ACCA INTERIM ASSESSMENT

Advanced Taxation (United Kingdom)

December 2011

Paper P6 (UK)

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

This paper is divided into two sections:

Section A – BOTH questions are compulsory and MUST be attempted

Section B – TWO questions ONLY to be attempted

Tax rates and allowances are on pages 3 – 6

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.

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TAX RATES AND ALLOWANCES

SUPPLEMENTARY INSTRUCTIONS

1 **You should assume that the tax rates and allowances for the tax year 2010/11 and for the Financial year to 31 March 2011 will continue to apply for the foreseeable future unless you are instructed otherwise.**

2 **Calculations and workings need only to be made to the nearest £.**

3 **All apportionments should be made to the nearest month.**

4 **All workings should be shown.**

INCOME TAX

		Normal rates	Dividend rates
		%	%
Basic rate	£1 – £37,400	20	10
Higher rate	£37,401 to £150,000	40	32.5
Additional rate	£150,001 and over	50	42.5

A starting rate of 10% applies to savings income where it falls within the first £2,440 of taxable income.

Personal allowances

Personal allowance	Standard	£6,475
Personal allowance	65 – 74	£9,490
Personal allowance	75 and over	£9,640
Income limit for age related allowances		£22,900
Income limit for standard personal allowance		£100,000

Car benefit percentage

The base level of CO_2 emissions is 130 grams per kilometre.

	%
Petrol cars with CO_2 emissions of 75 grams per kilometre or less	5
Petrol cars with CO_2 emissions between 76 and 120 grams per kilometre	10

Car fuel benefit

The base figure for calculating the car fuel benefit is £18,000.

Pension scheme limits

Annual allowance	£255,000
Lifetime allowance	£1,800,000

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

Authorised mileage allowance: cars

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

Capital allowances

	Rate of allowance
Plant and machinery	%
Main pool	20
Special rate pool	10
Motor cars (purchases since 6 April 2009 (1 April 2009 for limited companies))	
CO_2 emissions up to 110 grams per kilometre	100
CO_2 emissions between 111 and 160 grams per kilometre	20
CO_2 emissions above 160 grams per kilometre	10
Annual investment allowance	
First £100,000 of expenditure	100
Industrial buildings	
Writing-down allowance	1

CORPORATION TAX

Financial year	*2008*	*2009*	*2010*
Small profits rate	21%	21%	21%
Main rate	28%	28%	28%
Lower limit	£300,000	£300,000	£300,000
Upper limit	£1,500,000	£1,500,000	£1,500,000
Standard fraction	7/400	7/400	7/400

Marginal relief

Standard fraction × (U – A) × N/A

VALUE ADDED TAX

Standard rate of VAT	Up to 3 January 2011	17.5%
	From 4 January 2011	20%
Registration limit		£70,000
Deregistration limit		£68,000

INHERITANCE TAX

Tax rates

		%
£1 – £325,000		Nil
Excess	– Death rate	40
	– Lifetime rate	20

Taper relief

Years before death:	% reduction
More than 3 but less than 4 years	20
More than 4 but less than 5 years	40
More than 5 but less than 6 years	60
More than 6 but less than 7 years	80

CAPITAL GAINS TAX

Rates of tax	– Lower rate	18%
	– Higher rate	28%
Annual exemption		£10,100
Entrepreneurs' relief	– Lifetime limit	£5,000,000
	– Rate of tax on gain	10%

NATIONAL INSURANCE CONTRIBUTIONS

(Not contracted out rates)

		%
Class 1 Employee	£1 – £5,715 per year	Nil
	£5,716 – £43,875 per year	11.0
	£43,876 and above per year	1.0
Class 1 Employer	£1 – £5,715 per year	Nil
	£5,716 and above per year	12.8
Class 1A		12.8
Class 2	£2.40 per week	
	Small earnings exception limit – £5,075	
Class 4	£1 – £5,715 per year	Nil
	£5,716 – £43,875 per year	8.0
	£43,876 and above per year	1.0

RATES OF INTEREST

Official rate of interest:	4.0%
Rate of interest on underpaid tax:	3.0%
Rate of interest on overpaid tax:	0.5%

STAMP DUTY LAND TAX

	%
£150,000 or less (1)	0%
£150,001 – £250,000 (2)	1%
£250,001 – £500,000	3%
£500,001 or more	4%

(1) For residential property, the nil rate is restricted to £125,000.

(2) From 25 March 2010 to 24 March 2012 there is an exemption for first time buyers purchasing residential properties for no more than £250,000.

STAMP DUTY

Shares	0.5%

SECTION A

BOTH questions are compulsory and MUST be attempted.

1 Phil Mitchel, aged 47, died on 23 March 2011. At his death he owned the following assets:

(1) 30% of the £1 ordinary shares in Queen Ltd, an unquoted trading company. The remaining shares were held as follows:

Phil's wife	25%
Phil's son	10%
Unconnected persons	35%

Phil had originally acquired a 65% holding when he became a director of the company in April 2008, for £650,000, but had gifted his wife's shareholding to her on 10 July 2010 and his son's shareholding to him on 20 July 2010.

The value of the shares have been agreed by HMRC as follows:

% holding	*July 2010*	*March 2011*
	£	£
65	2,100,000	2,250,000
55	1,450,000	1,500,000
40	850,000	900,000
30	650,000	700,000
25	500,000	550,000
10	150,000	175,000

10% of the assets of Queen Ltd are surplus cash balances (i.e. excepted assets).

(2) 10,000 £1 ordinary shares in Club Ltd, an unquoted trading company. The value of these shares at 23 March 2011 has been agreed by HMRC at £100,000. Phil originally acquired these shares for £1,000 in October 2007. Club Ltd has issued 50,000 ordinary shares.

(3) Two properties – one used in the trade of Queen Ltd and the other used in the trade of Club Ltd.

The property used by Queen Ltd was acquired in April 2008 for £200,000 and was valued in March 2011 at £750,000.

The property used by Club Ltd was acquired in September 2007 for £100,000 and valued in March 2011 at £175,000. At March 2011, there is an outstanding mortgage of £75,000 on the property used by Club Ltd.

(4) On 23 March 2011, other net assets are valued for IHT purposes at £650,000. This figure is after taking account of the outstanding personal tax liabilities owed by Phil at this date.

Apart from the gifts of shares in Queen Ltd made to his wife and son, Phil has made the following cash gifts during his lifetime to his son:

Date	*Amount*
	£
28.3.2005	46,000
20.6.2005	37,000
11.3.2006	18,000
03.3.2007	211,000

The 20 June 2005 gift was made on the occasion of the son's marriage.

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Under the terms of his will, Phil left £325,000 in cash to his wife with the residue of his estate to his son.

Phil's son sold half of his shares in Queen Ltd in December 2011 for £550,000. Phil's son has never worked for Queen Ltd, and has made no other chargeable disposals in 2011/12.

Both Phil and his son are higher rate taxpayers.

Required:

(a) Explain the inheritance tax implications resulting from Phil's death on 23 March 2011.

Your answer should include a calculation of any inheritance tax liabilities arising, and also an explanation of the basis for valuing his shares in Queen Ltd and of any reliefs which are available. (18 marks)

(b) (i) Explain the capital gains tax implications arising as a result of the gifts in July 2010, and the sale by Phil's son in December 2011.

Your answer should include a calculation of any tax arising, assuming that gift relief is not claimed.

You should assume that the rates and allowances for 2010/11 apply throughout this part of the question. (8 marks)

(ii) Explain how your answer to part (b) (i) would be different if gift relief had been claimed.

You are not required to perform any calculations for this part. (4 marks)

(c) Explain whether any tax can be saved by entering into a deed of variation.

Specify the conditions which need to be satisfied and the potential disadvantages in varying the terms of a will. (5 marks)

The nil rate bands for earlier years are as follows:

2004/05	**£263,000**
2005/06	**£275,000**
2006/07	**£285,000**

(Total: 35 marks)

2 Duncan McByte is a computer programmer currently living in Scotland. He has recently accepted the offer of a contract of employment with Mainframe plc (a large company worth over £50 million) for a period of three years commencing on 1 July 2010 and ceasing on 30 June 2013. Duncan will be based in London during the period of the contract.

The remuneration package comprises:

(1) A salary of £65,000 per annum, together with a termination bonus of £40,000 upon satisfactory completion of the three-year contract.

(2) Mainframe plc is providing accommodation for Duncan in London. This is in an apartment that was purchased in 1993 for £94,000 and was improved at a cost of £35,000 during 2004. The apartment has a rateable value of £6,700 and is currently valued at £170,000.

(3) Duncan is using his private motor car for business mileage. The motor car is leased at a cost of £380 per month and the annual running costs, including fuel, are £1,800. He drives a total of 1,700 miles per month, of which 1,500 miles are for business purposes. Mainframe plc pays a mileage allowance of 30 pence per mile for business mileage.

(4) On 1 July 2010, Mainframe plc provided Duncan with a loan of £60,000 that he has used to purchase a holiday cottage in France. The loan will be repaid by six half-yearly instalments of £10,000 commencing on 31 December 2010. The loan has an interest rate of 1% p.a., therefore Duncan will have paid £425 interest in 2010/11.

(5) On 1 July 2010, Mainframe plc provided Duncan with a laptop for his personal use. The laptop cost £1,200.

(6) Mainframe plc will pay Duncan's annual subscription of £125 p.a. to the Institute of Chartered Computer Consultants, a sports club membership of £800 p.a., an annual premium of £650 for liability insurance, and £1,200 p.a. for computer training courses that will keep him up-to-date with the latest software developments. These amounts will all be paid during January of each year.

(7) On 1 July 2010, Duncan was granted options to purchase 15,000 £1 ordinary shares in Mainframe plc at their value on that date. The options were provided free and will be exercised by Duncan upon the termination of his contract on 30 June 2013. Mainframe plc's shares were valued at £1.75 on 1 July 2010 and are forecast to be worth £5 by 30 June 2013.

Duncan's options have been granted under a company share option plan approved by HMRC which is operated by Mainframe plc.

From 1 July 2010, Duncan has rented out his main residence in Scotland as furnished holiday accommodation. The forecast rental income for 2010/11, based on 22 weeks' letting, is £18,000, of which 22.5% will be paid to a letting agency. Running costs will amount to £900. The house was furnished at a cost of £6,000 during June 2010. Duncan has a mortgage of £60,000 on which the annual interest of £6,400 (gross) will be paid during 2010/11.

Required:

(a) Explain the income tax and NIC implications for Duncan arising from his remuneration package from Mainframe plc, and how the HMRC will collect the tax on the benefits provided.

Your answer should include calculations of the amounts assessable as employment income for 2010/11. (17 marks)

(b) Explain why it was beneficial for Duncan's share options (Note 7) to be granted under a share option scheme approved by HMRC. (3 marks)

(c) Advise Duncan of the property business profits that he will be assessed on for 2010/11. (5 marks)

(Total: 25 marks)

SECTION B

TWO questions ONLY to be attempted

3 Assume that today's date is 1 May 2011.

Pierre, who is single and aged 49, owns the following freehold properties. Pierre has no other sources of income.

Property 1 — A house in Surrey that Pierre lives in for approximately seven months of the year. This house was bought in June 1992 for £75,000 and is currently worth £200,000. The house comprises six main rooms of which two are currently let on a furnished basis to lodgers for aggregate annual rents of £6,320.

Associated utility and maintenance costs related to letting amount to £720 per year. In addition Pierre pays interest of £4,000 per year on a loan taken out to buy this property.

Pierre has no plans to dispose of this property.

Property 2 — A house in Yorkshire that Pierre lives in for the remaining part of the year. This house, which was bought on 1 July 2009 for £45,000, has a large garden extending to approximately 0·5 hectares. Pierre commenced living in this property on 1 July 2010. The property is currently worth £110,000.

Pierre sold part of the garden of this property to a developer in May 2010 for £19,600 at which time the value of the remaining property was £80,000. This is the only disposal that Pierre has made in 2010/11. The developer has also indicated to Pierre that he would be interested in acquiring further portions of this property in the near future, possibly even the house itself.

Property 3 — A commercial property let at an annual rent of £9,000. Pierre bought this property in June 1995 for £50,000 and its current value is £100,000.

On 5 June 2010 the property was vacated by the former tenant. On 6 September 2010 Pierre signed a new lease with Franks Limited, an unconnected trading company. The new lease is for a term of 10 years. A premium of £10,000 was paid by Franks Limited.

In addition under the terms of the lease Franks Limited was required to carry out structural improvements to the property which will add £10,000 to its value.

Pierre undertook repair work to this property in 2010/11 amounting to £1,500.

Property 4 — A commercial property let at an annual rent of £5,000. Pierre bought this property in June 1999 for £35,000 and its current value is £65,000.

Pierre had some difficulty in letting this property in recent years. The property was vacant for nearly two years prior to his entering into a new lease with Les Amis Limited, an unconnected unquoted trading company, on 6 September 2010. To encourage Les Amis Limited to sign the lease Pierre had agreed to pay them £2,500 as a contribution towards advertising their new business.

Pierre incurred advertising costs to find a new tenant of £1,000 and repairs of £3,000 in 2010/11.

Required:

(a) Calculate Pierre's property business income assessment for 2010/11.

Your answer should include a consideration of any reliefs available in relation to property 1 with due dates for any elections, and should include an explanation of the treatment of the inducement payment made in relation to property 4.

(8 marks)

(b) Assuming that principal private residence relief is not available calculate any taxable capital gain arising on the disposal of part of the garden of property 2 in May 2010 and advise what action could be taken in respect of this gain.

(4 marks)

(c) Explain the potential capital gains tax implications arising from the proposed part or entire disposal of the remainder of property 2.

Your answer should include recommendations of any action that Pierre should take in relation to this property.

Detailed calculations are not required for this part of the question. (8 marks)

(Total: 20 marks)

4 Assume today's date is 15 December 2010.

Anwar Christopher, an entrepreneur, was born on 7 May 1958 and has lived in the UK for the last ten years. He is domiciled in Pakistan.

He is married to Wendy who is UK domiciled.

Anwar's sources of income and gains are summarised in the table below:

Source	*Bank to which credited*	*Country in which bank situated*
Bournecliffe House	Abbeyminster	UK
Christopher Care Ltd	Abbeyminster	UK
Initial Irrigation Ltd (Pakistan duties)	National Bank of Pakistan	Pakistan
Initial Irrigation Ltd (UK duties)	National Bank of Pakistan	Pakistan
National Airlines plc bonds	Abbeyminster	UK
Glucozade plc Ordinary shares	Abbeyminster	UK

Anwar has been operating Bournecliffe House in a sole trader capacity as a nursing home in an English south coast resort since he bought it on 1 August 1997. His tax adjusted trading profit for the final year of trading ended 31 July 2010 is £14,000. There are no overlap profits brought forward.

Early in 2010, Anwar received an offer for Bournecliffe House from a developer which he accepted. Exchange of contracts took place on 1 May 2010 with completion on 1 August 2010. The chargeable gain arising on the disposal was £185,000.

Anwar identified another nursing home in Central England called Peak View, which he bought through the medium of his solely owned UK registered limited company, Christopher Care Limited. The company completed the purchase on 1 August 2010 and commenced trading immediately.

In addition to the net proceeds from the sale of Bournecliffe House Anwar had to raise a further £120,000 in order to effect the acquisition of Peak View. He achieved this by transferring £20,000 from his account with the National Bank of Pakistan and by borrowing £100,000 from the Abbeyminster Bank in the UK.

The loan is a capital repayment loan. The interest paid and capital repaid during the year ended 5 April 2011 were £6,400 and £12,800 respectively. The interest was paid gross.

Anwar pays himself director's remuneration of £1,000 per month from Christopher Care Ltd. The tax deducted under PAYE from his director's remuneration in the period to 5 April 2011 was £837.

Anwar owns 30% of the shares in Initial Irrigation Limited (Initial). The company is based in Pakistan and Anwar is the technical director. Initial has two divisions, the agricultural division and the fountains division. The agricultural division operates exclusively in Asia whereas the fountains division operates exclusively in the UK. Anwar works for both divisions. He has a separate employment contract for each set of duties. His remuneration in respect of his Asian activities in Sterling equivalent terms is £23,000 (gross). His remuneration in respect of his UK duties is £7,000 (gross). The remuneration for both contracts is paid in Pakistan. The rate of tax suffered by Anwar on the income paid in Pakistan is 35%.

Anwar also owns a substantial estate in Peshawar, Pakistan which he and his extended family use as a holiday home.

Anwar owns the following financial investments:

£800 of National Airlines plc 9.75% Convertible Capital Bonds 2013 (quoted in the UK)

1,000 Glucozade plc ordinary shares (registered in the UK)

Anwar received cash dividends of £270 from Glucozade plc in the year ended 5 April 2011.

Anwar made a self assessment payment on account on 31 January 2011 of £2,600 and is due to make a second on 31 July 2011, also of £2,600.

Required:

(a) **Explain how Anwar may be assessed to income tax in 2010/11 and advise which basis he should choose.**

You do not need to do any calculations in this section. **(6 marks)**

(b) **Assuming Anwar chooses to pay tax on the arising basis, calculate his income tax payable for the year ended 5 April 2011.** **(9 marks)**

(c) **Calculate Anwar's self assessment balancing payment for the year ended 5 April 2011.** **(3 marks)**

(d) **Explain the inheritance tax considerations that Anwar should take into account when transferring property to Wendy.** **(2 marks)**

(Total: 20 marks)

5 Molly Mop is a 71 year old pensioner who has been made a widow as a result of the death of her husband, aged 69, on 7 April 2010. Molly's husband had made no lifetime gifts.

Molly inherited all of her husband's estate upon his death and as at today's date (assume 6 April 2011) she owns the following assets:

(1) Her main residence, which is currently valued at £330,000.

(2) 20,000 50p ordinary shares in Shawl plc, a 'blue chip' UK company quoted at 410p – 426p. Shawl plc regularly pays a dividend of 27p per share each year.

(3) 45,000 £1 ordinary shares in Bit-Part Ltd, an unquoted trading company with a share capital of 200,000 ordinary shares. Molly's three children hold the other shares in the company equally. Bit-Part Ltd paid a dividend of 10p per share during 2010/11. Molly inherited all of these shares from her husband, who had originally acquired them at their par value in March 1989. The shares were valued at £160,000 on 7 April 2010, and are currently worth £236,250. Bit-Part Ltd has assets worth £1,050,000, of which £500,000 are investments in quoted shares.

(4) UK government stocks with an interest rate of 4% and a nominal value of £100,000. These are currently quoted at 90 – 94p.

(5) 25,000 units in Global Trust, a unit trust quoted in the UK at 210p – 218p. The trust is aimed at capital growth, and therefore only paid a dividend of £450 (net) during 2010/11.

(6) Deposits of £150,000 in an 'instant access' account with the Brat and Bong Building Society. This is a building society paying a high rate of interest of 5.50% per annum (gross) on this account.

(7) £10,000 in the National Savings Pensioners Guaranteed Income Bonds, which pays a gross interest rate of 7%.

(8) Molly has an ISA account with the Welich Building Society. The balance on the account is £3,210, of which £3,000 is capital. All interest was received during 2010/11.

(9) Molly invested £10,000 in a venture capital trust during 2010/11.

(10) Chattels, cash and other assets of £165,000.

During 2010/11, Molly received income of £1,500 (net) as a beneficiary of a discretionary trust. The trust holds cash of £65,200 held in a money market deposit account.

Molly's only other income is the UK National Insurance Retirement pension (£91 weekly) and a private pension of £12,200 per annum (gross). Her husband did not have any taxable income for 2010/11.

Under the terms of her will, Molly has left all of her estate to her family. Her only previous lifetime gift of assets was a gift of £160,000 to a discretionary trust for the benefit of her children in June 2005.

Required:

(a) Calculate Molly's income tax payable/repayable for 2010/11. (9 marks)

(b) Calculate the IHT liability that would arise if Molly were to die during April 2011.
Your answer should indicate who is liable for the tax and by what date.
The nil rate band for 2005/06 was £275,000. (11 marks)

(Total: 20 marks)