November 2018 Examination

PAPER 1

Personal Taxation

Part I Suggested Answers

1. Josh

If Josh had sold the shares in January 2017, he would have been subject to CGT on the gain of £50,000. **(½)** This is because he would have sold the shares within the 3 year qualifying period from the date of issue. **(½)** Josh would also be required to pay back the income tax relief he received on purchase **(½)** in full as he sold the shares at a profit. **(½)**

When Josh sold the shares in October 2017, the capital gain is exempt **(½)** as he had held the shares for more than the 3 year qualifying period. **(½)** Josh would not have been required to pay back any of his income tax relief **(½)** because he held the shares for more than 3 years. **(½)**

4 marks

2. Late filing of a tax return

	£
Initial (fixed) late filing penalty	100 (½)
Daily penalties as more than 3 months late: (½)	
£10 per for a maximum of 90 days	900 (1)
Additional 5% tax geared penalty as the return is more than 6 months late	
£8,500 x 5% (greater than £300)	425 (2 x ½)
Total penalty charged	1,425

3 marks

3. Cash gift aid

Gift aid donations are made net of 20% basic rate tax **(½)**, so the donation is grossed up by 100/80, ie the charity will receive £1,250 **(½)** and Reena has had 20% tax relief at source. **(½)**

As Reena is a higher rate taxpayer, she can obtain extra relief on her charitable donation. **(½)**. This works by extending her basic rate band by the gross donation. **(½)**. For 2017/18, Reena's basic rate band will be £34,750 (£33,500 + £1,250). **(½)**

This gives her an extra 20% tax relief on the gross payment of £1,250. **(½)**

Max 3 marks

4. Short tax returns

Short Tax Returns are a four page return instead of the longer return **(½)** and are for taxpayers with relatively simple tax affairs **(½)**. The sort of taxpayers who may be sent a Short Tax Return to complete include: **(½)** for any one of the examples below (or any other relevant example)

- Employees with taxable benefits

- Self-employed individuals who have a turnover of less than £85,000 in 2017/18
- Pensioners with straightforward investment income
- Taxpayers who have property income below £85,000

The sort of taxpayers who cannot use a Short Tax Return include: **(½)** for any one of the examples below (or any other relevant example)

- Taxpayers who are paid company directors
- Taxpayers who are in a partnership
- Taxpayers who receive trust income
- Taxpayers with foreign dividends exceeding £300

2 marks

5. Maria

	£	
Property income (1,800 x 12)	21,600	**(½)**
Less: Expenses		
Letting agent (150 x 12)	(1,800)	**(½)**
Fridge freezer (replacement of domestic item)	(450)	**(½)**
House insurance (6/12 x 800 **(½)** + 6/12 x 700) **(½)**	(750)	
Mortgage interest relief (8,000 x 75%) **(½)**	(6,000)	**(½)**
Total property income subject to Income Tax	**12,600**	**(½)**

4 marks

6. Qualifying conditions for a furnished holiday letting

The qualifying conditions are as follows:

- The property must be furnished **(½)**
- The property must be in the UK **(½)** or any other state in the European Economic Area (EEA) **(½)**
- The property has to be available commercially for letting as holiday accommodation for at least 210 days **(½)** in the relevant 12 month period (which is usually the tax year) **(½)**
- The property must also be let out for 105 days in the relevant period **(½)**
- If it is let for a continuous period of more than 31 days to the same person **(½),** this will be treated as "longer term occupation" **(½)**
- Any periods of "longer term occupation" must not exceed 155 days in the relevant period **(½)**

Max 4 marks

7. Termination payments

	£
Ex-gratia payment	65,000 **(½)**
Statutory redundancy pay	8,000 **(½)**
Less:	
Exemption	(30,000) **(½)**
	43,000
Less:	
Foreign service deduction of £43,000 **(½)** x 4/12 **(½)**	(14,333) **(½)**
Total subject to Income Tax 2017/18	28,667

3 marks

8. Pre-Owned Assets charge

	£
Market value –	
Rental of the asset (6 months)	
= 1,500 x 6 months	9,000 **(½)**
Less:	
Rent paid by the donor for use of the property **(½)**	
= 500 x 6 months	(3,000) **(½)**
Notional income	6,000 **(½)**

2 marks

9. Kumar

Chargeable gain calculation – 2017/18

	£
Proceeds	750,000
Less:	
Cost	(250,000)
Gain	500,000 **(½)**
Less:	
PPR relief (W1)	(375,000)
Chargeable gain	125,000 **(½)**

(W1)

PPR relief:	Occupation	Absence
1 March 2006 – 28 February 2009 – actual	3 **(½)**	
1 March 2009 – 31 August 2012 – deemed (working abroad)	3.5 **(½)**	
1 September 2012 – 31 August 2013 – actual	1 **(½)**	
1 September 2013 – 31 August 2016 – absent		3 **(½)**
1 September 2016 – 28 February 2018 – deemed	1.5 **(½)**	
Total	9	3

PPR relief = £500,000 x 9/12 = £375,000 **(½)**

4 marks

10. Temporarily non-UK resident for Capital Gains Tax

Howard will be treated as temporarily non-UK resident if:

- He becomes non-UK resident immediately after a period of being resident in the UK **(½)**
- He was UK resident for at least 4 of the 7 tax years **(½)** immediately before the year he departed **(½)**
- He is non-UK resident for 5 years or less **(½)**

If Howard is treated as temporarily non-UK resident and returns to the UK and becomes resident again **(½),** he will taxed in the year he returns on any gains made in the period of his absence. **(½)**

This only applies to assets owned by Howard at the date he left the UK. **(1)**

4 marks

11. Tenants in common

Tenants in common means each person holds a quantifiable share of the property **(½)** as separate legal entities. **(½)**

If one of them were to die, as the right of survivorship does not apply, **(1)** each person's share in the property passes under their will, **(½)** or under the rules of intestacy if they have not made a will. **(½)**

3 marks

[Scots Law variant answer:

Common property means each owner has title to their own share. **(1)** *They may dispose of their share separately,* **(½)** *or grant a security over it.* **(½)**

If one of them were to die, their share passes under their will, **(½)** *under the rules of intestacy if they have not made a will,* **(½)** *or under the terms of the title if there is a destination clause in the title itself.* **(½)**

Maximum 3 marks]

12. Gordon

Scottish Income Tax computation – 2017/18

		Total		Non-savings	Dividends	
		£		£	£	
Employment		55,000		55,000		
Dividends		12,000			12,000	
		67,000				
Less: Personal allowance		(11,500)		(11,500)		½
Taxable income		55,500		43,500	12,000	
		=======		=======	======	
Income tax:						
Basic rate (Note)	Non-savings	½ 31,500	x	20%	6,300	½
Higher rate	Non-savings	12,000	x	40%	4,800	½
		43,500				
Nil rate band	Dividends	5,000	x	0%	0	½
Basic rate	Dividends	7,000	x	32.5%	2,275	½
		55,500				
		======				
Income tax liability					13,375	
Less: PAYE					(11,000)	½
Income tax payable					**2,375**	½

Note:
The basic rate band for non-savings, non-dividend income is £31,500 for a Scottish taxpayer.

4 marks

November 2018 Examination

PAPER 1

Personal Taxation

Part II Suggested Answers

1.

REBECCA WORDSWORTH

1) Income Tax Computation – 2017/18

	Total income	Non-savings income	Savings income	Dividend income	
	£	£	£	£	
Employment income (W1)	124,605	124,605			**(see W)**
Bank interest (£2,800 × 50%)	1,400		1,400		**(½)**
Dividends	4,320			4,320	**(½)**
Total income	130,325	124,605	1,400	4,320	
Less: Adjusted PA (W5)	(2,650)	(2,650)			**(see W)**
Taxable income	127,675	121,955	1,400	4,320	
	=======	=======	======	======	

Income tax:				
Non-savings income – Basic rate (W6)	46,125	× 20%	9,225	**(2)**
Non-savings income – Higher rate	75,830	× 40%	30,332	
	121,955			
Savings income – NRB	500	× 0%	0	
Savings income – Higher rate	900	× 40%	360	
Dividends – NRB	4,320	× 0%	0	
	127,675			
	=======			
Income tax liability			39,917	
			=======	

Tutorial note:

The question asks for the income tax liability (not income tax payable) and therefore the PAYE given in the question is not relevant and is not deducted.

Max 15 marks

2) National Insurance Contributions

Class 1 contributions

Payable on Rebecca's cash earnings (i.e. salary and bonus) of £101,000 (W1). **(½)**

Also payable on the £3,900 earnings in respect of the exercise of quoted non-tax advantaged share options, as the shares are readily convertible assets. **(½)**

Class 1 primary contributions payable by Rebecca. **(½)**

Class 1 secondary contributions payable by Radnor plc. **(½)**

Class 1A contributions

Payable on all non-cash taxable benefits of £19,705 (W1). **(½)**

Payable by Radnor plc only. **(½)**

3) Statutory notice period

The statutory notice period is normally one week for each complete year worked, **(½)** up to a maximum of 12 weeks. **(½)**

The minimum statutory notice period overrides a shorter period stated in an employee's contract of employment. **(½)**

Liam worked for Radnor plc for nine years, therefore his minimum statutory notice is nine weeks. **(½)** Accordingly, Liam is correct in his belief that one month's notice is insufficient. He could insist that he stays for nine weeks and so he is there to complete the project. **(1)**

Max 2 marks

Workings

(W1) Employment income

	£	£	
Salary		86,000	**(½)**
Bonus		15,000	**(½)**
		101,000	
Taxable benefits:			
Living accommodation			
Annual value	9,100		**(½)**
Additional yearly rent (W2)	5,480		**(see W)**
First mobile phone	Exempt		**(½)**
Second mobile phone (£955 x 20% x 11/12)	175		**(1)**
Car benefit (W3)	4,950		**(see W)**
Employer contribution into PPS	Exempt		**(½)**
		19,705	
		120,705	
Exercise of share options (W4)		3,900	**(see W)**
Employment income		124,605	
		=======	

Tutorial note:
Bonuses are assessed on a cash receipts basis.
The bonus received on 30 April 2017 is therefore assessed in 2017/18.

(W2) Accommodation – additional yearly rent

	£	
Cost of property	276,000	**(½)**
Plus: Capital improvements up to 6.4.2017		
June 2016	18,200	**(½)**
August 2017	-	**(½)**
	294,200	
Less: Limit	(75,000)	**(½)**
	219,200	
	=======	
Benefit (£219,200 x 2.5% (official rate of interest))	5,480	**(½)**
	=======	

Tutorial notes:

Market value on 1 August 2014 is not relevant as Radnor plc owned the flat for less than 6 years before Rebecca moved in

The new bathroom is not included in the calculation of the benefit as it had not been completed by the start of the tax year 2017/18.

(W3) Car and fuel benefit

Car available: 1.9.17 to 5.4.18 (7 months)

CO_2 emissions = 143 g/km (round down to 140 g/km)

Appropriate percentage

= 18% (basic %) + 3% (diesel supplement) + 1/5 x (140 – 95) = 30% **(1)**

	£	
List price	33,285	
Less: Capital contribution (Maximum)	(5,000)	**(1)**
	28,285	
Car benefit (£28,285 x 30% x 7/12)	4,950	**(1)**

(W4) Exercise of share options

	£	
Market value on exercise date (£3.20 x 3,000)	9,600	**(½)**
Less: Cost of shares (£1.90 x 3,000)	(5,700)	**(½)**
Employment income	3,900	

(W5) Adjusted personal allowance

	£	£	
PA		11,500	
Total income = Net income	130,325		**(½)**
Less: Gross PPC (£10,100 x 100/80)	(12,625)		**(½)**
	117,700		
Less: Limit	(100,000)		
Excess	17,700		**(½)**
Reduction (£17,700 x 50%)		(8,850)	**(½)**
Reduced PA		2,650	

(W6) Extension of basic and additional rate band

	BRB limit	HRB limit	
	£	£	
Band	33,500	150,000	
Plus: Gross PPC (W5)	12,625	12,625	
	46,125	162,625	**(1)**

2.

1) Andrew's base cost in First Ltd:

Date		No	£
2009	Initial acquisition	2,000	20,000 (½)
2011	Rights issue – 4,000 x £15	4,000 (½)	60,000 (½)
2012	Inheritance - 500 x £20	500 (½)	10,000 (½)
		6,500	90,000

		Value of consideration £	Allocation of First Ltd base cost £	
Cash	6,500 x £80	520,000 (½)	36,923	(1 – for allocation of £90k base cost)
78,000 "A" Ordinary shares	6,500 x 12 x £2.50	195,000 (½)	13,846	
£325,000 7% loan stock	6,500 x £50	325,000 (½)	23,077	
£195,000 9% loan stock	6,500 x £35	227,500 (½)	16,154	
		1,267,500	90,000	

		£	£
In May 2017			
Cash		520,000	
Less: base cost		(36,923)	
Capital gain			483,077 (½)
In February 2018			
<u>Sale of "A" shares</u>			
Proceeds re. "A" shares	£4.75 x 78,000	370,500 (½)	
Less: base cost		(13,846) (½)	
			356,654
<u>Crystallisation of frozen gain on 9% loan stock</u>			
Proceeds		227,500	
Base cost		(16,154)	
Frozen gain		211,346 (½)	
50% (½) crystallised on redemption			105,673
			945,404
Less: Annual exempt amount			(11,300) (½)
Taxable gains			934,104
CGT at 20% (½)			186,821

2) If Andrew had accepted the role as non-executive director then, as he would then have been both an officer (½) and a 5% shareholder (½) for the year prior to the disposal (½), he would have fulfilled the conditions to claim Entrepreneurs' Relief (½) on the gain arising on the disposal of First Ltd shares for cash (½) in May 2017. As such he would incur just 10% CGT (½) on the gain arising from the receipt of cash.

In addition, Andrew could have made an election, by 31 January 2019 **(½),** to dis-apply share-for-share treatment **(½)** on the receipt of “A” ordinary shares **(½)**, and loan stock **(½)** in Last plc in May 2017. This would have enabled him to also benefit from Entrepreneurs’ Relief on that element of the consideration received **(½)**. The disadvantage of making this claim is that he would need to fund a tax liability now when he has not yet realised all value in cash from the disposal **(½).**

3.

My address

Alice address

The date

(Format – 1)

Dear Alice

Thank you for your letter.

I can advise in relation to the events that you describe as follows:

1) You may be able to claim a capital loss **(½)** for the £20,000 that you lent to Valentine. This will be the case as long as he is UK tax resident **(½)** and used the money wholly for the purposes of his trade **(½)**. You will be able to relieve this loss against your capital gains **(½)** of either the tax year in which you claim the loss i.e. 2018/19 **(½)** or either of the previous two tax years **(½)**. However, as Valentine was not declared bankrupt until February 2018, you may not be able to carry the loss back before 2017/18 **(½)** as HM Revenue & Customs may argue that the loan was still potentially recoverable at that time **(½)**.

2) You will be able to claim a capital loss in 2017/18 **(½)** of £95,000 **(½)** in relation to this disposal. This loss can be relieved against capital gains of the same year **(½)** or, if unrelieved, carried forward against future capital gains **(½)**. Alternatively, it is possible for the loss to be relieved against your total income **(½)** of either the 2017/18 or 2016/17 tax years **(½)**, or both **(½)**.

3) There is, unfortunately, no tax relief available for the loss of your necklace **(½)**. The receipt of compensation gives rise to a chargeable gain **(½)** equal to the difference between the insurance proceeds **(½)** and the price you paid in the 1990s **(½)** plus the amount you paid to add additional diamonds **(½)**. The gain arises in 2017/18, the year of receipt of the insurance proceeds, rather than the year in which the necklace was lost **(½)**. If you had decided to use the proceeds to buy a replacement necklace, rather than to pay your tax bill, you would have been able to "roll-over" **(½)** the capital gain so that it did not arise, if at all, until that replacement asset was disposed of **(½)**.

4) The disposal of the antique table to Richard is a chargeable disposal **(½)**. As this is a gift to a connected party the deemed disposal proceeds is the table's market value **(½)**. However, because the tables are worth more as a pair than separately **(½)** and you have disposed of them within 6 years **(½)** to connected persons **(½)**, the two disposals have to be considered in aggregate **(½)** and the resulting gain split between the two years. As a result, a capital gain of £50,000 **(½)** arises in both 2016/17 and 2017/18 and we will need to file an amendment to your 2016/17 tax return **(½)**.

Please do not hesitate to contact me if you have any queries.

Yours sincerely,

Adviser

[Max 15 marks]

4. PENSION ADVICE

1) NOTES FOR CLIENT MEETING

Annual allowance for 2017/18

The annual allowance (AA) in 2017/18 is £40,000, but it is gradually reduced for individuals with high income. A high income individual has 'threshold income' exceeding £110,000 and 'adjusted income' exceeding £150,000. The maximum reduction in AA is £30,000. Therefore the minimum AA available is £10,000.

(*1 mark given for written explanation as above and/or evidence that the above has been applied as shown below in the marking guide)

	£	
Net income	165,000	
Less: Individual's gross PPCs (£20,000 x 100/80)	(25,000)	**(1)**
Threshold income	140,000	
	=======	
Threshold income > £110,000*		**(½)**
Net income	165,000	
Add: Employees OPCs	Nil	**(½)**
Contributions by Hammond Ltd	Nil	**(½)**
Adjusted income	165,000	
	=======	
Adjusted income > £150,000*		**(½)**
AA	40,000	**(½)**
Less: Reduction in allowance		
(£165,000 – £150,000) x 50%	(7,500)	**(1)**
Reduced AA for 2017/18	32,500	
	=======	

Annual allowance charge or unused AA carried forward

	£	
AA for 2017/18 (above)	32,500	
Unused AA b/f		
2014/15	35,000	**(½)**
2015/16	24,000	**(½)**
2016/17	23,000	**(½)**
AA available	114,500	
	=======	
Total gross contributions of £25,000 are not in excess of the available AA, therefore no annual allowance charge arises		**(½)**
Unused AA c/f to 2018/19		
2015/16	24,000	**(½)**
2016/17	23,000	**(½)**
2017/18		
(£32,500 – £25,000 total gross contributions)	7,500	**(½)**
	54,500	
	=======	

Max 8 marks

Tutorial notes:

Where the total of all pension contributions on which relief has been obtained (by the individual, the employer and any third parties), exceeds the AA (including brought forward AAs from the previous three tax years) there is an 'annual allowance tax charge' on the excess.

The contributions are matched against the AA for the current year first, then the unused AA from prior years on a FIFO (first-in-first-out) basis (i.e. 2014/15 first, then 2015/16 and 2016/17).

Arthur has paid less than the current year AA, therefore an 'annual allowance tax charge' does not arise and he has unused AA to carry forward. However the unused AA for 2014/15 is now too old and is lost.

2) Confidentiality

As a member of the Association of Taxation Technicians, you are expected to adhere to the 'Professional Rules and Practice Guidelines' and one of the key fundamental principles embodied in all professional codes of ethical behaviour is confidentiality:

- you have a duty to your client to respect the confidentiality of information acquired as a result of your professional and business relationship **(½)**
- you should not disclose any information you have obtained to any third parties **(½)** (including spouses) unless
  - you have proper and specific authority to do so, **(½)** or
  - there is a legal or professional duty to disclose **(½)**

  nor use the information for your personal advantage. **(½)**

Accordingly, Arthur and Briony are two separate clients **(½)** and your manager cannot discuss Briony's tax position with Arthur without her direct authority. **(½)**

The fact that Arthur has told your manager that Briony will not mind you talking about her tax affairs to him is not sufficient. **(½)**

Max 2 marks

Tutorial notes: possible additional marks

In advance of the meeting, your manager should seek appropriate authority from Briony before agreeing to meet with Arthur to talk about the pension position.