May 2021 Examination

PAPER 1

Personal Taxation

Part I Suggested Answers

1.

		£	£
Car			
List price		22,000 (½)	
Less: contribution	Restricted to £5,000	(5,000) (½)	
Revised list price		17,000	
Relevant percentage	135 – 75 = 60 (½)		
	60 / 5 + 20 (½) = 32%		
Cash equivalent	32% x 17,000 (½)		5,440
Van			
Van benefit	5/12 (½) x 3,490 (½)	1,454	
Fuel benefit	5/12 x 666 (½)	278	
			1,732
Cash equivalent			7,172

2.

- An employee will pay income tax through the PAYE scheme whilst a self-employed individual will pay tax under the self assessment system **(½)**
- Only employees enjoy rights under employment protection legislation. **(½)**
- Employers can be held liable for the wrongful acts only of employees not of independent contractors. **(½)**
- Only employees are preferential creditors on the insolvency of their employers. **(½)**
- Only employees are entitled to certain social security benefits. **(½)**
- Deductions from self-employed individuals' income are generally easier to obtain (under the "wholly and exclusively" rule) as compared with deductions for employee expenses (under the more restrictive "wholly, exclusively and necessarily" rule). **(½)**
- Only employees may contribute to an employer's occupational pension scheme/benefit from auto-enrolment. **(½)**
- An independent contractor may have to register for VAT whereas an employee will not. **(½)**
- Employees receive some protection where an employer disposes of all or part of their business under the TUPE Regulations. **(½)**

(Max: 4 marks)

3. The 2% charitable contribution is deducted from Harry's salary before PAYE is applied **(½)** so that tax relief is received at source. As an additional rate taxpayer, Harry gets 45% tax relief on the contribution **(½)** so that the £5,200 **(½)** charitable contribution only costs him £2,860 **(½)**.

4. The relief that Megan is entitled to claim is the lower of the overseas tax paid and the UK tax liability on the foreign income **(½)**.

   Her remaining basic rate band is £37,500 – £22,500 = £15,000 **(1)**

   The UK tax paid on the overseas income is therefore:

	£	
£500 @ 0%	-	**(½)**
£14,500 @ 20%	2,900	**(½)**
£7,000 @ 40%	2,800	**(½)**
	5,700	

   So, Megan is able to claim double tax relief of the lower of £5,700 **(½)** and £8,000 **(½)**, so £5,700.

5.

<u>Safa CGT payable</u>	Investors' relief £	No Investors' relief £	
Famina Ltd shares	25,700		
Painting		18,500	
Less Annual exempt amount		(12,300)	**(½) + (½)**
Chargeable gain	25,700	6,200	
£25,700 x 10%		2,570	**(½)**
£6,200 x 20%		1,240	**(½)**
CGT payable		3,810	

The gain on the shares in Famina Ltd are eligible for investors' relief **(½)**. If they had been sold within three years **(½)** of purchase (ie in January 2021), or subscribed for before 17 March 2016 **(½)**, then they would not have been eligible and some of the gains would have been taxable at 20%.**(½)**

6.

		£
<u>Sculpture</u>		
Proceeds		20,000
Cost		(12,000)
Gain		8,000 **(½)**
<u>Painting</u>		
Proceeds		7,000
Cost		(4,500)
Gain		2,500 **(½)**
Limited to:	5/3 x (7,000 – 6,000)	1,667 **(½)**
<u>Snooker table</u>	Exempt as proceeds < £6k **(½)**	-
<u>Vase</u>		
Gross proceeds	Restricted to	6,000 **(½)**
Cost of disposal		(500) **(½)**
		5,500
Cost		(9,000)
<u>Loss</u>		(3,500)

7.

SAYE contract

	Mariella £	Jake £	
Amount saved			
£500 x 12 x 5	30,000		**(½) + (½)**
£5 x 12 x 5		300	**(½)**
Maximum number of shares			
£30,000/ 5.3	5660.4		**)**
£300/ 5.3		56.6	**) (½)**
ie	5,660	56	**(½) + (½)**

To be a tax-advantaged savings related share option scheme the maximum discount that can be applied to the option price is 20% of the market value at grant, giving a minimum price of £5.20 (£6.50 x 80%) **(1)**

8. The tax benefits of ISA investments are that both income **(½)** and capital gains **(½)** arising from the investments are tax free.

In the year of her husband's death, and in addition to her own regular £20,000 **(½)** ISA allowance, Elizabeth could benefit from a one-off increase equal to:

- The value in her husband's ISA when he died, or
- The value of her husband's ISA when it is closed. **(½)**

9.

Rental income	6 Aug – 6 Mar	(8 x £4,000)	32,000 (½)
Expenses:			
Repair hole in roof	To make it habitable - disallowed	- (½)	
Mortgage interest		- (½)	
Insurance	Allowed	2,200 (½)	
Tiles	Repair allowed	1,000 (½)+(½)	
Hedge trimmer	P&M allowed	350 (½)	
Fridge freezer	Initial cost disallowed	- (½)	
			(3,550)
			28,450

10.

		Penalty for late filing £	Penalty for late payment of tax £
Initial penalty	(½)	100	-
Filing > 6m late	5% of tax due (½) or £300 if greater (½)	300	-
Daily penalties	90 x £10 (½)	900	-
30 days late payment	5% of tax due (½)	-	250
6 months late payment	5% of tax due (½)	-	250
Total maximum penalties	£1,800		

11. There was no exposure to CGT in 2018/19 on the gain arising on the disposal of the shares and painting (½). This is because Joel was then non-UK resident (½).

    However, as Joel was UK resident for four of the seven years preceding his year of departure from the UK (½) and he was non-UK resident for a period of five years or less (½), the gain arising on the sale of the painting is taxed in 2020/21 (½).

    As the shares were acquired after he became non-UK resident and sold before he became UK resident again (½), the gain on their disposal will not be taxed in the UK (½).

    (Max: 3 marks)

12. Jane's salary – Primary Class 1 NICs (½) payable by Jane (½); Secondary Class 1 NICs (½) payable by Tower Ltd (½).

    John's self-employment – Class 2 (½) NICs payable by John (½).

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Part II Suggested Answers

13. Renata's Income Tax computation 2020/21

	Non-savings	Interest	Dividends	
	£	£	£	
Private pension	62,300			**(1/2)**
State pension	8,768			**(1/2)**
REIT (N3)	3,750			**(3 x 1/2)***
Unit trust distribution (N4)		270		**(2 x 1/2)****
UK dividends			27,500	**(1/2)**
Bank interest (£650 - £50)		600		**(1/2)**
ISA interest - exempt		-		**(1/2)**
Net income (£103,188)	74,818	870	27,500	
Less:				
Personal allowance (W1)	(10,906)			**(1/2)**
Taxable income	63,912	870	27,500	

Tax on taxable income:

Non-savings income	37,500	x 20%	7,500	**(1/2)**
Non-savings income	26,412	x 40%	10,565	**(1/2)**
Savings income (N5)	500	x 0%	0	**(1/2)**
Savings income	370	x 40%	148	**(1/2)**
Dividend income (N6)	2,000	x 0%	0	**(1/2)**
Dividend income	25,500	x 32.5%	8,288	**(1/2)**
			26,501	
Less: Tax reducers				
VCT relief (N1)	25,000	x 30%	(7,500)	**(1/2)**
EIS relief (N2)	12,000	x 30%	(3,600)	**(1/2)**
Less: Tax deducted at source				
PAYE deducted			(16,200)	**(1/2)**
REIT			(750)	**(1/2)**
Income tax payable/(repayable)			**(1,549)**	**(1/2)**

Workings

(W1) Personal allowance

NB – Renata's income is greater than the £100,000 threshold, but there are no adjustments to her net income.

	£
Net income	103,188 **(1/2)**
Less:	
Threshold	(100,000) **(1/2)**
Total	3,188

Therefore, Personal allowance is reduced by £1 for every £2 of income above the £100,000 limit.

Reduction = £3,188 / 2 = £1,594 **(1/2)**

Personal allowance = £12,500 - £1,594 = £10,906 **(1/2)**

Notes

(N1) VCT relief

Renata has subscribed **(1/2)** for shares and therefore relief for a VCT investment is given in 2020/21 via a 30% tax reducer. **(1/2)**

Income tax reducer = £25,000 x 30% = £7,500

(N2) EIS relief

As Renata has subscribed **(1/2)** for the EIS shares, she is entitled to a 30% tax reducer. **(1/2)**

Renata stated she wants to claim tax relief as soon as possible, therefore a claim can be made to carry back her 2021/22 EIS investment to the preceding tax year **(1/2)** and claim relief on her tax return.

Renata has not made any EIS investments in 2020/21, so she cannot have exceeded the annual maximum allowed (£1M) **(1/2)** for EIS subscriptions and is therefore able to carry back this subscription.

Income tax reducer = £12,000 x 30% = £3,600

(N3) UK REIT

UK REIT dividends are paid net of basic rate tax and are taxable as non-savings income.

Therefore, the gross income for 2020/21 = £3,000 x 100/80 = £3,750.

(N4) Unit trust

Renata has received an interest distribution from her holding in a unit trust, therefore the interest is received gross and taxed as interest income.

(N5) Savings income

As a higher rate taxpayer, Renata is entitled to a Personal Savings Allowance of £500 for 2020/21.

(N6) Dividend income

Renata is entitled to a dividend allowance of £2,000 for 2020/21 irrespective of whether she is a basic, higher or additional rate taxpayer.

Marking notes

* ½ for grossing(any); ½ for correct grossing ie 100/80; ½ for NSI

** ½ for not grossing; ½ for SI

Maximum 16 marks

2) A member should make a proper professional record of all their dealings in connection with their client in order that:

- They are able to communicate effectively; **(1/2)**
- They can access a record of the client history to inform future client service; **(1/2)**
- They are able to resolve any misunderstandings or complaints, including in relation to fees; **(1/2)** and
- They are able to defend any allegation of negligence. **(1/2)**

The records should include:

- All written communications relating to the client's affairs, including letters and emails; **(1/2)**
- File notes of meetings and telephone conversations (these should be contemporaneous and dated); **(1/2)**
- Records of how the advice given is reached; **(1/2)**
- All necessary permanent information and copies of such working documents as required. **(1/2)**

Maximum 4 marks

(Total 20 Marks)

14. LINDA POLLARD

1) Capital Gains Tax arising on proposed property disposals

(a) Disposal of home in Birmingham

	£	
Estimated sale proceeds	600,000	½
Less: Estimated legal and professional fees (1.5%)	(9,000)	½
Net sale proceeds	591,000	
Less: Cost	(98,000)	½
Legal and professional fees	(2,160)	½
Redecorating costs (not capital expenditure)	(Nil)	½
	490,840	
Less: PPR relief (W1)	(375,493)	½
	115,347	
Less: Letting relief (Note)	(Nil)	½
Chargeable gain	115,347	
Less: AEA	(12,300)	½
	103,047	
Capital gains tax (£103,047 x 28%)	28,853	½

Note: Letting relief is not available on this disposal as during the periods of letting the tenant had exclusive use of the whole property. To be available, the tenant must share occupation of the property with the owner and have exclusive use of their part.

Workings

(1) **Principal Private Residence relief**

		Months	Exempt	Charge		
1.12.04 – 31.12.06	Owner occupied	25	25			½
1.1.07 – 31.1.15	Elsewhere in UK – property let	97	48[1] 36[2]	13		½ ½
1.2.15 – 30.11.17	Elsewhere in UK					
	– property empty	34		34		½
1.12.17 – 31.7.21	Owner occupied[3]	44	44			½
		200	153	47		

PPR relief = £490,840 x (153 ÷ 200) = **£375,493** 1

Note:

1. The maximum exemption for working elsewhere in the UK = 48 months. **(½)**

2. Linda is allowed 36 months for no reason. **(½)**

   For both of these periods [1] and [2] to be exempt:

   - the property must be the individual's PPR at that time, and **(½)**
   - the owner must have actually occupied the property at some time before and at some time after the period being considered for exemption. **(½)**

3. The last 9 months of ownership of an individual's PPR is exempt, unconditionally. **(½)** However, Linda's all of the last period in the house is covered by the owner occupation exemption.

(b) Disposal of country cottage in Wales

	£	
Estimated sale proceeds	600,000	½
Less: Estimated legal and professional fees (1%)	(6,000)	½
Net sale proceeds	594,000	
Less: Cost	(415,000)	½
Extension	(44,600)	½
Conservatory	(18,500)	½
Chargeable gain	115,900	
AEA	(12,300)	½
	103,600	
Capital gains tax (£103,600 x 28%)	29,008	½

Maximum 14 marks

2) Net cash received

	House in Birmingham	Country cottage in Wales	
	£	£	
Net sale proceeds	591,000	594,000	1
Less: Capital Gains Tax	(28,853)	(29,008)	1
	562,147	564,992	

Advice

To maximise Linda's net cash, she should dispose of her country cottage in Wales **(½)** as she will realise £2,845 (£564,992 – £562,147) more cash. **(½)**

Maximum 3 marks

3) Reporting the gain and payment of Capital Gains Tax

Reported:

- within 30 days of the completion date of the disposal (not the exchange date) **(½)** (Note) using HMRC's capital gains tax UK property disposals return online **(½)**; and
- by 31 January 2023 **(½)** in Linda's self-assessment tax return on the capital gains tax pages. **(½)**

Include in the notification

- an estimated calculation of the chargeable gain and tax payable. **(½)**

Payment dates:

- Payment on account:
  within 30 days of the completion date of the disposal. **(½)**
- Balancing payment:
  31 January 2023 (i.e. 31 January following the end of the tax year of disposal). **(½)**

Maximum 3 marks

Tutorial note:
The date of disposal for CGT purposes, to determine in which tax year the disposal occurs, is the date contracts are exchanged.
However, the legal completion date is used to determine the HMRC notification date and payment date.

(Total 20 marks)

15. TWO CLIENTS

1) Gareth and Georgina Rushton

Transfer of unused personal allowance

- For 2020/21:
  –a fixed amount of 10% of Georgina's personal allowance can be transferred to Gareth ie £1,250 **(½)**
  –as the couple are married, and **(½)**
  –Neither Georgina nor Gareth pays above the basic rate of tax **(½)**, and
  –Neither have claimed the married couples' allowance (both are born after April 1935) **(½)**
- Georgina's personal allowance is reduced to £11,250 (£12,500 – £1,250) **(½)**
- Gareth receives a reduction in his income tax liability of £250 (£1,250 x 20%) **(½)**
- The deduction in Gareth's income tax liability computation cannot result in a tax repayment **(½)**

Maximum 3 marks

Tutorial note:

To be eligible, partners for this purpose must be married couples or in a registered civil partnership for all or part of the tax year. The transfer is not available for couples who are not married but are living together as if spouses.

2) Income tax computation – 2020/21

	Gareth	Georgina	
	£	£	
Employment income	42,900	11,550	½
Less: Personal allowance	(12,500)	(11,250)	1
Taxable income	30,400	300	
	=======	=======	
Income tax liability			
(£30,400 x 20%)	6,080		½
(£300 x 20%)		60	½
Less: Marriage allowance (£1,250 x 20%)	(250)		½
Income tax liability	5,830	60	
	=======	=======	

Tutorial note:

The total income tax liability for the couple is £5,890 (£5,830 + £60).

If they did not make the election, they would have paid £6,080.

Making the election therefore gives a tax saving of £190 (£6,080 – £5,890) which is 20% of the £950 unused personal allowance.

Maximum 3 marks

3) Heather Samburg

Withdrawal of child benefit

	£	
Net income	59,500	½
Less: Gross gift aid donation (gross amount given in question)	(500)	½
Gross personal pension contributions (£4,255 x 100/80)	(5,319)	1
ANI	53,681	
Less: Limit	(50,000)	½
Excess	3,681	
Withdrawal % (3,681 x 1/100) (round % down to nearest whole number)	36%	1
Child benefit charge (£1,820 x 36%)	655	½

Maximum 4 marks

Tutorial note:

- *Child benefit is withdrawn if*
  - *A couple receive child benefit for their children, and the adjusted net income (ANI) of one of the partners in a couple is in excess of £50,000*
  - *Partners for this purpose are married couples (provided they are not separated) and couples who are not married but are living together as if spouses*
  - *The charge is not calculated based on the combined income, just the income of the higher earner*
- *The partner with the higher income will suffer a child benefit charge which is added to their income tax liability*
- *The charge is 1% for every £100 of ANI in excess of £50,000 (the percentage is rounded down to the nearest %)*

Total: 10 marks

Internal Tax Department Update Course

MAY 2021 **Presentation = 1**

Why can Jason benefit from BADR on the disposal of VG plc shares

BADR is available as:

- Jason is a part time director of the company for 8 years and 5 months before the date of disposal i.e.
  - He has worked for at least 2 years; **(½)**
  - For a trading company. **(½)**

- At the date of disposal and for the preceding 11 months, VG plc is not Jason's personal trading company (PTC) **(½)** as he owns only 4% of the ordinary shares (60,000/1,500,000) and therefore he does not own at least 5% **(½)** of the ordinary share capital. **(½)** *(see Tutorial Note 1)*

- However, with effect from 6 April 2019:
  - if the company issues additional new shares; **(½)**
  - subscribed for wholly for cash; **(½)**
  - for genuine commercial reasons; **(½)** and
  - as a result an individual no longer holds a 5% interest; **(½)** (i.e. their shareholding is diluted)
  - relief is still available for gains up to date of dilution; **(½)**
  - provided all the qualifying conditions for the disposal of shares (above) are satisfied immediately before the issue of new shares. **(½)**
- On 19 March 2020:
  - Jason owned 6% of the ordinary shares (60,000/1,000,000) and therefore VG plc was Jason's PTC immediately before the issue of the new shares; **(½)**
  - Jason was a part time director of the company for 7 years and 6 months before the dilution of shares (i.e. at least two years); **(½)** *(see Tutorial Note 2)*
  - The shares issue was wholly for cash and for genuine commercial reasons, and accordingly BADR is available. **(½)**
- However, BADR is only available for gains made before 19 March 2020 (i.e. when Jason's shareholding is diluted to less than 5%). **(½)**

How the relevant elections operate and the resulting gain is taxed

- Jason needed to make an irrevocable election **(½)** to:
  - treat the dilution as a deemed disposal and reacquisition of shares on 19 March 2020 (i.e. immediately before the dilution); **(½)**
  - using £8 per share as the deemed disposal proceeds (i.e. the market value of the shares at that time assuming the whole share capital is disposed of on that date); **(½)**
  - a notional chargeable gain arises and is taxable in 2019/20 but BADR is available to tax the gain at only 10%; **(½)**
  - the £8 per share market value of the shares on 19 March 2020 becomes the base cost of the actual shares held. **(½)**
- A further irrevocable election is available to defer the notional gain until 20 February 2021 (i.e. the date the actual shares are disposed of): **(½)**

– this was advantageous to Jason as he has no cash available to pay the tax due at the time of the notional gain. **(½)**

- On 20 February 2021:
  – the deferred gain becomes chargeable and a claim for BADR must be made; **(½)**
  – the additional gain since the dilution to the date of disposal becomes chargeable but no BADR is available on that gain. **(½)**

Timing of elections/claims
To crystallise a notional chargeable gain on 19 March 2020:
– must elect by 31 January 2022 (i.e. 12 months after 31 January following the end of the tax year in which the notional gain arises); **(½)**
To defer the notional gain:
– must elect by 5 April 2024 (i.e. within four years of the end of the tax year of the notional disposal); **(½)**
Claim for BADR when the deferred gain becomes chargeable:
– must claim by 31 January 2023 (i.e. 12 months after 31 January following the end of the tax year of the actual disposal). **(½)**

Maximum 10 marks

Tutorial note:

1. *Marks will alternatively be given for reference to voting rights/ distributable profits/ assets on winding up etc*

2. *If the notional gain is deferred*
– *you must be an employee of the company for the two years before the notional gain, but in addition, you must still be an employee of the company for the two years before the actual disposal of the shares or else the BADR for the deferred gain will be lost*
– *you must defer all or none of the notional gain, partial deferral is not allowed*