three advantages have been explained here, candidates were only required to explain TWO to gain full marks.*

(c) Matters to be considered by Tomas in deciding whether it is financially beneficial to register voluntarily for value added tax (VAT)

The VAT status of his suppliers. If Tomas' suppliers are VAT registered, Tomas will be charged VAT on his purchases, which he will only be able to reclaim if he is registered for VAT himself. However, if he purchases from non-VAT registered businesses, or members of the public, he will not suffer any input VAT, so there will be no financial benefit from registering.

The VAT status of his customers. If Tomas' customers are registered for VAT, they will be able to reclaim the VAT charged by Tomas on the memorabilia. However, if they are not registered, the VAT will represent an additional cost for them, which may make Tomas' prices uncompetitive, or Tomas will have to bear the burden of the VAT himself.

Tutorial note: *Marks were also awarded where candidates made other sensible comments.*

(d) Sale of shares in Tavira Ltd

If the shares in Tavira Ltd are sold on 1 June 2020, Ines will have owned them for less than three years. The following consequences will therefore arise:

- A chargeable gain of £23,000 (£95,000 – £72,000) will arise on the sale; and
- The enterprise investment scheme (EIS) income tax relief obtained when the shares were acquired will be withdrawn. As the shares will be sold at a profit, the full amount of the tax credit originally given of £18,600 will be reclaimed by HM Revenue and Customs (HMRC).

In addition, the sale of the Tavira Ltd shares will result in the gain on the sale of the painting, which was deferred on the acquisition of the shares, being brought back into charge. The gain on this disposal was £86,000, but the maximum amount of the gain deferred was restricted to the qualifying expenditure of £72,000.

Ines will have a capital gains tax (CGT) liability in the tax year 2020/21, calculated as follows:

| | Gain eligible for entrepreneurs' relief £ | Gain not eligible for entrepreneurs' relief £ |
|---------------------------------------|---|---|
| Gain on Tavira Ltd shares | 23,000 | |
| Deferred gain on painting | | 72,000 |
| Less: annual exempt amount (best use) | 0 | (11,700) |
| Taxable gains | <u>23,000</u> | <u>60,300</u> |

Ines' CGT liability is £14,360 ((£23,000 x 10%) + (£60,300 x 20%)).

Ines' income tax liability is £18,600.

Accordingly, Ines' after-tax proceeds from the sale of the Tavira Ltd shares is £62,040 (£95,000 – £14,360 – £18,600).

4 Pedro

(a) Inheritance tax (IHT) implications of the gift of the holiday cottage to Pedro

The gift of the holiday cottage was a potentially exempt transfer (PET), and therefore no tax was payable in Marina's lifetime. Although Marina died more than seven years after making this gift, IHT was payable as a result of her death as the gift constituted a gift with reservation. This is because Marina continued to derive benefit from the use of the holiday cottage following the gift, and she did not pay a market rent for staying in the cottage.

As the reservation was not lifted prior to her death, the IHT payable would have been calculated as the higher of (1) the total IHT payable if the cottage was included in her death estate at its value on death, and (2) the total IHT payable, if the cottage was taxed as a PET made in March 2009. As the latter liability is £nil, due to the date of the PET being more than seven years before Marina's death, the cottage would have been included in Marina's death estate. As the value of her death estate exceeded the nil rate band of £325,000 (as it included a portfolio of properties valued at £670,000), IHT was payable on the estate. The IHT attributable to the cottage, being a gift with reservation, was payable by the recipient of the gift, which, in this case, was Pedro.

(b) Why the holiday cottage will qualify as a furnished holiday letting

The letting of the holiday cottage satisfies all the conditions to qualify as a furnished holiday letting:

Availability – the cottage is available continuously for commercial letting from 1 July 2019 onwards, so will meet the condition to be available for at least 210 days in the first 12-month period.

Actual letting – the cottage will have a 70% occupancy rate throughout the period it is available for letting, such that it will be let for at least 105 days in the first 12-month period.

Pattern of occupation – no tenant will stay in the cottage for more than 14 consecutive days during the first year for which it will be available for letting, so there is no possibility of the number of days of 'longer term occupation' (more than 31 consecutive days) exceeding 155 in the first 12-month period.

The cottage is situated in the UK, has been let furnished, and on a commercial basis.

(c) Reduction in Pedro's income tax liability for the tax year 2019/20 as result of making the planned contribution of £85,000 (gross) to a personal pension scheme

Income tax liability with the pension contribution

| | |
|--|----------------|
| | £ |
| Employment income (£75,000 + £0) | 75,000 |
| Property income (£14,500 + £32,000) | 46,500 |
| Total/net income | <u>121,500</u> |
| Less: personal allowance (see note below) | (11,850) |
| Taxable income | <u>109,650</u> |
| Income tax liability (W1) | |
| £109,650 x 20% | 21,930 |
| Add: pension contribution additional charge (W2) | |
| £9,850 x 20% | 1,970 |
| £11,150 x 40% | <u>4,460</u> |
| £21,000 | <u>6,430</u> |
| Income tax liability | <u>28,360</u> |

Payment of the pension contribution leads to a reduction of £12,900 (£41,260 – £28,360) in Pedro's income tax liability for 2019/20.

Personal allowance

The pension contributions which qualify for tax relief cannot exceed Pedro's relevant earnings for the tax year. Pedro's relevant earnings for 2019/20 are £89,500 (employment income of £75,000, plus income from furnished holiday lettings of £14,500). The whole of the £85,000 contribution is therefore eligible for tax relief.

Adjusted net income is £36,500 (£121,500 – £85,000), so there is no restriction of the personal allowance.

Workings:

1. Increase in basic rate band

The basic rate band threshold is increased to £119,500 (£34,500 + £85,000).

2. Annual allowance charge

| | £ |
|--|-----------------|
| Contribution by Pedro (gross) | 85,000 |
| Contribution by Loule Ltd to occupational scheme | <u>8,000</u> |
| Total contributions 2019/20 | 93,000 |
| Less: annual allowance available – 2019/20 (W3) | (40,000) |
| 2018/19 (W4) | <u>(32,000)</u> |
| Annual allowance charge | <u>21,000</u> |

3. Annual allowance available 2019/20

Threshold income

| | £ |
|-------------------------------------|-----------------|
| Net income | 121,500 |
| Less: pension contributions (gross) | <u>(85,000)</u> |
| Threshold income | <u>36,500</u> |

As Pedro's threshold income does not exceed £110,000, the annual allowance for 2019/20 is not restricted. It is not necessary to calculate Pedro's adjusted income for the year.

4. Unused annual allowance brought forward

The annual allowance brought forward from 2018/19 is £32,000 (£40,000 – £8,000).

The annual allowance is not available to bring forward from 2016/17 or 2017/18 as Pedro was not a member of a pension scheme in those years.

**Strategic Professional – Options, ATX – UK
Advanced Taxation – United Kingdom (ATX – UK)**

March 2020 Marking Scheme

| | <i>Available</i> | <i>Maximum</i> |
|--|------------------|------------------|
| 1 (a) Automatic non-UK residence | 1 | |
| Automatic UK residence | 2 | |
| UK ties | | |
| Number of ties required | 1 | |
| Consideration of each tie (1 mark each) | 4 | |
| Conclusion | 1 | |
| Liability to UK income tax | 2 | |
| | <u>11</u> | 9 |
| (b) Explanations | | |
| Disposals in 2018/19 | 4 | |
| Calculations | | |
| Sale of house | 0.5 | |
| Sale and gift of shares | 4 | |
| Capital gains tax | 3.5 | |
| | <u>12</u> | 11 |
| (c) Potentially exempt transfers and taper relief | 2.5 | |
| Valuation and exemptions | 3 | |
| Conclusion | 1 | |
| | <u>6.5</u> | 6 |
| (d) If caused by HMRC error, inform HMRC and refund | 2 | |
| Offence, penalties/interest, money laundering | 2 | |
| Corey unwilling to return the money | 2 | |
| | <u>6</u> | 5 |
| Problem solving | 1 | |
| Clarity of explanations and calculations | 1 | |
| Effectiveness of communication | 1 | |
| Overall presentation and style | 1 | |
| | <u>4</u> | 4 |
| Total | | <u>35</u> |
| 2 (a) Chargeable gain | 2 | |
| Gift relief | 1.5 | |
| Capital gains tax | 1 | |
| | <u>4.5</u> | 4 |
| (b) Research costs | | |
| Notes | 4.5 | |
| Calculation | 1.5 | |
| Amortisation of brand | 2 | |
| Calculation of available loss | 3 | |
| Consortium relief | 4 | |
| Value added tax | 3 | |
| | <u>18</u> | 15 |
| (c) UK corporation tax liability | 3 | |
| Effect of making election | 4.5 | |
| | <u>7.5</u> | 6 |
| Total | | <u>25</u> |

| | <i>Available</i> | <i>Maximum</i> |
|---|------------------|------------------|
| 3 (a) Income tax implications | 2 | |
| National insurance implications | 2 | |
| Capital gains tax – chattels < £6,000 | 1 | |
| Difference in tax payable | 0.5 | |
| | <u>5.5</u> | 5 |
| (b) Recognition of basis periods | 2 | |
| Advantages of 30 April year end | 4 | |
| | <u>6</u> | 5 |
| (c) VAT status of suppliers | 2 | |
| VAT status of customers | 2 | |
| | <u>4</u> | 3 |
| (d) Consequences of sale | 5 | |
| Tax liabilities | 3 | |
| After-tax proceeds | 0.5 | |
| | <u>8.5</u> | <u>7</u> |
| Total | | <u>20</u> |
| | | |
| 4 (a) Gift treated as a PET | 1 | |
| Recognition of gift with reservation | 2 | |
| Implications of gift with reservation | 3 | |
| | <u>6</u> | 5 |
| (b) Availability | 1.5 | |
| Actual days let | 1.5 | |
| Pattern of occupancy | 2 | |
| Furnished/commercial basis/UK | 1 | |
| | <u>6</u> | 5 |
| (c) With pension contribution | | |
| Total income | 2 | |
| Personal allowance note | 3 | |
| Tax calculation | 1 | |
| Annual allowance charge | 4 | |
| Tax on annual allowance charge | 1 | |
| Impact on tax liability | 0.5 | |
| | <u>11.5</u> | <u>10</u> |
| Total | | <u>20</u> |