

Professional Level – Options Module

Advanced Taxation (United Kingdom)

Monday 2 June 2008

Time allowed

Reading and planning: 15 minutes

Writing: 3 hours

This 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 3–5

Do NOT open this paper until instructed by the supervisor.

During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.

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

The Association of Chartered Certified Accountants

Paper P6 (UK)

ACCA

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The question paper begins on page 3.

SUPPLEMENTARY INSTRUCTIONS

1. You should assume that the tax rates and allowances for the tax year 2007/08 and for the financial year to 31 March 2008 will continue to apply for the foreseeable future unless you are instructed otherwise.
2. Calculations and workings need only to 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		
		%
Starting rate	£1 – £2,230	10
Basic rate	£2,231 – £34,600	22
Higher rate	£34,601 and above	40

Personal allowances		
		£
Personal allowance	Standard	5,225
	65–74	7,550
	75 and over	7,690
Income limit for age related allowances		20,900

Car benefit percentage

The base level of CO₂ emissions is 140 grams per kilometre.

Car fuel benefit

The base figure for calculating the car fuel benefit is £14,400.

Pension scheme limits

Annual allowance	£225,000
Lifetime allowance	£1,600,000
The maximum contribution that can qualify for tax relief without evidence of earnings	£3,600

Authorised mileage allowances: cars

Up to 10,000 miles	40p
Over 10,000 miles	25p

Capital allowances

	%
Plant and machinery	
Writing down allowance	25
First year allowance	
– Plant and machinery	40
– Low emission motor cars (CO ₂ emissions of less than 120 grams per kilometre)	100

For small businesses only:

The rate of plant and machinery first year allowance is increased to 50% for the periods from 1 April 2006 to 31 March 2008 (6 April 2006 to 5 April 2008 for unincorporated businesses).

Long life assets

Writing-down allowance	6
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Industrial buildings

Writing-down allowance	4
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Corporation tax

Financial year	2005	2006	2007
Small companies rate	19%	19%	20%
Full rate	30%	30%	30%
	£	£	£
Small companies rate lower limit	300,000	300,000	300,000
Small companies rate upper limit	1,500,000	1,500,000	1,500,000
Marginal relief fraction	11/400	11/400	1/40

Marginal Relief

$$(M - P) \times I/P \times \text{Marginal relief fraction}$$

Value added tax

	£
Registration limit	64,000
Deregistration limit	62,000

Inheritance tax

	%
£1–300,000	Nil
Excess	40

Capital gains tax: annual exemption

Individuals	£9,200
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Capital gains tax: taper relief

Complete years after 5 April 1998 for which asset held	Percentage of gain chargeable after relief	
	Business assets	Non-business assets
1	50%	100%
2	25%	100%
3	25%	95%
4	25%	90%
5	25%	85%
6	25%	80%
7	25%	75%
8	25%	70%
9	25%	65%
10	25%	60%

National insurance contributions (not contracted out rates)

			%
Class 1	Employee	£1 – £5,225 per year	Nil
		£5,226 – £34,840 per year	11·0
		£34,841 and above per year	1·0
Class 1	Employer	£1 – £5,225 per year	Nil
		£5,226 and above per year	12·8
Class 1A			12·8
Class 2		Small earnings exception limit – £4,635 £2·20 per week	
Class 4		£1 – £5,225 per year	Nil
		£5,226 – £34,840 per year	8·0
		£34,841 and above per year	1·0

Rates of interest

Official rate of interest	6·25%
Rate of interest on underpaid tax	7·5% (assumed)
Rate of interest on overpaid tax	3·0% (assumed)

Stamp duty land tax

Ad valorem duty	Rate
Residential property	
£125,000 or less (1)	Nil
£125,001 – £250,000	1%
£250,001 – £500,000	3%
£500,000 or more	4%

(1) For non-residential property, the nil rate is extended to £150,000.

Stamp duty

Shares	0·5%
Fixed duty	£5

Section A – BOTH questions are compulsory and MUST be attempted

- 1 An extract from an email from your manager is set out below.

I had a telephone conversation with Daniel Dare (DD), the managing director of Saturn Ltd, first thing this morning. We discussed the anticipated results of the Saturn Ltd group of companies and the proposed acquisition of a majority holding in Tethys Ltd. All the relevant details are included in the attached memorandum.

DD has asked me to call him later this afternoon to go through the tax implications of the various issues. The Saturn Ltd group is not a client; I think DD is just testing us to see whether he would like to use us for tax advice.

I need the following:

- (i) A memorandum that I can use to prepare for my telephone call to DD. I realise that DD did not give me all of the information we need so please identify any additional information that you think could have an effect on our advice.

It is important that you cover all of the points raised by DD; I don't want to end up with detailed answers to some of his questions and no answers to the others. Also, clients often forget about stamp duty and stamp duty land tax so please highlight any such amounts payable by the Saturn Ltd group in respect of the proposed transactions.

- (ii) A summary of the information we need and any action we should take before agreeing to become tax advisers to the Saturn Ltd group.

Tax manager

The memorandum attached to the email is set out below.

To Internal filing
From Tax manager
Date 2 June 2008
Subject **Saturn Ltd group of companies**

This memorandum sets out the matters discussed with Daniel Dare (DD), the managing director of Saturn Ltd, earlier today.

Group structure

Saturn Ltd has three wholly-owned subsidiaries; Dione Ltd, Rhea Ltd and Titan Inc. Titan Inc trades in and is resident in the country of Galactica. The other three group companies are resident in the UK. Saturn Ltd has owned all three subsidiary companies for many years.

Budgeted results for the year ending 30 June 2008

It is estimated that Dione Ltd will make a tax adjusted trading loss of £187,000 in the year ending 30 June 2008; it will have no other income or capital gains in the period. The budgeted profits chargeable to corporation tax of the other companies in the group are set out below.

	£
Saturn Ltd	385,000
Rhea Ltd	590,000
Titan Inc	265,000

Rhea Ltd paid a dividend of £240,000 to Saturn Ltd on 1 May 2008.

Proposed acquisition of 65% of Tethys Ltd

On 1 August 2008, Saturn Ltd will purchase 65% of the ordinary share capital of Tethys Ltd for £235,000 from the personal representatives of George Jetson. The whole of the balance of the company's share capital is owned either by Edith Clanger or by her family company, Clangers Ltd; DD cannot remember which.

It is anticipated that Tethys Ltd will make a tax adjusted trading loss of approximately £80,000 in the year ending 31 December 2008.

In early 2009, Tethys Ltd will sell its manufacturing premises for £240,000 and move to a rented factory. The premises were acquired new on 1 May 1998 for £112,000 and immediately brought into industrial use. The tax written down value for the purposes of industrial buildings allowances as at 31 December 2008 will be £62,720. We agreed that the indexation factor on the disposal can be assumed to be 27%.

Information requested by DD

- (i) The maximum amount of tax that can be saved via the use of the loss of Dione Ltd assuming it is not carried forward and the date by which the necessary claims must be submitted.
- (ii) The amount of the trading loss of Tethys Ltd for the year ending 31 December 2008 that can be used by Saturn Ltd and the ability of Tethys Ltd to use this loss in the future.
- (iii) In respect of the sale of the manufacturing premises:
 - Whether or not Tethys Ltd should charge value added tax (VAT) on the sale of the property.
 - The taxable profit arising in respect of the sale.
 - The amount of the gain that could be rolled over if Tethys Ltd or any of the other Saturn Ltd group companies acquired assets costing £200,000, the types of asset that would have to be purchased and the period during which the assets would need to be acquired.
- (iv) Any stamp duty and/or stamp duty land tax payable by the Saturn Ltd group in respect of the proposed transactions.

Tax manager

Required:

- (a) **Prepare the memorandum requested by your manager. The memorandum should include explanations together with supporting calculations and should identify any further information that you think is required. The following marks are available for the four components of the memorandum:**

- (i) **The amount of tax that can be saved via the use of the loss of Dione Ltd;** (7 marks)
- (ii) **The use of the trading loss of Tethys Ltd for the year ending 31 December 2008;** (6 marks)
- (iii) **Advice in connection with the sale of the manufacturing premises by Tethys Ltd;** (7 marks)
- (iv) **The stamp duty and/or stamp duty land tax payable by the Saturn Ltd group;** (2 marks)

Additional marks will be awarded for the appropriateness of the format and presentation of the memorandum and the effectiveness with which the information is communicated. (2 marks)

- (b) **A summary of the information needed to satisfy our obligations under the money laundering legislation and any action that should be taken before agreeing to become tax advisers to the Saturn Ltd group. (5 marks)**

(29 marks)

2 You have received the following memorandum from your manager, Irwin Allen.

To Tax senior
From Irwin Allen
Date 2 June 2008
Subject **John and Maureen Robinson**

I had a meeting with John Robinson and his wife Maureen yesterday. They have two children; Will, aged seven and Penny, aged nine. John and Maureen have made a number of errors in their income tax returns and Maureen requires advice in connection with her business.

Errors in income tax returns

John inherited a portfolio of quoted shares, an investment property and a large sum of cash in May 2005. Whilst completing his tax return for 2005/06 he decided to 'give' all of the income arising from the shares, property and cash deposits to his wife for tax purposes. Accordingly, he omitted the income from his own tax return and included it in that of his wife. He did the same thing in 2006/07.

John has since realised that such a 'gift' has no effect for tax purposes and has decided to notify HM Revenue and Customs (HMRC) of his mistake.

In January 2006 John gave the investment property to Maureen who sold it a week later. The gift to Maureen was the subject of a legitimate legal conveyance but, after the sale, Maureen gave the sales proceeds to John in accordance with an agreement they had made prior to the gift. Maureen declared the capital gain of £13,470 in her 2005/06 income tax return.

John has asked us to calculate the additional tax payable as a result of his mistaken declarations to HMRC. A schedule prepared by John summarising the family's income for the two tax years 2005/06 and 2006/07 together with details of the investment property is on your desk. The gain on the sale of the investment property was the couple's only capital gain in the last four years.

Maureen's business

Maureen began trading as Robinson Mapping on 1 November 2005. She registered for value added tax (VAT) immediately and prepared her first accounts to 30 September 2006. A schedule prepared by Maureen summarising the results of the business is also on your desk.

Maureen supplies specialised maps to businesses in the leisure industry. All of her customers are registered for VAT. The business has recoverable input tax of approximately £300 per quarter. Despite accounting for VAT on an annual basis, Maureen is finding the administration of the tax very time consuming and is considering deregistering unless the amount of administration can be reduced.

Please prepare the following for me.

- (a) A calculation of the additional taxes payable by John and Maureen Robinson in respect of the tax years 2005/06 and 2006/07 as a result of disclosing to HMRC the errors in their tax returns.

There's quite a bit to do here; please ensure that your calculations are clear and logical so that they are easy to follow. You'll need to work out the extra tax payable by John on the investment income and compare it with the tax paid by Maureen (probably a fairly small amount as most if not all of the income will have fallen into her basic rate band).

Please **do not** address the issue of interest and penalties for the moment.

- (b) Advice for Maureen on her ability to deregister for the purposes of VAT together with the procedure she should follow and the implications of deregistration. Include details of any alternative strategy that might solve her problem.

I do not want you to write a letter or to prepare illustrative calculations; just write the necessary paragraphs for me to incorporate in a letter that will cover a number of other issues.

Thank you

Irwin

The schedule summarising all of the family's income, with the exception of that relating to Maureen's business, is set out below.

Robinson Family – Income received in tax years 2005/06 and 2006/07			
	Notes	2005/06 £	2006/07 £
Income arising on inherited assets:			
Dividend income received in respect of share portfolio		8,856	9,108
Rental income in respect of investment property		2,550	–
Bank interest income received in respect of cash deposits		2,424	2,576
John – other income:			
Salary		29,400	30,500
Company car	1		
Trust income received	2	720	780
Maureen – other income:			
Unincorporated business	3		
Will – bank deposit interest received	4	Nil	88
Penny – bank deposit interest received	4	Nil	144
Notes			
1. I have had use of the car since 1 August 2005 for both business and private use. I also receive free petrol in respect of all of my mileage. The car had a list price when new of £17,400 and has a CO ₂ emission rate of 187 grams per kilometre.			
2. The trust is a discretionary trust established by my uncle.			
3. Maureen will provide you with a summary of the results of her business.			
4. I transferred cash from my bank account to two new accounts for the children on 1 June 2006. The interest is credited gross as there is no tax liability on the children's income.			

The schedule summarising the results of Maureen's business is set out below.

Maureen Robinson – Robinson Mapping	
– Began trading on 1 November 2005	
– Purchased a computer and other equipment for £5,850 (excluding value added tax (VAT)) in the first month of trading.	
– Tax adjusted trading profits, before deduction of capital allowances:	
Period ended 30 September 2006	£28,400
Year ended 30 September 2007	£31,240

Required:

- (a) Prepare a calculation of the additional taxes payable by John and Maureen Robinson in respect of the tax years 2005/06 and 2006/07 as a result of disclosing to HMRC the errors in their tax returns. (26 marks)

Additional marks will be awarded for the clarity with which the information is presented and the extent to which the calculations are structured in a logical manner. (2 marks)

- (b) Advise Maureen on deregistration for the purposes of value added tax (VAT) and any possible alternative strategy. (8 marks)

An additional mark will be awarded for the effectiveness with which the information is communicated. (1 mark)

(37 marks)

Section B – TWO questions ONLY to be attempted

- 3 Spica, one of the director shareholders of Acrux Ltd, has been in dispute with the other shareholders over plans to expand the company's activities overseas. In order to resolve the position it has been agreed that Spica will sell her shares back to the company. Once the purchase of her shares has taken place, the company intends to establish a number of branches overseas and acquire a shareholding in a number of companies that are resident and trade in overseas countries.

The following information has been obtained from client files and meetings with the parties involved.

Acrux Ltd:

- An unquoted UK resident company.
- Share capital consists of 50,000 ordinary shares issued at £1.90 per share in July 2000.
- None of the other shareholders has any connection with Spica.

The purchase of own shares:

- The company will purchase all of Spica's shares for £8 per share.
- The transaction will take place by the end of 2008.

Spica:

- Purchased 8,000 shares in Acrux Ltd for £2 per share on 30 September 2003.
- Has no income in the tax year 2008/09.
- Has chargeable capital gains in the tax year 2008/09 of £3,800.
- Has houses in the UK and the country of Solaris and divides her time between them.

Investment in non-UK resident companies:

- Acrux Ltd will acquire between 15% and 20% of each of the non-UK resident companies.
- The companies will not be controlled foreign companies as the rates of tax in the overseas countries will be between 23% and 42%.
- There may or may not be a double tax treaty between the UK and the overseas countries in which the companies are resident. Where there is a treaty, it will be based on the OECD model treaty.
- None of the countries concerned levy withholding tax on dividends paid to UK companies.
- The directors of Acrux Ltd are concerned that the rate of tax suffered on the profits of the overseas companies will be very high as they will be taxed in both the overseas country and in the UK.

Required:

- (a) (i) **Prepare detailed calculations to determine the most beneficial tax treatment of the payment Spica will receive for her shares;** (7 marks)
- (ii) **Identify the points that must be confirmed and any action necessary in order for capital treatment to apply to the transaction.** (4 marks)
- (b) **Provide the directors of Acrux Ltd with a detailed explanation of the maximum rate of tax that will be suffered on both the distributed and non-distributed profits of the non-UK resident investee companies where:**
- (1) **there is a double tax treaty between the UK and the country in which the individual companies are resident; and**
- (2) **there is no such double tax treaty.**

Note: you are not required to explain the position of the overseas resident branches. (6 marks)

(17 marks)

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Question 4 begins on page 12.**

- 4 Kepler gave his nephew, Galileo, 600 shares (a 30% holding) in Messier Ltd on 1 June 2004. On 1 May 2008, Kepler died and left the remaining 1,400 shares in Messier Ltd to Galileo. Galileo intends to move to the UK from the country of Astronmeria to participate in the management of Messier Ltd.

The following information has been obtained from client files and meetings with the parties involved.

Kepler:

- Died on 1 May 2008.
- Has two nephews; Galileo and Herschel.
- In his will he left 1,400 shares in Messier Ltd valued at £546,000 to Galileo and the residue of his estate valued at £480,000 to Herschel.

Kepler – Lifetime gifts:

- 1 February 2003 Gave a house to Herschel valued at £298,000.
- 1 July 2003 Gave a watch costing £900 to each of his two nephews.
- 1 June 2004 Gave 600 shares in Messier Ltd to Galileo.

Messier Ltd:

- Unquoted company that transports building materials.
- Incorporated on 1 February 1996 when Kepler subscribed for 2,000 shares, the whole of its share capital.

Messier Ltd – Value of an ordinary share:

As at	1 June 2004	1 May 2008
	£	£
As part of a 100% holding	485	570
As part of a 70% holding	310	390
As part of a 30% holding	230	260

Messier Ltd – Asset values:

As at 1 June 2004	£
Premises	900,000
Surplus land rented to third party	480,000
Vehicles	100,000
Current assets	50,000

Galileo:

- Resident, ordinarily resident and domiciled in the country of Astronmeria where he has lived since birth.
- Lives in rented accommodation in Astronmeria.
- Intends to sell two paintings in order to provide funds to go towards the cost of relocating to the UK and purchasing a house here.
- Has a full time employment contract with Messier Ltd commencing on 1 September 2008.
- Intends to stay in the UK for at least five years.

The two paintings:

- Are situated in Astronmeria and are worth approximately £20,000 each.
- Have been owned by Galileo since 1 May 1994; their cost is negligible and can be ignored.

Employment contract with Messier Ltd:

- Galileo will be paid an annual salary of £52,000.
- Messier Ltd will assist Galileo with the cost of relocating to the UK.

Required:

- (a) (i) Calculate the inheritance tax payable (if any) by Galileo in respect of (1) the gift of shares in June 2004 and (2) the inheritance of shares in May 2008; (7 marks)
- (ii) Explain why Galileo is able to pay the inheritance tax due in instalments, state when the instalments are due and identify any further issues relevant to Galileo relating to the payments. (3 marks)
- (b) Prepare a reasoned explanation of how any capital gains tax arising in the UK on the sale of the paintings can be minimised. (2 marks)
- (c) (i) Explain how Messier Ltd can assist Galileo with the cost of relocating to the UK and/or provide him with interest-free loan finance for this purpose without increasing his UK income tax liability; (3 marks)
- (ii) State, with reasons, whether Messier Ltd can provide Galileo with accommodation in the UK without giving rise to a UK income tax liability. (2 marks)

(17 marks)

- 5 Gagarin wishes to persuade a number of wealthy individuals who are business contacts to invest in his company, Vostok Ltd. He also requires advice on the recoverability of input tax relating to the purchase of new premises.

The following information has been obtained from a meeting with Gagarin.

Vostok Ltd:

- An unquoted UK resident company.
- Gagarin owns 100% of the company's ordinary share capital.
- Has 18 employees.
- Provides computer based services to commercial companies.
- Requires additional funds to finance its expansion.

Funds required by Vostok Ltd:

- Vostok Ltd needs to raise £420,000.
- Vostok Ltd will issue 20,000 shares at £21 per share on 31 August 2008.
- The new shareholder(s) will own 40% of the company.
- Part of the money raised will contribute towards the purchase of new premises for use by Vostok Ltd.

Gagarin's initial thoughts:

- The minimum investment will be 5,000 shares and payment will be made in full on subscription.
- Gagarin has a number of wealthy business contacts who may be interested in investing.
- Gagarin has heard that it may be possible to obtain tax relief for up to 60% of the investment via the enterprise investment scheme.

Wealthy business contacts:

- Are all UK resident higher rate taxpayers.
- May wish to borrow the funds to invest in Vostok Ltd if there is a tax incentive to do so.

New premises:

- Will cost £446,500 including value added tax (VAT).
- Will be used in connection with all aspects of Vostok Ltd's business.
- Will be sold for £600,000 plus VAT in six years time.
- Vostok Ltd will waive the VAT exemption on the sale of the building.

The VAT position of Vostok Ltd:

- In the year ending 31 March 2009, 28% of Vostok Ltd's supplies will be exempt for the purposes of VAT.
- This percentage is expected to reduce over the next few years.
- Irrecoverable input tax due to the company's partially exempt status exceeds the *de minimis* limits.

Required:

(a) Prepare notes for Gagarin to use when speaking to potential investors. The notes should include:

- The tax incentives immediately available in respect of the amount invested in shares issued in accordance with the enterprise investment scheme;** (5 marks)
- The answers to any questions that the potential investors may raise in connection with the maximum possible investment, borrowing to finance the subscription and the implications of selling the shares.** (7 marks)

Note: you should assume that Vostok Ltd and its trade qualify for the purposes of the enterprise investment scheme and you are not required to list the conditions that need to be satisfied by the company, its shares or its business activities.

(b) Calculate the amount of input tax that will be recovered by Vostok Ltd in respect of the new premises in the year ending 31 March 2009 and explain, using illustrative calculations, how any additional recoverable input tax will be calculated in future years. (5 marks)

(17 marks)

End of Question Paper