

Professional Pilot Paper – Options module

Advanced Taxation (United Kingdom)

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

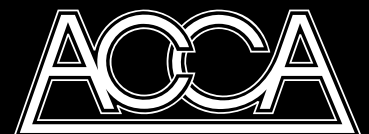
Section B – TWO questions ONLY to be attempted

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)

The following tax rates and allowances are to be used in answering the questions:

Tutorial note

This pilot paper has been written as though being examined in June 2007, using the rates and allowances from the Finance Act 2006.

Income Tax

		%
Starting rate	£1 – £2,150	10
Basic rate	£2,151 – £33,300	22
Higher rate	£33,301 and above	40

Personal Allowance

Personal allowance	£5,035
Personal allowance aged 65 to 74	£7,280
Personal allowance aged 75 and over	£7,420
Income limit for age related allowances	£20,100

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	£215,000
Lifetime allowance	£1,500,000
The maximum contribution that can qualify for tax relief without any earnings is £3,600.	

Authorised Mileage Allowances

All 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 not more than 120 grams per kilometre) (17 April 2002 to 31 March 2008)	100

For small businesses only: the rate of plant and machinery first-year allowance is increased to 50% for the periods from 1 April 2004 to 31 March 2005 (6 April 2004 to 5 April 2005 for unincorporated businesses) and 1 April 2006 to 31 March 2007 (6 April 2006 to 5 April 2007 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	2004	2005	2006
Starting rate	nil	nil	–
Small companies rate	19%	19%	19%
Full rate	30%	30%	30%
Starting rate lower limit	10,000	10,000	–
Starting rate upper limit	50,000	50,000	–
Lower limit	300,000	300,000	300,000
Upper limit	1,500,000	1,500,000	1,500,000
Marginal relief fraction			
Starting rate	19/400	19/400	–
Small companies rate	11/400	11/400	11/400

Marginal Relief

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

Value Added Tax

	£
Registration limit	61,000
Deregistration limit	59,000

Inheritance Tax

First £285,000	Nil
Excess	40%

Capital Gains Tax: Annual Exemption

Individuals	£8,800
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Capital Gains Tax: Taper Relief

Complete years after 5 April 1998 for which asset held	Gains on business assets	Gains on 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 – £5,035 per year	Nil
	£5,036 – £33,540 per year	11.0
	£33,541 and above per year	1.0
Class 1 Employer	£1 – £5,035 per year	Nil
	£5,036 and above per year	12.8
Class 1A		12.8
Class 2	£2.10 per week	
Class 4	£1 – £5,035 per year	Nil
	£5,036 – £33,540 per year	8.0
	£33,541 and above per year	1.0

Rates of Interest

Official rate of interest:	5.0%
Rate of interest on underpaid tax:	6.5% (assumed)
Rate of interest on overpaid tax:	2.25% (assumed)

Stamp Duty and Stamp Duty Land Tax

Ad Valorem Duty	Rate
Residential property:	
£125,000 or less (1)	Nil
£125,001 to £250,000	1%
£250,001 to £500,000	3%
£500,001 or above	4%
(1) for non residential property, the nil rate is extended to £150,000	
Shares	0.5%
Fixed duty	£5

Calculations and workings need only be made to the nearest £. All apportionments may be made to the nearest month. All workings should be shown.

Section A: BOTH questions are compulsory and MUST be attempted

1 Hutt plc has owned the whole of the ordinary share capital of Rainbow Ltd and Coronet Ltd since 1998. All three companies are resident in the UK. Their results for the year ended 31 March 2007 are as follows:

	Hutt plc	Rainbow Ltd	Coronet Ltd
	£	£	£
Taxable trading profit/(loss)	(105,000)	800,000	63,000
Capital gain	144,000	–	–
Rental income	65,000	–	–
UK bank interest receivable	2,000	57,000	18,000

Hutt plc’s rental income of £65,000 per annum arises in respect of Hutt Tower, an office building acquired on 1 April 2006.

In the year ended 31 March 2006 Hutt plc had a trading profit of £735,000, UK bank interest receivable of £2,000 and a capital loss of £98,000, which was carried forward as at 31 March 2006.

Hutt plc and Coronet Ltd both carry on trades in the UK. Rainbow Ltd conducts both its manufacturing and trading activities wholly in the country of Prismovia. The system of corporation tax in Prismovia is mainly the same as that in the UK although the rate of corporation tax is 28%. There is no double taxation agreement between the UK and Prismovia.

Hutt plc has agreed that it will purchase the whole of the share capital of Lucia Ltd, a UK resident engineering component manufacturing company, on 1 July 2007 for £130,000.

Hutt plc will need to take out a loan to finance the purchase of Lucia Ltd. The company intends to borrow £190,000 from BHC Bank Ltd on 1 July 2007. BHC Bank Ltd will charge Hutt plc a £1,400 loan arrangement fee and interest at 7.25% per annum. Hutt plc only needs £130,000 of the loan to buy the share capital of Lucia Ltd and intends to use the balance of the loan as follows: £45,000 to carry out repairs to Hutt Tower; and the remainder to help fund the company’s ongoing working capital requirements.

Lucia Ltd is a UK resident company. The scale of its activities in the last few years has been very small and it has made tax adjusted trading losses. As at 31 March 2007 Lucia Ltd has trading losses carried forward of £186,000. The company’s activities from 1 April 2007 to 30 June 2007 are expected to be negligible and any profit or loss in that period can be ignored. Because of the small scale of its activities Lucia Ltd has not been registered for value added tax (VAT) since March 2006. In arriving at the purchase price for the company, the owners of Lucia Ltd have valued the company’s trading losses at £35,340 (£186,000 at 19%), as Lucia Ltd has always been a small company.

On the purchase of Lucia Ltd, Hutt plc has plans to return the company to profitability and the budgeted turnover of Lucia Ltd for the nine months ended 31 March 2008 is as set out below. All amounts relate to the sales of engineering components and are stated exclusive of VAT. It can be assumed that all categories of turnover will accrue evenly over the period.

		£
UK customers:	– VAT registered	85,000
	– non-VAT registered	25,000
European Union customers:	– VAT registered	315,000
	– non-VAT registered	70,000
Other non-UK customers		180,000
		<u>675,000</u>

Lucia Ltd will incur input VAT of £7,800 per month from 1 July 2007 in respect of purchases from UK businesses. It will also purchase raw materials from Dabet GmbH for £17,000 in November 2007. Dabet GmbH is resident and registered for VAT in Germany.

Lucia Ltd owns a factory that was built in May 1971 at a cost of £210,000. The factory was acquired by Lucia Ltd on 30 June 2003, for £270,000. It can be assumed that the factory’s current value of £80,000 will not change in the foreseeable future. On 1 January 2008, Lucia Ltd will sell this factory and take out a short lease on a new, larger one. The indexation allowance applicable to the period June 2003 to January 2008 can be assumed to be £27,000.

It is proposed that an office building owned by Coronet Ltd be sold to Lucia Ltd in May 2008 at its market value. This building will then be sold on by Lucia Ltd, to Vac Ltd, an unconnected third party in June 2008, giving rise to a capital gain of £92,000. The intention is that this gain will be reduced by the capital loss arising on the sale of the factory.

Required:

(a) Describe and evaluate the options available in respect of the trading losses of Hutt plc for the year ended 31 March 2007. Your answer should include a recommendation on the most tax efficient use of these losses, together with details of and time limits for any elections or claims that would need to be submitted, assuming that the losses are to be used as soon as possible and are not to be carried forward. (13 marks)

(b) Prepare a report for the management of Hutt plc concerning the acquisition of Lucia Ltd. The report should be in three sections, addressing the three sets of issues set out below, and should, where appropriate, include supporting calculations.

(i) The purchase price

Comment on the valuation placed on Lucia Ltd's trading losses, by the owners of Lucia Ltd.

Provide an explanation of the tax treatment of the loan arrangement fee and the interest payable on the loan of £190,000, assuming that Hutt plc continues to have bank interest receivable, in the year ended 31 March 2008, of £2,000. (9 marks)

(ii) VAT issues

Provide an explanation of the date by which Lucia Ltd will be required to register for VAT in the UK and any other relevant points in respect of registration.

Provide a calculation of the VAT payable by, or repayable to, Lucia Ltd in respect of the period from registration to 31 March 2008.

With reference only to the facts in the question, suggest ONE disadvantage of Lucia Ltd entering into a group VAT registration with Hutt plc. (6 marks)

(iii) The office building

Advise on the tax implications of the proposed sale of the office building by Coronet Ltd to Lucia Ltd in May 2008. Your answer should consider all relevant taxes.

Evaluate the proposed strategy to reduce the capital gain arising on the sale of the office building by offsetting the capital loss on the sale of the factory, on the assumption that both Lucia Ltd and Coronet Ltd will pay corporation tax at the rate of 30%, for the year ended 31 March 2009. (9 marks)

Appropriateness of the format and presentation of the report and the effectiveness with which its advice is communicated. (2 marks)

You may assume that the tax rates and allowances for the financial year to 31 March 2007 and for the tax year 2006/07 will continue to apply for the foreseeable future.

(39 marks)

- 2 Your manager has had a meeting with Pilar Mareno, a self-employed consultant, and has sent you a copy of the following memorandum.

To The files
 From Tax manager
 Date 31 May 2007
 Subject Pilar Mareno – Business expansion

Pilar Mareno (PM) has been offered a contract with DWM plc, initially for two years, which will result in fees of £80,000 plus VAT per annum.

In order to service this contract, PM would have to take on additional help in the form of either a part-time employee for two days a week, or the services of a self-employed contractor for 100 days per year. She would also have to acquire a van, which would be used wholly for business purposes. PM has decided that she will only enter into the contract if it generates at least an additional £15,000 per annum, on average, for the family after all costs and taxes.

PM's annual profitability and the profit generated by the contract (before taking into account the costs of the part-time employee/contractor and the van) are summarised below.

	Existing business	New contract
	£	£
Sales	210,000	80,000
Less: Materials, wages and overheads	(120,000)	(35,000)
Profit per accounts and taxable profit	90,000	45,000

Supplies made under the contract will be 65% standard rated and 35% exempt for value added tax (VAT) purposes; this is the same as for PM's existing business. £31,500 of the costs incurred in relation to the contract will be subject to VAT at the standard rate. The equivalent figure for PM's existing business is £100,000.

PM has identified Max Wallen (MW) as a possible self-employed contractor. MW would charge £75 per day plus VAT for a contract of 100 days per year, with a rate of £25 per day plus VAT in respect of any days when he is ill (up to a maximum of 8 days per year). PM has a spare copy of the specialist software that MW would need but MW would use his own laptop computer.

Alternatively, PM could employ her husband, Alec (AM), paying him a gross annual salary of £7,600. AM would have to give up his current full time job, but would expect to do other part-time employed work earning a further £10,000 (gross) per annum.

PM estimates that a second hand van will cost £7,800 plus VAT or alternatively, a van could be leased for £300 plus VAT per month. We can assume that if the van is purchased, it will be sold at the end of the two year contract for £2,500 plus VAT.

Tax manager

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

Please prepare a memorandum for me, incorporating the following:

- 1 Calculations to demonstrate whether or not Pilar's desired annual after tax income from the new contract will be achievable depending on:
 - whether she leases or buys the van; and
 - whether she employs Alec or uses Max Wallen.

You may find it easier to:

- (i) work out the after tax cost of buying or leasing the van. (When calculating the annual cost of the van, assume that the total cost can be averaged over the two years of the contract.)

and then to consider:

- (ii) the after tax income depending on whether Alec is employed or the self-employed contractor, Max, is used.

- 2 A rationale for the approach you have taken and a summary of your findings.
- 3 Any other issues we should be considering in respect of Pilar employing Alec, including any alternative to employment.
- 4 It seems to me that HM Revenue and Customs may be able to successfully contend that Max Wallen would be an employee, rather than a self-employed contractor. Prepare your figures on the basis that he is self-employed but include a list of factors in your memorandum, based on the information we have, that would indicate either employed or self-employed status.

Take some time to think about your approach to this before you start. Also, as always when working on Pilar's affairs, watch out for the VAT as it can get quite tricky. I suspect the VAT will affect the costs incurred so you'll need to address VAT first. Pilar's estimate of the profit on the contract will have ignored these complications.

Tax manager

You have extracted the following further information from Pilar Mareno's client file.

- None of Pilar's VAT inputs is directly attributable to either standard rated or exempt supplies.
- Alec has worked for a UK bank for many years and is currently paid an annual salary of £17,000.
- The couple have no sources of income other than those set out above.

Required:

Prepare the memorandum requested by your manager.

Marks are available for the four components of the memorandum as follows:

1. **Relevant calculations.** (16 marks)
2. **Rationale for the approach taken and summary of findings.** (2 marks)
3. **Other issues in respect of Pilar employing Alec, together with any suggestions as to an alternative to employment.** (2 marks)
4. **The employment status of Max Wallen.** (3 marks)

Appropriateness of the format and presentation of the memorandum and the effectiveness with which the information is communicated. (2 marks)

You may assume that the rates and allowances for the tax year 2006/07 will continue to apply for the foreseeable future.

(25 marks)

Section B: TWO questions ONLY to be attempted

- 3 Stanley Beech, a self-employed landscape gardener, intends to transfer his business to Landscape Ltd, a company formed for this purpose.

The following information has been extracted from client files and from meetings with Stanley.

Stanley:

- Acquired a storage building for £46,000 on 1 July 1998 and began trading.
- Has no other sources of income.
- Has capital losses brought forward from 2002/03 of £11,400.

The whole of the business is to be transferred to Landscape Ltd on 1 September 2007:

- The market value of the assets to be transferred is £118,000.
- The assets include the storage building and goodwill, valued at £87,000 and £24,000 respectively, and various small pieces of equipment and consumable stores.
- Landscape Ltd will issue 5,000 £1 ordinary shares as consideration for the transfer.

Advice given to Stanley in respect of the sale of the business:

- “No capital gains tax will arise on the transfer of your business to the company.”
- “You should take approximately 30% of the payment from Landscape Ltd in shares with the balance left on a loan account payable to you by the company, such that you can receive a cash payment in the future.”

Advice given to Stanley in respect of his annual remuneration from Landscape Ltd:

- “The payment of a dividend of £21,000 is more tax efficient than paying a salary bonus of £21,000 as you will pay income tax at only 25% on the dividend received, whereas you would pay income tax at 40% on a salary bonus. The dividend also avoids the need to pay national insurance contributions.”
- “There is no tax in respect of an interest free loan from an employer of less than £5,000.”
- “The provision of a company car is tax neutral as the cost of providing it is deductible in the corporation tax computation.”

Stanley’s proposed remuneration package from Landscape Ltd:

- An annual salary of £40,000 and an annual dividend of approximately £21,000.
- On 1 December 2007 an interest free loan of £3,600, which he intends to repay in two years time.
- A company car with a cost when new of £11,400. The only costs incurred by the company in respect of this car will be lease rentals of £300 per month and business fuel of £100 per month.
- The annual employment income benefit in respect of the car is to be taken as £3,420.

Landscape Ltd:

- Will prepare accounts to 31 March each year.
- Will pay corporation tax at the rate of 19%.

Required:

- (a) (i) Explain why there would be no capital gains tax liability on the transfer of Stanley’s business to Landscape Ltd in exchange for shares. Calculate the maximum loan account balance that Stanley could receive without giving rise to a capital gains tax liability and state the resulting capital gains tax base cost of the shares. (8 marks)
- (ii) Explain the benefit to Stanley of taking part of the payment for the sale of his business in the form of a loan account, which is to be paid out in cash at some time in the future. (1 mark)
- (b) Comment on the accuracy and completeness of the advice received by Stanley in respect of his remuneration package. Supporting calculations are only required in respect of the company car. (9 marks)

Ignore value added tax (VAT) in answering this question.

You may assume that the rates and allowances for the financial year to 31 March 2007 and the tax year 2006/07 will continue to apply for the foreseeable future.

(18 marks)

- 4 Mahia Ltd is an unquoted, UK resident trading company formed in May 2000. One of its shareholders, Claus Rowen, intends to sell his shares back to Mahia Ltd on 31 July 2007. Another shareholder, Maude Brooke, intends to give some of her shares to her daughter, Tessa.

The following information has been extracted from client files and from meetings with the shareholders.

Mahia Ltd:

- In May 2000 the company issued 40,000 shares at £3.40 per share as follows:

Claus Rowen	16,000
Charlotte Forde	12,000
Olaf Berne	12,000
- Olaf sold his 12,000 shares to Maude Brooke on 1 October 2005 when they were worth £154,000.

Claus and Charlotte:

- Have always lived in the UK.
- Are higher rate taxpayers who use their capital gains tax annual exemption every year.

Maude:

- Was born in the UK, but moved to Canada on 1 April 2003 with her daughter, Tessa.
- Has not visited the UK since leaving for Canada, but will return to the UK permanently in December 2012.
- Is employed in Canada with an annual salary equivalent to £70,000.

Sale of shares by Claus:

- Charlotte and Maude want to expand the company’s activities in the UK but Claus does not. The shareholders have been arguing over this matter for almost a year.
- In order to enable the company to prosper, Claus has agreed to sell his shares to the company on 31 July 2007.

Gift of shares by Maude:

- Maude will gift 4,000 shares in Mahia Ltd to her daughter, Tessa, on either 1 August 2007 or 1 June 2008.
- She will delay the gift until 1 June 2008 (Tessa’s wedding day) if this reduces the total tax due.
- The tax due in Canada will be the same regardless of the date of the gift.
- She has made no previous transfers of value for UK inheritance tax purposes.
- For the purposes of this gift, you should assume that Maude will die on 31 December 2011.

Market values of shares in Mahia Ltd on all relevant dates are to be taken as:

Size of shareholding	Market value per share
%	£
< 25	10.20
25 – 35	14.40
> 35	38.60

Market values of the assets of Mahia Ltd on all relevant dates are to be taken as:

	£
Land and buildings used within the trade	1,400,000
Three machines of equal value used within the trade	15,000
Motor cars used by employees	45,000
Quoted shares	42,000
Inventory, trade receivables and cash	145,000

Required:

- (a) Advise Claus on the tax treatment of the proceeds he will receive in respect of the sale of his shares to Mahia Ltd. Prepare a calculation of the net (after tax) proceeds from the sale based on your conclusions. (8 marks)
- (b) Advise Maude on the UK tax consequences of gifting the shares to Tessa and prepare computations to determine on which of the two dates the gift should be made, if the total UK tax due on the gift is to be minimised. Your answer should consider all relevant taxes. (10 marks)

You may assume that the rates and allowances for the tax year 2006/07 will continue to apply for the foreseeable future.

(18 marks)

- 5 Vikram Bridge has been made redundant by Bart Industries Ltd, a company based in Birmingham. He intends to move to Scotland to start a new job with Dreamz Technology Ltd.

The following information has been extracted from client files and from meetings with Vikram.

Vikram Bridge:

- Is unmarried, but has been living with Alice Tate since 1996. The couple have four young children.
- Receives dividends of approximately £7,800 each year and makes annual capital gains of approximately £1,200 in respect of shares inherited from his mother.
- The couple have no sources of income other than Vikram's employment income and the £7,800 of dividends.

Made redundant by Bart Industries Ltd on 28 February 2007:

- Vikram's employment contract entitled him to two months' notice or two months salary in lieu of notice. On 28 February 2007 the company paid him his salary for the two-month period of £4,700, and asked him to leave immediately.
- On 30 April 2007 the company paid him a further £1,300 in respect of statutory redundancy, together with a non-contractual lump sum of £14,500, as a gesture of goodwill.

Job with Dreamz Technology Ltd:

- Starts on 1 October 2007 with an annual salary of £38,500.
- The company will contribute £9,400 in October 2007 towards Vikram's costs of moving to Scotland.
- In November 2008, the company will issue free shares to all of its employees. Vikram will be issued with 200 shares, expected to be worth approximately £2,750.

Moving house:

- Vikram's house in Birmingham is fairly small; he intends to buy a much larger one in Glasgow.
- The cost of moving to Glasgow, including the stamp duty land tax in respect of the purchase of his new house, will be approximately £12,500.
- To finance the purchase of the house in Glasgow Vikram will sell a house he owns in Wales, in August 2007.

House in Wales:

- Was given to Vikram by his mother on 1 September 1999, when it was worth £145,000.
- Vikram's mother continued to live in the house until her death on 1 May 2007, when she left the whole of her estate to Vikram.
- At the time of her death the house had severe structural problems and was valued at £140,000.
- Vikram has subsequently spent £18,000 improving the property and expects to be able to sell it for £195,000.
- Vikram is keen to reduce the tax payable on the sale of the house and is willing to transfer the house, or part of it, to Alice prior to the sale if that would help.

Required:

Prepare explanations, including supporting calculations where appropriate, of the following issues suitable for inclusion in a letter to Vikram.

- The capital gains tax payable on the sale of the house in Wales in August 2007, together with the potential effect of transferring the house, or part of it, to Alice prior to the sale, and any other advice you consider helpful.** (7 marks)
- The inheritance tax implications in respect of the house in Wales on the death of Vikram's mother.** (2 marks)
- The income tax treatment of the receipt by Vikram of the shares in Dreamz Technology Ltd.** (3 marks)
- How Vikram's job with Dreamz Technology Ltd will affect the amount and date of payment of the income tax due on his dividend income for 2009/10 and future years.** (6 marks)

Ignore national insurance contributions in answering this question.

You may assume that the rates and allowances for the tax year 2006/07 will continue to apply for the foreseeable future.

(18 marks)

End of Question paper

Answers

1 (a) Options available in respect of the trading losses of Hutt plc of £105,000

(i) Within Hutt plc

The loss can be offset against the profits chargeable to corporation tax of Hutt plc for the year ended 31 March 2007.

	£
Capital gain	144,000
Less: capital loss brought forward	(98,000)
	<u>46,000</u>
Rental income	65,000
Interest income	2,000
	<u>113,000</u>

Hutt plc, Rainbow Ltd and Coronet Ltd are associated as Hutt plc controls the other two companies. As a result, the small companies rate lower limit for the purposes of determining the rate of corporation tax is reduced from £300,000 to £100,000. Accordingly, Hutt plc will pay corporation tax at 30% less marginal relief. This means that the first £100,000 of the company's profits will be taxed at 19% and the final £13,000 at the marginal rate of 32¾%.

A current period offset has to be made before losses can be carried back to the previous twelve months. The trading loss for the year ended 31 March 2007 is less than the profits chargeable to corporation tax and therefore a claim to carry back the losses cannot be made.

(ii) Group relief

Hutt plc, Rainbow Ltd and Coronet Ltd are in a group for group relief purposes as Hutt plc controls at least 75% of the other two companies. Any amount of the loss can be surrendered to each of the two subsidiary companies in order to reduce their profits chargeable to corporation tax. The maximum surrender is the profits chargeable to corporation tax of the recipient company.

Coronet Ltd has profits chargeable to corporation tax of £81,000 (£63,000 + £18,000). As stated above, due to the number of associates, the small companies rate lower limit is reduced to £100,000 (£300,000 x ⅓). Accordingly, Coronet Ltd will pay tax at 19%.

The profits chargeable to corporation tax of Rainbow Ltd exceed £500,000 (£1,500,000 x ⅓) and therefore, the company will pay UK corporation tax at the rate of 30%.

However, Rainbow Ltd has a permanent establishment in Prismovia as it manufactures and trades in that country. The profits arising in Prismovia will be taxed in that country at 28%. Double tax relief will be available in the UK in respect of the Prismovian tax suffered, up to a maximum of the UK tax on the Prismovian profits; any surrender to Rainbow Ltd must ensure that relief for the foreign tax suffered is not lost.

The maximum surrender that can be made to Rainbow Ltd whilst preserving relief for the foreign tax is calculated as follows.

	£
Trading profit ((£800,000 x 2%) / 30%)	53,333
Interest income	57,000
	<u>110,333</u>

(iii) Recommendations

In order to maximise the tax saved the losses should be offset against the profits taxed at 32¾% in Hutt plc and the profits taxed at 30% in Rainbow Ltd whilst preserving the relief for the foreign tax suffered.

Accordingly, £13,000 of the losses should be offset against the profits chargeable to corporation tax in Hutt plc with the balance of £92,000 (£105,000 – £13,000) surrendered to Rainbow Ltd. This is less than £110,333, and therefore, preserves relief for all of the foreign tax.

When making a claim to offset a company's trading loss against its total profits, it is not possible to specify the amount to be offset; all of the losses available will be offset subject to the level of taxable profits. Accordingly, in order to achieve the desired result, the two claims must be made in the following order.

1. An election to surrender losses of £92,000 to Rainbow Ltd. This must be made by 31 March 2009, i.e. within one year of the filing date of the claimant company's tax return. Both Rainbow Ltd and Hutt plc must elect.
2. An election to offset the remaining losses (£13,000) against the total profits of Hutt plc should be submitted by the same date, i.e. within two years of the end of the period in which the loss was made.

Tutorial note

The tax computation of Rainbow Ltd for the year ended 31 March 2007 following the group relief claim is set out below. Group relief of £57,000 is offset against the interest income with the balance of £35,000 being offset against the trading profit in order to maximise the double tax relief.

	£
Trading profit (£800,000 – £35,000)	765,000
Interest income (£57,000 – £57,000)	–
	<hr/>
Profits chargeable to corporation tax	765,000
	<hr/>
Corporation tax @ 30%	229,500
Less Double tax relief (£800,000 x 28%)	(224,000)
	<hr/>
Corporation tax payable	5,500
	<hr/>

(b) Report to the management of Hutt plc

To The management of Hutt plc
From Tax advisers
Date 1 June 2007
Subject The acquisition of Lucia Ltd

(i) The purchase price

Valuation of the trading losses in Lucia Ltd

Lucia Ltd has no profits in the year ended 31 March 2007 or the previous year against which to offset the losses.

The trading losses arose before Lucia Ltd joined the Hutt plc group, and therefore, they cannot be surrendered to any of the group members.

The losses cannot be carried forward as there will be a change of ownership of Lucia Ltd after its activities have become negligible. Losses arising prior to the change of ownership cannot be offset against profits arising once the trade has been revived.

The losses cannot be used, and therefore, they have no value.

Loan from BHC Bank

Hutt plc is to enter into a loan relationship with BHC Bank. Any amounts charged to the company's profit and loss account in respect of the relationship are allowable deductions for tax purposes. Accordingly, a tax deduction is available for the interest and the loan arrangement fee on the accruals basis.

On the assumption that the loan arrangement fee is charged to the profit and loss account in full in the year ended 31 March 2008, the total amount charged in the accounts will be £11,731 (£1,400 + (£190,000 x 7.25% x 9/12)). The income from which this amount can be deducted in the corporation tax computation depends on the use made of the finance obtained.

	Finance £		Allowable cost £
For the purpose of investments:			
Acquisition of Lucia Ltd	130,000		
Repairs to Hutt Tower	45,000		
	<hr/>		
	175,000	175/190 x £11,731	<hr/>
			10,805
For the purpose of the trade:			
Working capital requirements	15,000	15/190 x £11,731	<hr/>
			926
Total finance obtained	<hr/>		<hr/>
	190,000		11,731

Where the finance has been used for trading purposes, the cost of £926 is deductible in arriving at Hutt plc's taxable trading income.

Where the finance has been used for non-trading purposes, the cost of £10,805 is deductible from Hutt plc's interest income in respect of loan relationships. This results in a deficit, or loss, of £8,805 (£10,805 – £2,000) in the year ended 31 March 2008.

The deficit can be:

- Offset against other income and gains of Hutt plc of the same accounting period.
- Offset against the interest income of Hutt plc of the previous 12 months.
- Surrendered as group relief to companies within the group relief group.
- Carried forward and offset against future non-trading income and gains.

The most tax efficient use of the deficit will depend on the level of profits in Hutt plc and the other group companies in the year ended 31 March 2008.

(ii) VAT issues

Registration

All the supplies made by Lucia Ltd are taxable supplies for the purposes of VAT. The company must register for VAT:

- If its taxable supplies in the previous 12 months exceed £61,000; or
- If its taxable supplies in the next 30 days are expected to exceed £61,000.

It is anticipated that the company's supplies in the nine months ended 31 March 2008 will be £675,000 and that these supplies will accrue evenly over the period. This amounts to supplies of £75,000 per month. Accordingly, Lucia Ltd must register with effect from 1 July 2007 and must notify HMRC by 30 July 2007.

Lucia Ltd intends to make supplies to non-VAT registered customers in the European Union (EU). If Lucia Ltd is responsible for the delivery of the goods it should be aware that once its supplies in any one particular member state exceed that state's 'distance selling' threshold, it may be required to register for VAT in that state.

VAT in respect of the nine months ended 31 March 2008

	£
Output tax	
UK customers – VAT registered (£85,000 x 17½%)	14,875
UK customers – non-VAT registered (£25,000 x 17½%)	4,375
EU customers – VAT registered – zero-rated	–
EU customers – non-VAT registered (£70,000 x 17½%)	12,250
Other non-UK customers – zero-rated	–
Acquisition from Dabet GmbH (£17,000 x 17½%)	2,975
	<hr/> 34,475
Input tax	
In respect of purchases from UK businesses (9 x £7,800)	70,200
Acquisition from Dabet GmbH	2,975
	<hr/> 73,175
Repayment of VAT due (£73,175 – £34,475)	<hr/> 38,700

Disadvantage of entering into a group VAT registration

Lucia Ltd makes mainly zero-rated supplies and is in a VAT repayment position. It can improve its cash flow position by accounting for VAT monthly and receiving monthly repayments of VAT. It would not be in a position to do this if it were to register in a VAT group.

Under a group registration, the group's representative member will account for VAT payable to HMRC on behalf of all group companies. It may be some time before Lucia Ltd's accounting system is aligned with that of Hutt plc. The existence of two different systems may create administrative difficulties in preparing a group VAT return.

Note – Only one of the above disadvantages was required

(iii) The office building

Tax implications of the sale of the office building from Coronet Ltd to Lucia Ltd

Corporation tax

At the time of the transfer, Coronet Ltd and Lucia Ltd will be in a capital gains group as they will both be 75% subsidiaries of Hutt plc. Therefore the transfer of the office building will be deemed to occur at no gain, no loss. Lucia Ltd will have a capital gains tax base cost in the building equal to the cost to Coronet Ltd plus indexation allowance up to the date of the transfer.

Value added tax (VAT)

The transfer will be outside the scope of VAT if the two companies are in a VAT group.

If the two companies are registered separately, the treatment depends on whether or not Coronet Ltd has opted to tax the building. If it has, then the transfer to Lucia Ltd will be standard rated and VAT must be charged. If it has not, the transfer will be an exempt supply.

Stamp duty land tax

There will be no stamp duty land tax on the transfer as both companies are 75% subsidiaries of Hutt plc.

Relief of the gain on the sale of the office building to Vac Ltd

The loss arising on the sale of the factory will be £190,000 (£270,000 - £80,000). Indexation allowance is not available to increase a loss.

Lucia Ltd acquired the factory before it joined the Hutt plc group. Accordingly, the factory is a pre-entry asset and that part of the loss that arose prior to 1 July 2007 is restricted in use. In particular, it cannot be offset against gains arising in other companies in the Hutt plc group or gains on assets transferred from other group members on a no gain no loss basis.

As at 1 January 2008, Lucia Ltd will have owned the factory for four and a half years, of which four years are outside of the Hutt plc group. The pre-entry element of the loss is £168,889 (£190,000 x 4/4.5).

The pre-entry element of the loss could be computed by reference to the market value of the building at the time Hutt plc acquires Lucia Ltd. However this would not be advantageous in this case as the whole of the loss would then be a pre-entry loss.

The balance of the loss of £21,111 can be offset against the gain on the office building. Based on a corporation tax rate of 30%, this will save tax of £6,333.

There is no need to actually transfer the office building to Lucia Ltd in order to relieve the gain in this way. Coronet Ltd and Lucia Ltd can simply elect to treat the gain as if it has been made by Lucia Ltd. The election must be submitted by 31 March 2011, ie within two years of the end of the accounting period in which the disposal of the office building occurs.

2 To The files
From Tax assistant
Date 1 June 2007
Subject Pilar Mareno - Business expansion

This memorandum considers the implications of Pilar Mareno (PM) accepting the DWM plc contract.

Rationale and approach

PM has decided to accept the contract if it generates at least £15,000 per annum on average for the family after all costs and taxes.

PM will either employ her husband, Alec, or use the services of Max Wallen, and will either buy or lease a van. However, it can be seen from workings 3 and 4 that it is cheaper to buy rather than lease the van, and therefore, there are only two options to consider.

- Employ Alec and buy a van – Appendix 1
- Use Max Wallen and buy a van – Appendix 2

Summary of findings

The contract generates sufficient after tax income whether PM buys a van and employs Alec or uses Max Wallen. However, the issues raised below in relation to PM employing Alec should be considered before a decision is made.

Issues in respect of Pilar employing Alec

1. Alec has worked for a UK bank for many years. It is risky to give up an apparently secure job in exchange for a two year contract requiring two days work a week and other, as yet unidentified, part-time work.

Accordingly, Alec should obtain advice as regards his personal situation. If we are asked to provide this advice we must recognise that Pilar and Alec would be two separate clients. The work would have to be managed in such a way as to ensure that we do not allow the interests of Pilar to adversely affect those of Alec or vice versa.

2. PM and Alec should consider forming a partnership. This would reduce national insurance contributions as Alec would only pay 8% on his share of the profit plus class 2 at £2.10 per week whereas the cost of employer and employee class 1 contributions where Alec is an employee is 12.8% and 11% respectively.

Alec's profit share could be more than £7,600. This would enable income currently taxed at 40% in PM's hands to be taxed at 22% in Alec's hands. However, this saving in income tax would be offset by increased national insurance costs as the national insurance on PM's marginal income is only 1% whereas Alec would pay 8%.

Employment status of Max Wallen

Max's employment status will be determined by reference to all of the facts surrounding his agreement with PM.

Factors indicating employee status

1. It appears that Max has to do the work himself and cannot use a substitute.
2. Max is to be paid by the day rather than by reference to the performance of particular tasks.
3. Max is to be paid for the days when he is sick.
4. Max is to be provided with the specialist software he needs to do the work.

Factors indicating self-employed status

1. Max provides his own laptop computer.

Tax assistant

Tutorial Note

There is insufficient information provided regarding other factors, such as the level of control over Max's work, to justify their inclusion within the terms of the brief provided.

Appendix 1 – Employ Alec and buy a van

	£
Profit on contract	45,000
Irrecoverable VAT due to partial exemption (W1)	(8,054)
Salary paid to Alec	(7,600)
Class 1 secondary NIC re Alec ((£7,600 – £5,035) x 12.8%)	(328)
	<hr/> 29,018
Income tax and class 4 NIC due (£29,018 x (40% + 1%))	(11,897)
	<hr/> 17,121
Increase in Alec's income (W2)	402
Purchase of van (less than cost of leasing van) (W3 and W4)	(1,704)
	<hr/> 15,819

Tutorial Note:

The salary paid to Alec is a cost as far as Pilar is concerned. The effect of the salary on Alec's income is calculated in working 2, below.

Appendix 2 – Use Max Wallen and buy a van

	£
Profit on contract	45,000
Irrecoverable VAT due to partial exemption (W1)	(8,054)
Fees paid to Max Wallen (100 x £75)	(7,500)
Irrecoverable VAT on fees (£7,500 x 17½% x 35%)	(459)
	<hr/> 28,987
Income tax and class 4 NIC due (£28,987 x (40% + 1%))	(11,885)
	<hr/> 17,102
Purchase of van (less than cost of leasing van) (W3 and W4)	(1,704)
	<hr/> 15,398

Workings

(1) Irrecoverable VAT due to partial exemption

	£
Without the new contract:	
In respect of the existing business (£100,000 x 17½% x 35%)	6,125
	<hr/>
This is below the annual de minimis limit of £7,500 (£625 x 12) and is fully recoverable.	
With the new contract:	
In respect of the existing business (as above)	6,125
In respect of the costs of the DWM contract (£31,500 x 17½% x 35%)	1,929
	<hr/> 8,054

This exceeds the annual de minimis limit and is irrecoverable.

Tutorial Note

Pilar's taxable turnover is not affected by the sale of the van as it is a capital asset.

(2) Increase in Alec's income

	£
Increase in gross salary ((£7,600 + £10,000) – £17,000)	600
Less income tax and NIC (£600 x (22% + 11%))	(198)
	<hr/> 402

Tutorial Note

At the margin, Alec pays income tax at the basic rate of 22% and NIC at 11%.

(3) Cost of purchasing van

	£
Net cost (£7,800 – £2,500) for two year period	5,300
Income tax and class 4 NIC saved (£5,300 x (40% + 1%))	(2,173)
Irrecoverable VAT (£7,800 x 17½% x 35%)	478
Income tax and class 4 NIC saved (£478 x (40% + 1%))	(196)
	<hr/> 3,409
Average cost per year (£3,409 x ½)	<hr/> 1,704

(4) Cost of leasing van (per year)

	£
Lease rentals (£300 x 12)	3,600
Income tax and class 4 NIC saved (£3,600 x (40% + 1%))	(1,476)
Irrecoverable VAT (£3,600 x 17½% x 35%)	220
Income tax and class 4 NIC saved (£220 x (40% + 1%))	(90)
	<u>2,254</u>

3 (a) Use of a loan account

(i) The split of consideration between the shares and loan account

Where all of the assets of Stanley's business are transferred to Landscape Ltd as a going concern wholly in exchange for shares, any capital gains arising are relieved via incorporation relief such that no capital gains tax liability arises.

However, where part of the payment received from the company is in the form of a loan account, Stanley will have chargeable gains as set out below. For Stanley to have no liability to capital gains tax in 2007/08, his chargeable gains must equal the annual exemption of £8,800.

	£
Gain on building (£87,000 – £46,000)	41,000
Gain on goodwill	24,000
	<u>65,000</u>
Gains after incorporation relief:	
£65,000 x $\frac{\text{Value of the loan account}}{\text{£118,000}}$	y
Less: Capital losses brought forward	<u>(11,400)</u>
	z
Taper relief – business assets owned for at least two years	<u>x 25%</u>
Chargeable gains	<u>8,800</u>

Gains after incorporation relief, y, must equal £46,600 ((£8,800 x 4) + £11,400).

The value of the loan account needs to be £84,597 (£46,600 x £118,000/£65,000) such that the gains after incorporation relief are £46,600 (£65,000 x £84,597/£118,000).

The shares will have a capital gains tax base cost of £15,003 computed as follows.

	£
Market value of assets transferred to Landscape Ltd	118,000
Less Consideration left on loan account	<u>(84,597)</u>
	33,403
Incorporation relief:	
£65,000 x $\frac{\text{£33,403}}{\text{£118,000}}$	<u>(18,400)</u>
	<u>15,003</u>

(ii) The benefit of using a loan account

The loan account crystallises capital gains at the time of incorporation without giving rise to a tax liability due to the availability of capital losses, taper relief and the annual exemption. This reduces the gains deferred against the base cost of the shares in Landscape Ltd from £65,000 to £18,400 such that any future gains on the disposal of the shares will be smaller. Stanley can extract £84,597 from Landscape Ltd in the future with no 'tax cost', by having the loan repaid.

(b) Advice on Stanley's remuneration package

(i) Dividend

The advice in respect of the dividend is accurate but not complete as it ignores the cost to Landscape Ltd. Because Stanley owns Landscape Ltd, he must consider the effect on the company's position as well as his own.

Dividends are not tax deductible. The profits paid out as a dividend to Stanley will have been subject to corporation tax at 19%. On the other hand, Landscape Ltd will obtain a tax deduction at 19% for a salary bonus together with the related national insurance contributions.

There will be an overall tax saving from paying a dividend as opposed to a salary bonus. However the benefit will not be as great as suggested by the advice that Stanley has received due to the different treatment of the two payments in the company.

(ii) Interest free loan

The advice in respect of the loan is again accurate but not complete. The loan will not give rise to an employment income benefit as it is for not more than £5,000, but the advice again ignores the position of the company.

As it is controlled by Stanley, Landscape Ltd will be a close company. Accordingly, the loan to Stanley is a loan to a participator in a close company, and as Stanley owns more than 5% of the company's share capital there is no de minimis in this case.

Thus, Landscape Ltd must pay an amount equal to 25% of the loan (£900) to HMRC. The payment will be due on 1 January 2009, i.e. nine months and one day after the end of the accounting period in which the loan is made.

When the loan is repaid by Stanley, Landscape Ltd may reclaim the £900. The repayment by HMRC will be made nine months and one day after the end of the accounting period in which the loan is repaid.

(iii) Company car

The advice in respect of the company car is not correct because of the difference in the tax rates applying to the company and to Stanley, and the liability to Class 1A national insurance contributions.

	£
Tax cost of providing car:	
Class 1A national insurance contributions	
£3,420 x 12.8%	438
Income tax on benefit (£3,420 x 40%)	1,368
	<u>1,806</u>
Tax saved:	
Cost of providing car (£400 x 12)	4,800
Class 1A national insurance contributions	438
	<u>5,238</u>
Corporation tax @ 19%	995
Net tax cost (£1,806 – £995)	<u>811</u>

4 (a) Sale of shares in Mahia Ltd

The proceeds received on a purchase by a company of its own shares are subject to either income tax or capital gains tax depending on the circumstances.

The normal assumption on a purchase of own shares by a company is that any payment you receive for the shares, over and above the amount originally subscribed for them, would be an income distribution, and treated in the same way as a payment of a dividend. The net amount received, less the amount originally subscribed, would be grossed up by 100/90 and included in your taxable income.

Alternatively, where the transaction satisfies the conditions set out below, the proceeds are treated as capital proceeds giving rise to a capital gain. Your proposed sale of shares to Mahia Ltd satisfies these conditions and will therefore give rise to a capital gain.

- Mahia Ltd is an unquoted trading company.
- The purchase of shares is for the benefit of the company's trade as the disagreement between you and your sisters is having an adverse effect on the company's trade.
- You are resident and ordinarily resident in the UK.
- You have owned the shares for more than five years.
- You are selling all of your shares such that your holding is reduced by at least 25% and you will own less than 30% of Mahia Ltd following the sale.
- The purchase is not part of a scheme designed to avoid tax.

Advance clearance can be obtained from HM Revenue and Customs, to confirm that the capital treatment applies to a purchase of own shares.

The capital gains tax arising on the sale and the net cash proceeds after tax will be:

	£
Shares sold (40% x 40,000)	16,000
Proceeds (16,000 x £38.60)	617,600
Less: Cost (16,000 x £3.40)	(54,400)
	<u>563,200</u>
Taper relief	
Business asset owned for more than two years – 75% relief	(422,400)
	<u>140,800</u>
Capital gains tax at 40%	56,320
Proceeds after tax (£617,600 – £56,320)	<u>561,280</u>

Tutorial note

Mahia Ltd is a trading company such that its shares are business assets for the purposes of taper relief despite the fact that it owns investments in quoted companies. This is because its non-trading activities are no more than 20% of its overall activities.

(b) Gift to Tessa

Capital gains tax (CGT)

Maude lives in Canada and is non-UK resident and not-ordinarily resident. In addition, she is not a temporary non-resident for the purposes of capital gains tax as her stay in Canada will be for more than five years.

Accordingly, there will be no UK CGT on the gift of the shares to Tessa.

Even if Maude were a temporary non-resident, there would be no capital gains tax on the gift of the shares as she acquired them after she left the UK.

Inheritance tax (IHT)

As the shares are situated in the UK, UK IHT will be due on any transfers of value concerning them, regardless of the domicile of the transferor. Therefore, we do not need to consider Maude's domicile.

The gift by Maude to Tessa will be a potentially exempt transfer (PET) and no IHT will be payable. In addition, if Maude were to survive seven years from the date of the gift, there would be no IHT to pay on death. However, the question asks us to assume that Maude will die on 31 December 2011. As this date is within seven years of the proposed dates of the gift, there would be a potential liability to IHT on death for each proposed date as follows:

Gift on 1 August 2007

	£
Value of shares before gift (12,000 x £38.60 (50% holding))	463,200
Value of shares after gift (8,000 x £14.40 (33.3% holding))	(115,200)
Fall in value	<u>348,000</u>
No BPR as Maude has not owned the shares for two years	
Annual exemptions for 2007/08 and 2006/07	(6,000)
	<u>342,000</u>
IHT (40% x (£342,000 – £285,000))	22,800
IHT after taper relief (4 to 5 years) (£22,800 x 60%)	<u>13,680</u>

Tutorial Note

On 1 August 2007 Mahia Ltd will have 24,000 issued shares as the shares sold by Claus to the company will have been cancelled.

Double tax relief may be available to reduce this UK liability, in respect of any inheritance taxes payable in Canada.

Gift on 1 June 2008

	£
Fall in value (as above)	348,000
Business property relief (BPR)	
£348,000 x $\frac{£1,605,000}{£1,647,000}$ (£1,400,000 + £15,000 + £45,000 + £145,000)	(339,126)
	<u>8,874</u>
Marriage exemption	(5,000)
Annual exemptions for 2008/09 and 2007/08 (part only)	(3,874)
	<u>0</u>

Maude should make the gift on 1 June 2008 as this produces a nil IHT liability due to the availability of BPR. This presupposes that Tessa will continue to own the shares or replacement business property up to the date of Maude's death on 31 December 2011, and so preserve the entitlement to BPR.

Stamp duty

As the transfer of shares is made by way of gift, i.e. for no consideration, no stamp duty is payable.

5 (a) Capital gains tax payable on the sale of the house in Wales

Your taxable capital gain on the sale of the Welsh property will be computed as follows.

	£
Proceeds in August 2007	195,000
Less: Cost (market value as at 1 September 1999)	(145,000)
Enhancement expenditure	(18,000)
	32,000
Taper relief (£32,000 x 75%) (non-business asset held for seven years)	24,000
Less: Annual exemption (£8,800 – £1,200)	(7,600)
Taxable capital gain	16,400

Giving the house or part of it to Alice prior to the sale will not reduce the gain as you and Alice are not married. If you make a gift to Alice a capital gain will arise by reference to the market value of the property in exactly the same way as if you had sold the property to an unconnected third party. The gain on such a gift cannot be deferred as the house is not a business asset.

The basic rate band remaining after taxing your income in 2007/08 is as set out below.

When reviewing the computation please note that you do not have any taxable income from Bart Industries Ltd in 2007/08; the payments you received on being made redundant are taxed as follows.

- The payment in lieu of notice of £4,700 is taxed in 2006/07, the year of receipt.
- Statutory redundancy pay is not taxable.
- A non-contractual lump sum up to a maximum of £30,000 is not subject to income tax.

The relocation costs paid by Dreamz Technology Ltd are exempt from income tax up to a maximum of £8,000.

	£
Employment income – Dreamz Technology Ltd	
Salary (£38,500 x 6/12)	19,250
Removal costs (£9,400 – £8,000)	1,400
Dividend income (£7,800 x 10/9)	8,667
	29,317
Less: Personal allowance	(5,035)
Taxable income	24,282
Basic rate band	33,300
Basic rate band remaining	9,018

The computation of your capital gains tax liability is thus:

Capital gains tax:

£	@	£
9,018	@ 20%	1,804
7,382	@ 40%	2,953
		4,757

An additional year of taper relief would be available if you were to delay the sale until after 1 September 2007. This would reduce the tax due by £640 (£32,000 x 5% x 40%).

(b) Inheritance tax due in respect of the house in Wales

Usually, where a gift is made to an individual more than seven years prior to the donor's death, as in the case of your mother's gift of the house to you, there are no inheritance tax (IHT) implications on the death of the donor. However, because your mother continued to live in the house after she gave it to you, the gift will be taxed under the rules applying to 'gifts with reservation of benefit'.

In these circumstances, HM Revenue and Customs will ignore the original gift as, although the asset was gifted, your mother continued to use it as if it were her own. Therefore, the house will be included in your mother's death estate for IHT purposes at its market value at the date of her death, ie £140,000.

(c) Shares in Dreamz Technology Ltd

The income tax treatment of the issue to you of shares in Dreamz Technology Ltd depends on whether the shares are issued via an approved share incentive plan or not.

Where there is no share incentive plan, the market value of the shares received (£2,750) will be taxable as employment income in 2008/09, i.e. the year in which you receive them.

If there is a share incentive plan approved by HM Revenue and Customs then an employer can give shares to its employees, up to a maximum value of £3,000 per employee per year, with no income tax consequences. However, the shares must be kept within the plan for a stipulated period and income tax will be charged if they are withdrawn within five years.

If you withdraw the shares from the plan within three years, income tax will be charged on their value at the time of withdrawal. If you withdraw them more than three years but within five years, income tax will be charged on the lower of their value when you acquired them and their value at the time of withdrawal.

(d) Amount of income tax on dividend income

When you worked for Bart Industries Ltd you were not a higher rate taxpayer as your taxable income was less than £33,300, as set out below. Accordingly, your dividend income was taxed at 10% with a 10% tax credit such that there was no income tax payable.

	£
Employment income (£4,700 x ½ x 12)	28,200
Dividend income (£7,800 x 10/9)	8,667
	<hr/>
	36,867
Less Personal allowance	(5,035)
	<hr/>
Taxable income	31,832

In 2009/10 your annual salary from Dreamz Technology Ltd less the income tax personal allowance is £33,465 (£38,500 – £5,035). As this exceeds £33,300, all of your dividend income will fall into the higher rate tax band such that it is taxed at 32½% less a 10% tax credit. This gives rise to income tax payable on the dividend income of £1,950 (£8,667 x 22½%).

Date of payment of income tax on dividend income

The tax due in respect of your dividend income must be paid on 31 January after the end of the tax year (i.e. on 31 January 2011 for 2009/10) under self-assessment. You do not have to pay the tax earlier than this by instalments as the amount due is less than 20% of your total annual income tax liability as set out below. The income tax on your employment income from Dreamz Technology Ltd will continue to be collected under the PAYE system.

	£
Taxable employment income (£38,500 – £5,035)	33,465
	<hr/>
Income tax:	
£	
2,150 @ 10%	215
31,150 @ 22%	6,853
165 @ 40%	66
	<hr/>
Income tax liability on employment income	7,134
Income tax liability on dividend income (£8,667 x 32½%)	2,817
	<hr/>
Total annual income tax liability	9,951
Less: PAYE (equal to liability on employment income)	(7,134)
Tax credit on dividend income (£8,667 x 10%)	(867)
	<hr/>
Income tax payable via self-assessment	1,950
	<hr/>
Threshold for payments by instalments (£9,951 x 20%)	1,990

	Available	Max
1 The Hutt plc group		
(a) Hutt plc trading losses		
Within Hutt plc		
Current year offset	0.5	
Available profits	1	
Application of the small companies rate limits	1	
Effective rate of tax/relief	1	
No carry back opportunity	0.5	
Group relief		
Relevant companies	0.5	
Available relief	0.5	
Coronet Ltd:		
Available profits	0.5	
Effective rate of tax	1	
Rainbow Ltd:		
Effective rate of UK tax	0.5	
Tax position in Prismovia	1	
Effect of DTR	2	
Recommendation		
Identify correct objective	1	
Hutt plc – profits at 32¾%	0.5	
Rainbow Ltd – the balance	0.5	
Order of elections	1	
Group relief election – both companies/time limit	1	
Current year offset election/time limit	1	
Total for (a)	<u>15</u>	13
(b) (i) The purchase price		
Trading losses:		
No current relief in Lucia Ltd	0.5	
No group relief with reason	1	
No carry forward with reasons	1.5	
Conclusion	0.5	
Loan from BHC Bank		
Tax deduction per accounts treatment	1	
Total amount allowable in the period	0.5	
Amount relating to trading purpose	1	
Amount relating to non-trading purpose	2	
Uses of deficit	2	
Recommendation	0.5	
Total for (b) (i)	<u>10½</u>	9
(ii) VAT issues		
Registration		
Historic and future limits	1	
Registration and notification dates	1	
Distance selling thresholds	0.5	
Calculation		
Output tax	2.5	
Input tax	1	
Disadvantage of group VAT registration – either of Lucia Ltd in repayment position; or administrative difficulties	1	
Total for (b) (ii)	<u>7</u>	6

	Available	Max
(iii) The office building		
Sale from Coronet Ltd to Lucia Ltd		
Capital gain		
CGT group	0.5	
Consequences	1	
VAT		
If group registration	0.5	
If no group registration	1.5	
Stamp duty land tax	1	
Sale of building to Vac Ltd		
Loss on sale – no IA	0.5	
Pre-entry asset		
Identify	0.5	
Consequences	1	
Calculation of post-entry loss/tax saving	1	
Use of market value	0.5	
Election re notional transfer – availability	1	
Both companies and time limit	1	
Total for (b) (iii)	<u>10</u>	9
Format and style		
Appropriate style and presentation	1	
Effectiveness of communication	1	
Total for format and style	<u>2</u>	2
Total for Q1	<u>44½</u>	<u>39</u>

2 Pilar Moreno

(1) Calculations

Employ Alec:

Net profit of contract	0.5	
Alec's salary and class 1 secondary NIC	1.5	
Irrecoverable VAT/purchase of van	0.5	
Tax and NIC saved	0.5	
Increase in Alec's income:		
Identification of issue	1	
Calculation	1.5	

Use Max:

Fees paid	0.5	
Irrecoverable VAT on fees	0.5	
Tax and NIC saved	0.5	

Supporting calculations

Irrecoverable VAT:		
Identification of issue	1	
Current partial exemption position	1	
Application of de minimis	1	
Irrecoverable amount with new contract	1	
Purchase of van:		
Net cost	0.5	
Irrecoverable VAT	1	
Tax and NIC saved	1	
Cost per year	0.5	
Leasing van		
Rentals	0.5	
Irrecoverable VAT	1	
Tax and NIC saved	1	

Total for (1)	<u>16½</u>	16
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(2) Rationale and summary

Reference to Pilar's income criterion	1	
Conclusion re van and implications	1	
Summary of findings	1	
Total for (2)	<u>3</u>	2

	Available	Max
(3) Employment of Alec		
Secure job, short-term contract	1.5	
Use of partnership	2	
Alec would be a separate client from Pilar	1	
Total for (3)	<u>4½</u>	2
(4) Employment status of Max		
Depends on all of the facts	0.5	
Each valid factor – ½ mark (max 5 factors)	2.5	
Total for (4)	<u>3</u>	3
Format and style		
Appropriate style and presentation	1	
Effectiveness of communication	1	
Total for format and style	<u>2</u>	2
Total for Q2	<u>28</u>	<u>25</u>

3 Stanley

(a) (i) Split of consideration		
Incorporation relief – 3 conditions	1.5	
Amount of future cash payment:		
Rationale – gains to equal annual exemption	1	
Gains on transfer of business	1	
Gains after incorporation relief:		
Incorporation relief	1	
Capital loss and taper relief	1.5	
Calculation of gains after incorporation relief	0.5	
Solving to find value of the loan account	1	
CGT base cost of shares:		
Value of assets transferred for shares	0.5	
Incorporation relief	1	
(ii) Benefit of using a loan account		
Capital gains	1	
Extract funds with no tax cost	0.5	
Total for (a)	<u>10½</u>	9
(b) Advice on remuneration package		
Dividend		
Advice is correct but incomplete with reason	1	
CT position re dividend	0.5	
CT position re bonus	0.5	
Conclusion with reason	1	
Interest free loan		
Advice is correct but incomplete with reason	1	
Close company	0.5	
Loan to a participator and reason	1	
Tax due /when	1	
Repayment position	0.5	
Company car		
The advice is not correct with reason	1	
Calculation		
Tax cost	1	
Tax saving	1	
Total for (b)	<u>10</u>	9
Total for Q3	<u>20½</u>	<u>18</u>

	Available	Max
4 Mahia Ltd		
(a) Sale of shares by Claus		
Purchase of own shares		
Identify and distinguish between the two possible treatments	1	
CGT treatment applies	1	
Reasons why:		
Unquoted trading company	0.5	
Resident and ordinarily resident	0.5	
Owned for more than 5 years	0.5	
Not part of a scheme to avoid tax	0.5	
For benefit of company's trade with reason	1	
Reduction in holding criteria	1	
Availability of advance clearance	1	
Calculation		
Gain before taper relief	1	
Taper relief	1	
Net of tax proceeds	0.5	
Total for (a)	<u>9½</u>	8
(b) Gift to Tessa		
CGT		
No CGT due	0.5	
Reasons why:		
Not resident or ordinarily resident	0.5	
Asset acquired after becoming resident abroad	0.5	
Not temporarily non-resident	0.5	
IHT		
IHT applies, shares are UK property	0.5	
Gift on 1 August 2007		
Fall in value	1	
No BPR with reason	1	
Chargeable transfer (2 x annual exemption)	0.5	
Taper relief available	0.5	
Calculation of tax due	0.5	
Reference to DTR	0.5	
Gift on 1 June 2008		
Assumption re Tessa's continued ownership	1	
BPR	1	
Marriage and annual exemptions	1	
Advice	1	
Stamp duty		
Not applicable, gift	0.5	
Total for (b)	<u>11</u>	10
Total for Q4	<u>20½</u>	<u>18</u>

	Available	Max
5 (a) Taxable capital gain on the sale of the house		
Computation of capital gain		
Untapered gain	0.5	
Taper relief	1	
Annual exemption	0.5	
Effect of gift to Alice	1	
Computation of basic rate band remaining	2	
Treatment of payments on redundancy	1	
Capital gains tax payable	1	
Advice to delay sale	1	
Total for (a)	8	7
(b) Inheritance tax due in respect of the house		
Gift more than seven years prior to death	0.5	
Gift with reservation rules apply	0.5	
Consequences	1	
Total for (b)	2	2
(c) Shares in Dreamz Technology Ltd		
Identify two possible treatments	0.5	
Treatment if no share incentive plan	1	
Exemption under share incentive plan	1	
Withdrawal from plan within five year	1	
Total for (c)	3½	3
(d) Amount of income tax on dividend income		
Tax position whilst working for Bart Industries Ltd		
No tax payable on dividends	1	
Computation	1	
Tax position whilst working for Dreamz Technology Ltd	1.5	
Date of payment of income tax on dividend income		
Due date with reason	1.5	
Computation	2.5	
Total for (d)	7.5	6
Total for Q5	21	18