



ACCA

Paper P6

Advanced Taxation  
June 2012

Revision Mock – Answers



**To gain maximum benefit, do not refer to these answers until you have completed the revision mock questions and submitted them for marking.**

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**1 BAZZANO PLC**



**Key answer tips**

The first part of the question is a standard use of losses within a group to achieve the 'most tax efficient' result. However, you must be careful of the complication, which is that Spoleto has most of its profits taxed abroad, so any group relief claim must not prejudice the double tax relief available.

There are two aspects to part (ii):

- 1 Consortium relief
- 2 The possible restriction on relief for losses where there is both a change in ownership of a company and a major change in the nature or conduct of trade.

Both of these are popular exam topics.

Part (iii) is all about the loan relationship rules. Make sure that you set out details of the options available for loan relationship deficits here.

Note the instruction to consider all relevant taxes in part (iv), which for a building transfer will always include stamp duty land tax and VAT.

VAT on imports and exports and group VAT registration, both tested in part (v), often feature in the exam.

**Meeting notes**

**Date** 7 June 2012

**Subject** Bazzano plc

**(i) Use of Bazzano plc trading loss for the year ended 30 June 2012**

The taxable total profits for the Bazzano plc group, before taking into account Bazzano plc's loss, are as follows:

	<i>Bazzano plc</i>	<i>Spoletto Ltd</i>	<i>Leonardo Ltd</i>
	£	£	£
Trading profit	–	950,000	53,000
Capital gain	172,000	–	–
Less: capital loss brought forward	(123,000)	–	–
Rental income	78,000	–	–
	<hr/>	<hr/>	<hr/>
Taxable total profits	127,000	950,000	53,000
	<hr/>	<hr/>	<hr/>

**Rates of corporation tax**

- There will be three associated companies in the group, including Bazzano plc.

Accordingly the limits for the purposes of determining the rate of corporation tax payable are:

Lower limit: (£300,000 ÷ 3) = £100,000

Upper limit: (£1,500,000 ÷ 3) = £500,000.

- Bazzano plc will pay corporation tax at 26% less marginal relief. This means that the first £100,000 of the company's profits will be taxed at 20% and the final £27,000 at the marginal rate of 27.5%.
- Leonardo has taxable total profits of less than £100,000 and accordingly, Leonardo Ltd will pay tax at 20%.
- The taxable total profits of Spoleto Ltd exceed £500,000 and therefore, the company will pay UK corporation tax at the rate of 26%.

**Group relief**

- Bazzano plc, Spoleto Ltd and Leonardo Ltd are in a group for group relief purposes as Bazzano plc controls at least 75% of the other two companies. Any amount of the £147,000 loss can be surrendered to each of the two subsidiary companies in order to reduce their taxable total profits. However, the maximum surrender is restricted to the taxable total profits of the recipient company.

**Recommendations**

- In order to maximise the tax saved the losses should be offset against the profits taxed at 27.5% in Bazzano plc and the profits taxed at 26% in Spoleto Ltd.
- However, Spoleto Ltd has a permanent establishment in Umbriana as it manufactures and trades in that country. The profits arising in Umbriana will be taxed in that country at 21%. In the absence of any double tax treaty, double tax relief will be available in the UK in respect of the Umbrianan tax suffered, up to a maximum of the UK tax on the Umbrianan profits; any surrender to Spoleto Ltd must ensure that relief for the foreign tax suffered is not lost.

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

	£
Trading profit ((£950,000 × 5%)/26%)	182,692
	182,692
Maximum surrender	182,692



**Tutorial note**

*The DTR available for Spoleto Ltd is £199,500 (£950,000 × 21%).*

*Spoleto will therefore need sufficient TTP taxed at 26% to give a tax liability of at least £199,500 to avoid wasting DTR.*

*Minimum TTP must be £767,308 (£199,500 × 100/26) (see proof below), which would require a loss of £182,692 (£950,000 – £767,308).*

- Accordingly, £27,000 of the losses should be offset against the taxable total profits as a current year offset in Bazzano plc with the balance of £120,000 (£147,000 – £27,000) surrendered to Spoleto Ltd. This is less than £182,692, and therefore, preserves relief for all of the foreign tax.

**Claims and elections**

- 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 £120,000 to Spoleto Ltd. This must be made by 30 June 2014 (i.e. within one year of the filing date of the claimant company’s tax return). Both Spoleto Ltd and Bazzano plc must elect.
  - 2 An election to offset the remaining losses (£27,000) against the total profits of Bazzano 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 Spoleto Ltd for the year ended 31 June 2012 following the group relief claim is set out below.*

	£
TTP (£950,000 – £120,000)	830,000
	215,800
Corporation tax @ 26%	(199,500)
Less Double tax relief (£950,000 × 21%)	16,300
Corporation tax payable	16,300



**Tutorial note**

*Bazzano plc has losses below the maximum surrender. However, if Bazzano plc had trading losses in excess of £182,692, the maximum group relief claim that should be made to preserve DTR would be only £182,692 as shown below:*

	£
TTP (£950,000 – £182,692)	767,308
	199,500
Corporation tax @ 26%	(199,500)
Less Double tax relief (£950,000 × 21%)	Nil
Corporation tax payable	Nil

Further information required:

- Income and gains of Bazzano plc for the year ended 30 June 2011
  - Following a current year loss offset, the remaining loss could be carried back for offset against the total profits of Bazzano plc for the year ended 30 June 2011.
  - Whether or not this would be advantageous would depend on the company's total profits for that year. Higher rates of corporation tax would have applied in that year and there would be a cash flow benefit of carrying back losses.
- Details of any double tax treaty between the UK and Umbriana.

(ii) **Marianna Ltd – Use of trading loss**

- The two companies will not be in a group relief group as Bazzano plc will not own 75% of Marianna Ltd.
- For a consortium to exist, 75% of the ordinary share capital of Marianna Ltd must be held by companies which each hold at least 5%. Accordingly, Marianna Ltd will be a consortium company.
- As Marianna Ltd qualifies as a consortium company: 60% of its trading losses in the period from 1 September 2012 to 31 March 2013 can be surrendered to Bazzano plc, i.e. £24,500 ( $£70,000 \times 7/12 \times 60\%$ ).
- The acquisition of 60% of Marianna Ltd is a change in ownership of the company. If there is a major change in the nature or conduct of the trade of Marianna Ltd within three years of 1 September 2012, the loss arising prior to that date cannot be carried forward for relief in the future.
- Introducing new products and exporting overseas could represent a major change.
- In this case, the losses arising before 1 September 2012 could not be carried forward against future trading profits of Marianna Ltd.

(iii) **Treatment of loan from NatEast Bank**

- Bazzano plc is to enter into a loan relationship with NatEast Bank. Any amounts charged to the company's income statement 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 income statement in full in the year ended 30 June 2013, the total amount charged in the accounts will be £11,917 ( $£2,000 + (£250,000 \times 6.8\% \times 7/12)$ ).
- The income from which this amount can be deducted in the corporation tax computation depends on the use made of the finance obtained.

	<i>Finance</i>		<i>Allowable cost</i>
	£		£
<i>For the purpose of investments:</i>			
Acquisition of share capital	190,000		
Repairs to Bazzano House	30,000		
	220,000	$220/250 \times \text{£}11,917$	10,487
<i>For the purpose of the trade:</i>			
Advertising campaign	0,000	$30/250 \times \text{£}11,917$	1,430
	250,000		11,917

- Where the finance has been used for trading purposes, the cost of £1,430 is deductible in arriving at Bazzano plc's taxable trading income.
- Where the finance has been used for non-trading purposes, the cost of £10,487 treated as a deficit, or loss in the year ended 30 June 2013. This is assuming there is no interest income to utilise the deficit against in the current year.
- The deficit can be: (assuming there is no interest income in the previous 12 months)
  - Offset against other income and gains of Bazzano plc of the same accounting period.
  - 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 Bazzano plc and the other group companies in the year ended 30 June 2013

(iv) **Sale of premises**

**Tax implications of the sale of the office building from Leonardo Ltd to Donatella Ltd**

**Corporation tax**

- At the time of the transfer, Leonardo Ltd and Donatella Ltd will be in a capital gains group as they will both be 75% subsidiaries of Bazzano plc.
- Therefore the transfer of the office building will be deemed to occur at no gain, no loss.
- Donatella Ltd will have a capital gains tax base cost in the building equal to the cost to Leonardo 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 the building is less than three years old or if Leonardo Ltd has opted to tax the building.
  - If so, then the transfer to Donatella Ltd will be standard rated and VAT must be charged.
  - If 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 Bazzano plc.

**Relief of the gain on the sale of the office building to Norma Ltd**

- The warehouse was sold before Donatella Ltd became a member of the Bazzano plc group. As a result, the capital loss of £62,000 can only be deducted from capital gains made by Donatella Ltd on assets it owned when it joined the group, or ones bought from unconnected parties and used for the purpose of its own business.
- The loss arising on the sale of the manufacturing premises will be £95,000 (£245,000 – £150,000). Indexation allowance is not available to increase a loss.
- Donatella Ltd sold the manufacturing premises after it joined the Bazzano plc group. Accordingly, the capital loss can be set against any gains made by Donatella Ltd, including the gain on the sale of the office building to Norma Ltd
- Based on a corporation tax rate of 26%, this will save tax of £24,700 (£95,000 x 26%).
- There is no need to actually transfer the office building to Donatella Ltd in order to relieve the gain in this way. Leonardo Ltd and Donatella Ltd can simply elect to reallocate the gain to Donatella Ltd. The election must be submitted by 30 June 2016 (i.e. within two years of the end of the accounting period in which the disposal of the office building occurs).

**(v) VAT issues**

- Marianna Ltd intends to make supplies to non-VAT registered customers in the European Union (EU). If Marianna 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 year ending 31 March 2014**

	£
<i>Output tax</i>	
UK customers – VAT registered (£119,000 × 20%)	23,800
UK customers – non-VAT registered (£35,000 × 20%)	7,000
EU customers – VAT registered – zero-rated	–
EU customers – non-VAT registered (£98,000 × 20%)	19,600
Other non-UK customers – zero-rated	–
Acquisition from Gelato SpA (£23,000 × 20%)	4,600
	55,000
<i>Input tax</i>	
In respect of purchases from UK businesses (12 × £9,300)	111,600
Acquisition from Gelato SpA	4,600
	116,200
Repayment of VAT due (£116,200 – £55,000)	61,200



**Tutorial note**

*VAT must be charged on supplies to all UK customers, whether or not they are registered for VAT.*

*Supplies to EU customers are zero-rated in the country of origin, unless the customer is not registered. In this case, VAT is charged at the point of origin at the appropriate rate. Therefore Marianna Ltd must charge 20% VAT in the normal way (i.e. the origin system).*

*All supplies to non-EU customers are zero-rated, regardless of whether or not the customer is registered.*

*An acquisition from a VAT registered EU supplier will be treated as zero-rated in the country of origin, however is chargeable at the appropriate rate in force in the country of destination. Therefore Marianna Ltd must account for output VAT at 20% on the purchase from Gelato SpA, but can reclaim the equivalent amount of input VAT in the same quarter (i.e. the destination system).*

**Group VAT registration**

- Marianna 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; therefore a group VAT registration would not be beneficial.

<b>Marking guide</b>		<i>Marks</i>
(i)	Bazzano plc trading losses	1.0
	Available profits	1.0
	Calculation of corporation tax rate limits	1.0
	Effective rate of tax/relief	0.5
	Group relief group	
	Spoletto Ltd	1.0
	Tax position in Umbriana	2.0
	Effect of DTR	
	Recommendation	1.0
	Identify correct objective	0.5
	Bazzano plc – profits at 27.5%	0.5
	Spoletto Ltd – the balance	1.0
	Order of elections	1.0
	Group relief election – both companies/time limit	1.0
	Current year offset election/time limit	1.5
	Possibility of loss carry back	0.5
	Information required re: double tax treaty	13.5
<b>Maximum</b>	<b>11.0</b>	
(ii)	Not in group relief group	1.0
	Recognition of condition for consortium to exist	1.0
	Relief available	1.5
	Possible restriction on ability to carry forward loss	2.0
	<b>Maximum</b>	<b>4.0</b>
(iii)	Loan from NatEast Bank	
	Tax deduction per accounts treatment	1.0
	Total amount allowable in the period	0.5
	Amount relating to trading purpose	1.0
	Amount relating to non-trading purpose	2.0
	Uses of deficit	2.0
	Recommendation	0.5
<b>Maximum</b>	<b>6.0</b>	
(iv)	The office building	
	Sale from Leonardo Ltd to Donatella Ltd	
	Capital gain	
	CGT group	0.5
	Consequences	1.0
	VAT	
	If group registration	0.5
	If no group registration	1.0
	Stamp duty land tax	1.5
	Sale of building to Norma Ltd	
	Pre-entry loss	
	Identify	0.5
	Consequences	1.0
	Loss on manufacturing premises	
No IA	0.5	
Calculation of post entry loss/tax saving	1.0	
Election re notional transfer – availability	1.0	
Both companies and time limit	1.0	
<b>Maximum</b>	<b>8.0</b>	

(v)	VAT issues	
	Calculation	
	Output tax	2.5
	Input tax	5.0
	Disadvantage of group VAT registration: Marianna Ltd in repayment position	1.0
		—
		4.5
	<b>Maximum</b>	4.0
		—
	Format and style	
	Appropriate style and presentation	1.0
	Effectiveness of communication	1.0
		—
		2.0
		—
	<b>Total</b>	<b>35.0</b>
		—

**2 MIKE AND HANNAH**



**Key answer tips**

This is a typical section A scenario question, with a large amount of information to deal with.

As is usual in this type of question, the requirements at the end of the question are incomplete, and really just tell you the number of marks available for each section.

The full requirements are set out in the manager’s email. Make sure that you present your answer in the correct format, as a letter, as there are marks for doing this. Detailed calculations should be included in appendices. Whilst these would normally appear at the end of a letter, it is acceptable in the exam to present your appendices first, as long as they are clearly labelled.

Part (a) requires discussion of the tax treatment of Mike’s redundancy payment. There are several possibilities here, so make sure that you discuss them all.

Part (b) requires you to calculate tax savings for a sole trader employing his wife in his business or taking her on as an equal partner. The calculations here are quite straightforward, but you will need to heed the examiner’s advice to make sure that your answer is easy to follow. It is vital that you label all of your workings.

Note that there are only 3 marks available for calculating the tax savings if the business is transferred to a company in part (c). The reason for this is that you have already done some of the calculations that you need here earlier in the question, so there is no point in repeating them!

Part (d) covers the popular planning consideration of lease versus buy for an asset. To succeed here you needed to think about all of the tax implications, including VAT. Remember that MHS Consulting Ltd is a company, so any tax deductible amounts will save corporation tax. Don’t forget the employer’s Class 1A NICs on the employment benefit!

If you have time, part (e) contains some very easy marks for discussion of tax avoidance versus tax evasion. It may be wise to attempt this part of the question first, in case you run out of time.

Tax adviser  
1 High Street  
Anytown

Mr Mike Snow  
2 Low Street  
Anytown

2 March 2012

Dear Mike

**Tax issues**

Further to our recent meeting, I set out below the answers to your queries.

(a) **Redundancy package**

If there is any statutory redundancy included in your redundancy payment, this will be tax free.

The tax treatment of the rest of your redundancy will depend on whether or not the amounts received are contractual or usual employer practice.

*Contractual*

If the payments are contractual or expected, then they will be taxed when you receive them on 31 March 2012. The market value of the car will be treated as a cash receipt, so you will be taxed on a total value of £29,000 (£20,000 + £9,000).

*Non-contractual*

However, if the payment is a genuine, non-contractual ex gratia redundancy payment, then there will be no tax to pay as the total value is less than £30,000.

(b) **New business – tax savings from employing Hannah versus operating in partnership**

*Operating as a sole trader*

If you operate as a sole trader, with no income other than rental income covering your personal allowance, you will be assessed to tax on £60,000 taxable income (all non-savings), resulting in total tax and NIC of £20,652 per annum (Appendix 1).

*Employing Hannah*

If you employ Hannah at a gross salary of £15,000 pa, your total income tax and NIC will be £18,920 per annum (Appendix 2), saving you £1,732 (£20,652 – £18,920) as a couple.

*Running the business in equal partnership with Hannah*

You will both be assessed on taxable income of £30,000, giving total tax and NIC of £16,360 (Appendix 3), saving you £4,292 (£20,652 – £16,360) as a couple.

*Conclusion*

The biggest tax savings can be achieved by entering into an equal partnership with Hannah, mainly because neither of you will be paying any tax at higher rates.

(c) **Tax savings if the business is transferred to a company**

Operating as equal partners with £120,000 profits, you and Hannah will be assessed to tax on £60,000 each, giving tax (as for you as a sole trader) of £20,652 and total tax of £41,304 (£20,652 × 2).

If a company is formed, you will be assessed individually to income tax and national insurance on your gross salaries. The company will pay employer's national insurance, and the net profit after deducting the salaries and national insurance will be subject to corporation tax.

This gives combined total tax of £34,528 (Appendix 4), saving you £6,776 (£41,304 – £34,528) as a couple.

(d) **Lease or buy car**

Based on my calculations (Appendix 5), it will be cheaper for MHS Consulting Ltd to buy the car than to lease it. This will save £944 per annum (£3,620 – £2,676).

I hope this answers your questions. Please telephone me if you require any further information.

Yours sincerely

Lucy Clint

Tax manager

**Appendix 1**

**Operating as a sole trader**

	£		£	<i>Total tax and NICs</i> £
Income tax on profit of £60,000				
Basic rate band	35,000	@ 20%	7,000	
Higher rate band	25,000	@ 40%	10,000	
	<u>60,000</u>		<u>          </u>	
Income tax liability				17,000
National insurance contributions				
Class 2 (52 weeks @ £2.50 per week)				130
Class 4 (£42,475 – £7,225) × 9%			3,172	
(£60,000 – £42,475) × 2%			350	
			<u>          </u>	<u>3,522</u>
Total tax and NIC liability				<u>20,652</u>



**Appendix 3**

**Running the business in equal partnership with Hannah**

As rental income covers both of your personal allowances, you will both be assessed to tax on £30,000 (£60,000 × 50%) taxable income (all non-savings) as follows:

	£		£	<i>Total tax &amp; NICs</i>
				£
Income tax on profit of £30,000				
Basic rate band	30,000	@ 20%	6,000	
Income tax liability (£6,000 × 2)				12,000
National insurance contributions				
Class 2 (52 weeks @ £2.50 per week) × 2				260
Class 4 (£30,000 – £7,225) × 9% × 2				4,100
Total tax and NIC liability				16,360

**Appendix 4**

**Tax savings if the business is transferred to a company**

			£	<i>Total tax &amp; NICs</i>
				£
If a company is formed:				
<i>Tax payable by you and Hannah on taxable income of £30,000 each:</i>				
Income tax (as above)		6,000	× 2	12,000
National insurance contributions				
Class 1 primary				
(£30,000 – £7,225) × 12%		2,733	× 2	5,466
<i>Tax payable by the company:</i>				
National insurance contributions				
Class 1 secondary				
(£30,000 – £7,072) × 13.8%		3,164	× 2	6,328
Corporation tax				
Trading profits		120,000		
Less: Salaries		(60,000)		
Less: NIC secondary contributions		(6,328)		
Taxable total profits = augmented profits		53,672		
Augmented profits less than £300,000 therefore small companies rate applies				
Corporation tax (£53,672 × 20%)				10,734
Total tax and NIC liability				34,528

**Appendix 5****Lease or buy car****Cost of purchasing car**

MHS Consulting Ltd will be able to claim capital allowances equal to the net cost of the car.

There would in fact be a 100% first year allowance in the year of purchase, as the emissions are less than 110 g/km, with a balancing charge in the year of cessation of trade, but for simplicity, the total allowances are assumed to accrue over the period of ownership.

	£
Net cost (£23,000 – £17,000) for two year period (Note 1)	6,000
	<hr/>
Average cost per year (£6,000 × ½) = capital allowances	3,000
Employer's Class 1 A NIC on car benefit (£2,500 (W) × 13.8%)	345
	<hr/>
	3,345
Corporation tax saved (£3,345 × 20%)	(669)
	<hr/>
Net annual cost	2,676
	<hr/>

**Cost of leasing car**

	£
Lease rentals (£380 × 12)	4,560
Less: Recoverable VAT (£4,560 × 1/6 × 50%) (Note 1)	(380)
	<hr/>
	4,180
Employer's Class 1 A NIC on car benefit (£2,500 (W) × 13.8%)	345
	<hr/>
	4,525
Corporation tax saved (£4,525 × 20%) (Note 2)	(905)
	<hr/>
Net annual cost	3,620
	<hr/>

**Tutorial notes**

- The VAT on the purchase of a car is irrecoverable where there is some private use. However, where a car is leased and there is some private use, 50% of the VAT is recoverable.*
- The car lease rental payments are fully deductible for corporation tax, as CO<sub>2</sub> emissions are less than 160 g/km.*



**Working**

**Car benefit for Mike**

The benefit is based on the list price of the car, whether it is purchased or leased by the company.

As CO<sub>2</sub> emissions are between 76 and 120 g/km, the benefit is at 10%:

$£25,000 \times 10\% = £2,500.$

(e) **Note – Tax avoidance versus tax evasion**

It is our overall objective to ensure that Mike and Hannah minimise their total tax liability, however we are obliged to conduct any business within the law and in accordance with the ACCA Professional Code of Ethics.

The tax planning advice given to Mike and Hannah will reduce their tax liabilities as a couple, and represents perfectly legal tax avoidance.

Manipulation of the figures, such as declaring Mike’s income as his wife’s income, would amount to tax evasion, which is illegal. A taxpayer who dishonestly falsifies information for tax evasion purposes may be subject to criminal proceedings or suffer civil penalties.

The ACCA professional code of ethics sets out the standards of professional conduct expected from the members of the Association and sets out a framework of principles that should be applied. Failure by any member could lead to disciplinary action.

We would not wish to be associated with a client who engages in deliberate tax evasion as this poses a threat to the fundamental principles of integrity and professional behaviour.

Accordingly, we should advise Mike of the implications of artificially transferring income to Hannah, and if Mike still intends to do this we should cease to act as his tax advisor. We would also need to consider our position under the money laundering legislation, as tax evasion is a form of money laundering.

<b>Marking guide</b>		<i>Marks</i>
(a)	Statutory redundancy exempt	1.0
	Treatment of rest depends whether contractual	1.0
	If contractual will be taxed	1.0
	If ex gratia will be exempt	1.0
	£30,000 limit	0.5
	<b>Maximum</b>	4.5
		4.0
(b)	Tax payable currently as sole trader:	
	IT	0.5
	NIC Class 2	0.5
	NIC Class 4	0.5
	Employing Hannah	
	Employer’s NIC for Mike	0.5
	Deduct salary and employer’s NIC	1.0
	Revised IT	0.5
	No change to Class 2 NIC	0.5
	Revised Class 4 NIC	0.5
	Hannah – IT	0.5
	Class 1 NIC on salary	0.5
Tax saving	0.5	

<b>Marking guide</b>		
(b)	Hannah as partner	
	IT – each taxed on £30,000	1.0
	Class 2 NIC for both	0.5
	Class 4 NIC for both	0.5
	Tax saving	0.5
	Conclusion	1.0
	<b>Maximum</b>	9.5
	8.0	
(c)	Total tax as equal partners	1.0
	Transfer of business to company	
	IT on £30,000 each	0.5
	Class 1 NIC on salary	0.5
	Employer's NIC for company	0.5
	Salary and NIC deductible for company	1.0
	Corporation tax at 20%	0.5
	Tax saving	0.5
	<b>Maximum</b>	4.5
	3.0	
(d)	Purchase of car:	
	Net cost	0.5
	Calculation of car benefit	1.0
	Class 1A NIC on car benefit	1.0
	Corporation tax saving at 20%	1.0
	Leasing car	
	Rentals	0.5
	Recoverable VAT	1.0
	Class 1A NIC on car benefit	0.5
	Corporation tax saving at 20%	1.0
	<b>Maximum</b>	6.5
	5.0	
(e)	Tax avoidance versus evasion	
	Advice given represents tax avoidance and is legal	1.0
	Manipulation of figures is tax evasion and is illegal	1.0
	Advise client re: potential penalties for evasion	0.5
	Advisor must abide by ethical code	0.5
	Potential threat to integrity and professional behavior	1.0
	Consider ceasing to act for client	1.0
	Possible money laundering implications	1.0
	<b>Maximum</b>	6.0
		5.0
Format and style	Appropriate style and presentation	1.0
	Effectiveness of communication, including correct use of appendix	2.0
	Logical structure	0.5
	<b>Maximum</b>	3.5
		3.0
<b>Total</b>	<b>28.0</b>	

### 3 TAHOA



#### Key answer tips

This question covers the popular area of CGT versus IHT for lifetime gifts, with a short section on income tax.

The key to success in a question such as this is to deal with one tax at a time, and to ensure that you are very clear about which reliefs and exemptions apply to which tax.

In this question, the examiner helps you by specifically asking you to deal with each tax separately.

The question asks you to explain any reliefs, so make sure that you do this.

In part (a) watch out for the valuation of the shares, and remember that shares in the same company are pooled. The reliefs to consider here are gift relief and Entrepreneurs' relief.

Remember that the valuation rules for IHT are not the same as CGT. You will need to consider related property and diminution in value in part (b), and the only relief available here is business property relief.

It may not be obvious what is required for part (c). Some of the shares were transferred to a child, so you needed to consider the rules relating to parental dispositions. The other shares were transferred to a trust, so the question was really asking about the income tax treatment of dividends within a trust.

#### (a) Capital gains tax implications of Tahoa's disposals

##### Gift of BTP plc shares

For capital gains purposes, the deemed sales proceeds on a gift is the market value of the assets gifted.

Quoted shares are valued at the lower of the quarter up method = £2.72 [ $£2.70 + (\frac{1}{4} \times (2.78 - 2.70))$ ] or and the mid-bargain price of £2.73 [ $\frac{1}{2} \times (2.68 + 2.78)$ ]. Therefore the shares are valued at £2.72 each.

The shares are all pooled, and the cost is apportioned based on the number of shares disposed of.

Gift relief is not available as the shares are not qualifying assets for gift relief purposes. This is because Tahoa owns less than 5% and they are quoted shares.

The total chargeable gain on the disposal of shares is £73,200 (W1).

Ignoring the annual exemption, the tax due on 31 January 2013 is:

$$(\pounds 73,200 \times 28\%) = \pounds 20,496.$$

**Gift of Necklace**

The necklace is a non-wasting chattel and therefore a gain arises as it has a market value in excess of £6,000 at the date of the gift.

A chargeable gain of £3,200 (W2) arises.

Gift relief is not available as a necklace is not a qualifying asset.

Ignoring the annual exemption, capital gains tax of £896 (£3,200 × 28%) is therefore due on 31 January 2013.

**Gift of AJB Ltd shares**

Tahoa owns a  $\frac{1}{6}$  th interest in the company (i.e. 16.667%) and therefore the shares are valued at £14.40 each. Tahoa has given the trustees all 16.67% of AJB Ltd.

The full gain of £516,000 (W3) can be held over, with no restriction for the investments held by the company, as the transfer is immediately chargeable to inheritance tax. This requires an election by Tahoa.

The gain of £516,000 would be deferred against the base cost of the shares to the trustees, leaving Tahoa with no chargeable gain on these shares in 2011/12.

Alternatively, as Tahoa has held at least 5% of the shares for at least 12 months and works for the company, he could choose not to claim gift relief and claim Entrepreneurs' relief instead.

The gain would be immediately taxable in full, but at a reduced rate of only 10%.

Ignoring the annual exemption, capital gains tax of £51,600 would therefore be due on 31 January 2013.

If gift relief is claimed, and not Entrepreneurs' relief, there will eventually be more tax to pay, as disposal of the asset by the trustees will be taxed at 28%.

Assuming that Tahoa wants to avoid any immediate tax charge, he should make the gift relief claim.

**Tutorial notes**

- 1 *A partial claim for gift relief cannot be made, it is an "all or nothing" relief.*
- 2 *Trustees of a relevant property trust cannot claim Entrepreneurs' relief.*

*It is possible for trustees of a qualifying interest in possession trust to claim Entrepreneurs' relief on certain assets provided conditions are satisfied, but this knowledge is beyond the P6 syllabus.*

(b) **Inheritance tax implications of lifetime gifts**

**BTP plc shares**

The gift is a PET of £217,600 ( $£80,000 \times £2.72$ ).

No tax will be charged at the time of the gift as it is a PET and no tax will be charged unless Tahoā dies before 22 December 2018.

Any tax due on death will be reduced by taper relief by reference to the time between the date of the gift and the date of death.

**Necklace**

The gift of the necklace is a PET of £17,400 from which the marriage exemption of £5,000 can be deducted. No IHT is payable at the time of the gift as it is a PET.

No tax will be charged unless Tahoā dies before 18 November 2018.

Any tax due on death will be reduced by taper relief as explained above.

**AJB Ltd shares**

The gift is a chargeable lifetime transfer. IHT is payable when the shares are put into the trust provided the value exceeds the nil rate band (£325,000) available. However, Tahoā's nil rate band has been fully used by the CLT made in December 2008.

The value of the CLT is £74,400 (W4) using the related property rules.

As Tahoā pays the IHT, it is a net gift which is taxed at 25%. All of it is taxable as there is no nil rate band remaining.

Lifetime IHT of £18,600 ( $(£74,400 \times 25\%)$ ) is due by 30 September 2012.

No further IHT is payable unless Tahoā dies before 4 March 2019.

(c) **Income tax**

**BTP plc shares**

Where a parent transfers capital to a child which gives rise to income of more than £100 in a tax year, the income is treated as that of the parent rather than the child.

Tirua is a minor as he is still at school. Accordingly, any income arising in respect of the shares will be included in the income tax computation of his father, Tahoā, unless it is less than £100 in the tax year.

**AJB Ltd shares**

Dividends arising on the shares will be taxed in the hands of the trustees at 42½%, as it is a relevant property trust.

However, any income distributed to the nephews will be grossed up by 100/50 and taxed at non-savings rates in the nephews' income tax computations, with a tax credit of 50%.

**Workings****(W1) Gift of the BTP shares**

		£
Market value ( $£2.72 \times 80,000$ )		217,600
Less: Cost (pool)		(144,400)
		<hr/>
Chargeable gain		73,200
		<hr/>
<i>Share pool</i>	<i>No of shares</i>	<i>Cost</i>
		£
January 1994	60,000	68,000
January 2010	30,000	94,450
		<hr/>
	90,000	162,450
Disposal	(80,000)	(144,400)
		<hr/>
Pool c/f	10,000	18,050
		<hr/>

**(W2) Gift of necklace**

	£
Market value (November 2011)	17,400
Less: Cost (probate value) (May 2001)	(14,200)
	<hr/>
Chargeable gain	3,200
	<hr/>

**(W3) Gift of AJB Ltd shares**

	£
Market value ( $40,000 \times £14.40$ ) (March 2012)	576,000
Less: Cost	(60,000)
	<hr/>
Chargeable gain	516,000
	<hr/>

**(W4) IHT value of AJB Ltd shares put into discretionary trust**

The value of the chargeable lifetime transfer (CLT) is the diminution in value of Tahoā's estate (i.e. from a 16.667% holding to a Nil holding). However, his shares must be valued taking account of related property (i.e. taking account of the shares held by both Tahoā and his wife) as follows:

	<i>Before gift</i>	<i>After gift</i>
Tahoā	40,000	Nil
Wife	40,000	40,000
	<hr/>	<hr/>
	80,000	40,000
	<hr/>	<hr/>
	33.33%	16.667%
		£
Value of Tahoā's estate before gift (40,000 × £18.60)		744,000
Value of Tahoā's estate after gift		(Nil)
		<hr/>
Transfer of value		744,000
Less: BPR (£744,000 x 90% x 100%) (See below)		(669,600)
Annual exemptions (to be ignored)		(Nil)
		<hr/>
CLT		74,400
		<hr/>

BPR is available at 100% as AJB Ltd is an unquoted trading company and Tahoā has held the shares for more than two years.

However, the relief is restricted due to the excepted assets held by the company.

<b>Marking guide</b>		<i>Marks</i>
(a)	CGT implications of gifts	
	Gift of BTP shares	
	Valuation	2.0
	Calculation of cost	1.0
	No gift relief	0.5
	CGT at 28%	0.5
	Gift of necklace	
	Gain based on probate value	0.5
	No gift relief	0.5
	CGT at 28%	0.5
	Gift of AJB shares	
	Gain using MV	0.5
	Gift relief	1.0
	Entrepreneurs relief available	1.0
	Tax at 10% with Entrepreneurs' relief	1.0
	Gift relief better as no immediate tax	1.0
		-----
	<b>Maximum</b>	10.0
		-----
(b)	IHT implications of gifts	
	Gift of BTP shares	
	Valuation	0.5
	PET – no tax unless Tahoa dies within 7 years	0.5
	Possible taper relief	0.5
	Gift of necklace	
	Marriage exemption £5,000	0.5
	PET – no tax unless Tahoa dies within 7 years	0.5
	Possible taper relief	0.5
	Gift of AJB shares	
	CLT	0.5
	Related property valuation	2.0
	BPR 100%	0.5
	Restrict BPR for excepted assets	0.5
	Nil band used	0.5
	Life tax 25%	0.5
	Further tax if Tahoa dies within 7 years	0.5
		-----
	<b>Maximum</b>	8.0
		-----
(c)	Gift of BTP shares	
	Children's income – identification of issue	1.0
	£100 de minimis limit	1.0
	Reverts back to parent	1.0
	Gift of AJB shares	
	Dividends taxed on trustees at higher rate	1.0
		-----
	<b>Maximum</b>	4.0
		-----
	<b>Total</b>	3.0
		-----
		18.0
		-----



## 4 JARDIN LTD

**Key answer tips**

This question is really two separate questions: one on VAT, the other on purchase of own shares.

Part (a) covers VAT on land and buildings, a popular exam topic. There are 8 marks available here, broken down into four subsections. This means you need to try to make at least two points for each!

Part (b) is an exam favourite regarding the purchase of own shares, comparing income and capital treatment. Since Fleur has no other income, her personal allowance and basic rate band are available. This means you cannot use the shortcut method applicable to higher rate taxpayers of saying that tax on a dividend is 25% of the net dividend. With the capital route you must be careful not to use all the annual exemption as Fleur has other gains. In (b)(ii) you must focus on points to be confirmed, not just list the conditions for the capital treatment.

**(a) Effect on VAT of renting out the factory**

The rental of a building is an exempt supply for VAT purposes. Accordingly, Jardin Ltd will become a partially exempt supplier.

Jardin Ltd will then only be able to recover input VAT which is directly attributable to its taxable supplies. Any input VAT relating to overheads will have to be apportioned, and only the proportion which relates to taxable supplies will be reclaimed.

The remainder of the input VAT (i.e. relating to the rental) will only be recoverable if it is no more than £625 per month on average and no more than 50% of the total input tax.

Alternatively, the input tax is recoverable if the total input tax is no more than £625 per month on average and the value of the exempt supplies no more than 50% of the total supplies.

Finally, the input tax is recoverable if the total input tax less input tax directly attributable to taxable supplies is no more than £625 per month on average and the value of the exempt supplies no more than 50% of the total supplies.

The business only needs to satisfy one test.

**Effect on the input VAT reclaimed on the initial purchase price**

There is also an issue with the capital goods scheme, because the building costs more than £250,000. Under the scheme, the total amount of input tax recovered reflects the use of the building over a 10 year adjustment period.

The VAT on the initial acquisition of the factory will be reclaimable in full in the year of purchase, as Jardin Ltd currently makes 100% standard rated supplies for VAT. Jardin Ltd will be able to reclaim input tax of £70,000 (£420,000 x 1/6).

If Jardin Ltd rents out the property as an exempt supply during this 10 year period, then part of this original input VAT will have to be repaid.

For example, if the rent were to represent 20% of total revenue in a subsequent year, the percentage of taxable supplies would fall to 80%, and the input VAT repayable would be calculated as follows:

$$£70,000 \times 1/10 \times (80\% - 100\%) = (£1,400) \text{ repayable to HMRC}$$

### The implications of opting to tax the factory

Alternatively, Jardin Ltd could opt to tax the factory. The rental of the factory would then be a standard rated supply. Jardin Ltd could then recover all of its input VAT, regardless of the amount attributable to the rent, and there would be no repayment of input VAT under the capital goods scheme.

However, Jardin Ltd would have to charge VAT on all rent and on any future sale of the building.

### Factors affecting the decision

The decision as to whether or not to opt to tax the factory will depend on:

- The amount of input tax at stake; and
- Whether or not those who rent the factory and any potential future purchaser of the factory are in a position to recover any input VAT charged.

(b) (i) **The most beneficial tax treatment of the payment received**

The payment received by Fleur will be treated as either an income distribution or as capital.

#### Income treatment

	£
Payment received (9,000 × £9.50)	85,500
Less: Original subscription price (9,000 × £1)	(9,000)
	76,500
Distribution (Note 1)	76,500
	85,000
Taxable dividend income (£76,500 × 100/90)	85,000
Less: Personal allowance	(7,475)
	77,525
Taxable income	77,525
Income tax	
£	
35,000 × 10%	3,500
42,525 × 32.5%	13,821
	17,321
77,525	77,525
	17,321
Income tax liability	17,321
Less: Income tax credit (£77,525 × 10%) (Note 2)	(7,753)
	9,568
Income tax payable	9,568



**Tutorial note**

- 1 Remember that you must deduct the original subscription price from the payment irrespective of who subscribed for the shares.
- 2 The tax credit on the dividend is restricted to that on the dividend actually brought into the charge to tax. In this case, £7,475 of dividend income is covered by the personal allowance; therefore the tax credit is only available on £77,525, not £85,000.  
*However, as this is a rather rare situation, you would still have gained full marks if you had shown the tax credit as £8,500 (£85,000 × 10%).*
- 3 A capital loss of £18,900 [9,000 × (£3.10 – £1)] will also arise. Fleur cannot claim to offset this capital loss against income as she did not subscribe for the shares. £3,400 of the loss will be offset against her gains in 2012/13 (wasting the annual exemption) and the remaining £15,500 will be carried forward. However, she does not anticipate making any capital gains in the foreseeable future against which she could set this loss.

**Capital treatment**

	£
Sales proceeds (9,000 × £9.50)	85,500
Less: Cost (9,000 × £3.10)	(27,900)
	57,600
Less: Remainder of the annual exemption (£10,600 – £3,400)	(7,200)
	50,400
Taxable gain	50,400
Capital gains tax:	
Gain eligible for Entrepreneurs’ relief (£50,400 × 10%)	5,040
	5,040



**Tutorial note**

*Entrepreneurs’ relief is available as the shares are shares in Fleur’s personal trading company. Fleur has a holding of more than 5%, held for over a year, is an employee of the company and Jardin Ltd is a trading company.*

**Conclusion**

The capital treatment gives rise to the lower tax liability.

**(ii) Ensuring capital treatment**

For the capital treatment to apply, a number of conditions need to be satisfied such that the following points need to be confirmed.

- Fleur is UK resident and ordinarily resident despite living in both the UK and Utopia.

- The transaction is being carried out for the purpose of the company's trade and is not part of a scheme intended to avoid tax. This is likely to be the case, as HMRC accept that a management disagreement over the running of the company has an adverse effect on the running of the business.

In addition, Fleur must have owned the shares for at least five years so the transaction must not take place until 1 November 2012.



**Key answer tips**

The question asks for points that must be confirmed. Since Fleur is selling back all her shares, the conditions for substantial reduction of her shareholding, and ceasing to be connected with the company, will automatically be met and will therefore not attract marks.

<b>Marking guide</b>		<i>Marks</i>
(a)	VAT effect of renting out factory	
	Partial exemption with reason	1.5
	Recoverable input tax	1.5
	De minimis limits	1.0
	Capital goods scheme	1.0
	Effect of capital goods scheme – repayment of input VAT	1.0
	Effect of opting to tax	1.5
	Factors affecting decision (1 each, max 2)	2.0
		9.5
	<b>Maximum</b>	8.0
(b)	(i) Income treatment	
	Calculation of distribution	1.0
	Gross up by 100/90	0.5
	Personal allowance	0.5
	Income tax liability	1.0
	Income tax credit	0.5
	Capital treatment	
	Capital gain	1.0
	Entrepreneurs' relief	1.5
	Annual exemption	1.0
	Capital gains tax liability	0.5
	Conclusion	0.5
		8.0
	<b>Maximum</b>	7.0
	(ii) Fleur UK resident and ordinarily resident	1.0
	Benefit of company's trade	2.0
	Five year ownership period	1.0
		4.0
	<b>Maximum</b>	3.0
<b>Total</b>		18.0

## 5 AMRIT

**Key answer tips**

Part (a) covers the popular exam topic of overseas aspects of income tax. You should first explain Amrit's tax status in terms of his residence, ordinary residence and domicile. Your answer needs to be specific to Amrit and not just general points that could apply to many people.

In part (b) there are some easy marks for calculating pension contributions but the tricky thing is to make sure you answer the question and calculate the after tax cost to both Amrit and Lorton Ltd.

**(a) UK tax on the rental income**

Amrit is UK resident in 2012/13 because he is present in the UK for more than 182 days. He will have been treated as UK resident since 2001 when he moved here.

Amrit is ordinarily resident in the UK in 2012/13 as he is habitually resident in the UK, has lived here since 2001 and does not intend to leave the UK until he retires in 23 years time.

Amrit has therefore been resident for more than 7 out of the previous 9 tax years before 2012/13.

Amrit has not acquired a domicile of choice in the UK as he has not severed his ties with Kika and does not intend to make his permanent home in the UK. Therefore, he is not UK domiciled for tax purposes.

Accordingly, Amrit will be taxed on his rental income from the house in Kika as follows:

**2012/13**

If the unremitted overseas rental income  $\leq$  £2,000 in a tax year the implications are:

- taxed in the UK on the remittance basis
- personal allowances are available in full

This is likely to be the case in 2012/13 as the maximum rental income earned will be £1,200 (£600 x 2 months)

Any rental income remitted to the UK will fall into the basic rate band and will be subject to income tax at 20% on the gross amount (before deduction of Kikan tax). Unilateral double tax relief will be available in respect of the 7% tax suffered in Kika such that the effective rate of tax suffered by Amrit in the UK on the grossed up amount of income remitted will be 13%.

In order to minimise the total income tax suffered on the rental income Amrit should ensure that it is not remitted (i.e. brought into or used in the UK). It will therefore not be subject to income tax in the UK.

Amrit should retain evidence, for example bank statements, to show that the rental income has not been removed from Kika. Amrit can use the money whilst he is on holiday in Kika with no UK tax implications.



### **Tutorial note**

*Note that if Amrit does spend his unremitted income whilst abroad on items which he later takes to the UK, the importation of these items back into the UK may be treated as a remittance. However, there are exemptions such as personal items and items costing less than £1,000.*

### **Subsequent years**

The treatment outlined above may not apply in subsequent years however as the income earned will exceed £2,000, therefore the amount of unremitted income is important.

If the unremitted overseas rental income > £2,000 in a tax year Amrit has a choice of treatment, the arising or remittance basis

#### *Arising basis*

- Arising basis is mandatory unless an election is made
- Amrit will be taxed in the UK on the rental income on an arising basis
- Potential taxable income is therefore £5,400 (i.e. £600 × 9 months)
- Personal allowances are available in full
- Double tax relief will be available as above.

#### *Election for remittance basis*

- Amrit can choose to be assessed on a remittance basis and therefore only pay tax when cash is brought into the UK
- He is unlikely to do so however as he would lose the availability of his personal allowances, which are greater than the amount of rental income
- In addition to any tax levied on amounts actually remitted into the UK, he will be subject to an annual £30,000 tax charge payable for every year he wishes the remittance basis to apply.

### **(b) Minimising the total after tax cost of the pension contributions**

#### **Lorton Ltd makes the pension contributions**

The pension contributions will not give rise to any national insurance implications and are an exempt benefit for the purposes of income tax.

The pension contributions will be deductible from Lorton Ltd's trading profits. As Lorton Ltd's taxable profits fall between £300,000 and £1,500,000, this will save tax at the marginal rate of 27.5%.

	£
Contributions made by Lorton Ltd	20,000
Reduction in corporation tax liability (£20,000 × 27.5%)	(5,500)
	<hr/>
Total after tax cost	14,500
	<hr/>

**Amrit and Lorton Ltd make the pension contributions between them**

The maximum gross tax allowable pension contributions that can be made by Amrit are equal to his relevant UK earnings of £13,200 ( $£1,100 \times 12$ ). The dividend income and any rental income from the overseas property are not relevant earnings.

Amrit will make the contributions net of 20% income tax. Accordingly, his contributions will be £10,560 ( $£13,200 \times 80\%$ ) and he will require a dividend from Lorton Ltd of this amount. HMRC will contribute £2,640 ( $£10,560 \times 20/80$ ) such that the gross contributions will be £13,200.

The dividend will not be allowable for the purposes of corporation tax.

The dividend will not give rise to an income tax liability as Amrit's basic rate band will be extended by the gross amount of pension contributions made (£13,200) which is more than the taxable dividend income received of £11,733 ( $£10,560 \times 100/90$ ). Amrit is not currently a higher rate tax payer as shown in the working below. Accordingly, the dividend income will be taxed at 10% with a 10% tax credit.

	£
Contributions made by Amrit	10,560
Contributions made by Lorton Ltd ( $£20,000 - £13,200$ )	6,800
Reduction in corporation tax liability ( $£6,800 \times 27.5\%$ )	(1,870)
	15,490

The calculations indicate that Lorton Ltd should make all of the pension contributions as this results in the lower tax cost.

**Working: 2012/13 income**

	£
Director's fees	13,200
Dividends ( $£25,200 \times 100/90$ )	28,000
	41,200
Total income	41,200
Personal allowance	(7,475)
	33,725
Taxable income	33,725

As Amrit's taxable income is less than £35,000, he is a basic rate taxpayer.



**Tutorial note**

*Rental income in respect of furnished holiday accommodation is relevant earnings but such furnished holiday accommodation must be situated in the UK or EEA.*

*Whether the overseas income is assessed on the arising basis or remittance basis in subsequent years then Amrit will be a higher rate taxpayer and the conclusions above will alter. Some of his pension contributions will attract relief at the higher rate.*

<b>Marking guide</b>		<i>Marks</i>
(a)	UK resident with reason	1.0
	Taxed on overseas income	0.5
	Ordinarily resident with reason	1.0
	Domicile of choice with reason	1.0
	2012/13	
	Rental income taxed on the remittance basis	1.0
	Basic rate band	0.5
	Double tax relief	1.0
	Do not remit income to the UK	1.0
	No income tax	0.5
	Evidence	0.5
	Subsequent years	
	Importance of unremitted income figure	1.0
	Arising basis	1.0
	Personal allowance available	0.5
	Election for remittance basis	1.0
	Loss of personal allowance	0.5
	Annual £30,000 charge	1.0
		13.0
		<b>Maximum</b>
	9.0	
(b)	Lorton Ltd makes the pension contributions	
	Amount of contributions to be made to achieve objective	1.0
	Corporation tax saving	1.0
	No national insurance or income tax implications	1.0
	Amrit and Lorton Ltd make the pension contributions between them	
	Amrit's contributions	
	Maximum tax allowable amount equals relevant earnings	0.5
	Salary but not dividends or rental income	1.0
	Amount of dividend required from Lorton Ltd	1.5
	Corporation tax implications of dividend	0.5
	Income tax implications of dividend	1.5
	Contributions from HMRC	0.5
	Lorton Ltd's contributions	
	Amount	0.5
	Corporation tax saving	0.5
	Conclusion	1.0
	10.5	
	<b>Maximum</b>	
	9.0	
<b>Total</b>	18.0	