# May 2018 Examination

## PAPER 1

### Personal Taxation

Part I Suggested Answers

## 1. Michael

### Income Tax computation – 2017/18

| | | Total | | Non-savings | Savings | Dividends | |
|---|---|---|---|---|---|---|---|
| | | £ | | £ | £ | £ | |
| Property income | | 11,000 | | 11,000 | | | |
| Bank interest | | 6,750 | | | 6,750 | | |
| Dividends | | 8,500 | | | | 8,500 | |
| | | 26,250 | | | | | ½ |
| Less: Personal allowance (Note) | | (11,500) | | (11,000) | (500) | | 1 |
| Taxable income | | 14,750 | | – | 6,250 | 8,500 | |
| Income tax: | | | | | | | |
| Starting rate | Savings | 5,000 | x | 0% | | 0 | ½ |
| Nil rate band | Savings | 1,000 | x | 0% | | 0 | ½ |
| Basic rate | Savings | 250 | x | 20% | | 50 | ½ |
| | | 6,250 | | | | | |
| Nil rate band | Dividends | 5,000 | x | 0% | | 0 | ½ |
| Basic rate | Dividends | 3,500 | x | 7.5% | | 262 | ½ |
| | | 14,750 | | | | | |
| Income tax liability | | | | | | 312 | |

*Note:*

*The personal allowance will be matched first against the non-savings income to make the full £5,000 savings starting rate band available.*

*The remaining £500 personal allowance will be matched against savings income in preference to dividend income as the basic rate for taxable savings income is 20% whereas the dividend ordinary rate applicable to taxable dividend income is 7.5%.*

4 marks

## 2. Norma

Dividends received out of qualifying tax-exempt property income or gains are treated in the hands of the shareholder as follows:

- assessed as UK property income **(½)** (not dividends) **(½)**
- received net of basic rate income tax (20%) **(½)**
- grossed up at 100/80 **(½)**
- taxed as non-savings income **(½)**
- deduct a tax credit of 20% from the income tax liability. **(½)**

3 marks

**3. Junior ISAs**

- To invest in a Junior ISA, the individual must be:
  - UK resident **(½)**
  - under the age of 18. **(½)**
- The maximum amount that can be invested in 2017/18 is £4,128. **(½)**
- Withdrawals from Junior ISAs are not generally permitted until the investor reaches the age of 18. **(½)**

2 marks

**4. Paul**

Diamond necklace = non-wasting chattel
Marginal gain rules apply as sold for gross sale proceeds > £6,000 and cost < £6,000 **(½)**

Chargeable gain = Lower of: **(½)**

(i) Normal gain

| | £ | |
|---|---|---|
| Gross sale proceeds | 8,500 | ½ |
| Less: Incidental selling expenses – Commission (10%) | (850) | ½ |
| Net sale proceeds | 7,650 | |
| Less: Cost of necklace | (3,240) | ½ |
| Incidental acquisition costs – Professional valuation fees | (50) | ½ |
| | 4,360 | |
| | ====== | |

(ii) 5/3rds rule

| | | |
|---|---|---|
| = (£8,500 gross sale proceeds – £6,000) x 5/3 | **4,167** | 1 |
| | ====== | |

4 marks

**5. Cash earnings for NIC purposes**

Cash earnings for Class 1 NIC purposes includes:

- salary and bonus payments (excluding taxable portion of termination payments) **(½)**
- cash or non-cash vouchers (excluding exempt portion of childcare vouchers) **(½)**
- ITEPA mileage payments in excess of 45p per mile **(½)**
- reimbursement of travel from home to work (but not reimbursement of genuine business expanses) **(½)**
- payments in the form of 'readily convertible assets' (e.g. assets traded on a recognised stock or commodities exchange) **(½)**
- non-cash payments that can be surrendered for cash (e.g. premium bonds) **(½)**
- settlement of an employee's personal liability. **(½)**

Any four of the above
**Max 2 marks**

**6. Unilateral DTR**

*Unilateral DTR is given as follows:*

- A tax credit is deducted from the individual's income tax liability **(½)**
- The DTR tax credit = Lower of **(½)**
  - UK income tax suffered on that source of overseas income **(½)**
  - Overseas tax suffered **(½)**
- The UK tax suffered on the source of overseas income is:
  - the reduction in the total income tax liability that would arise if that source of overseas income is excluded from the total taxable income of the individual **(½)**
  - calculated assuming that the overseas income is the 'top slice' of that income type. **(½)**
- The DTR tax credit deduction cannot create a tax repayment, but may reduce the individual's income tax liability to nil. **(½)**
- If the taxpayer has more than one source of overseas income, a separate DTR calculation is needed for each source. **(½)**

**Max 3 marks**

**7. Stephanie**

Stephanie filed her 2015/16 return on 30 November 2017, which is 10 months after the due date of 31 January 2017.

Accordingly, Stephanie will be liable to pay:

- A fixed penalty of £100, **(½) plus**
- Daily penalties of £10 per day for a maximum of 90 days (as the return is more than 3 months late), **(1) plus**
- Higher of:
  - £300, **(½)** or
  - 5% of the tax due for the tax year 2015/16 **(½)**

  (as the return is more than 6 months late). **(½)**

3 marks

**8. Tania**

**Capital Gains Tax computation – 2017/18**

| | £ | |
|---|---|---|
| Market value | 575,000 | ½ |
| Less: Cost | (125,000) | ½ |
| Capital gain | 450,000 | |
| Less: Gift relief (balancing figure) (Note (i)) | (**315,000**) | ½ |
| Chargeable gain (£260,000 actual sale proceeds received – £125,000 cost) | 135,000 | ½ |
| Less: Annual exempt amount | (11,300) | ½ |
| Taxable gain | 123,700 | |
| | ======= | |
| Capital gains tax liability<br>(£123,700 x 28%) (Note (ii)) | **34,636** | ½ |
| | ====== | |

Gift relief is available where there is an outright gift or sale at undervalue of a qualifying business asset. **(½)**

The disposal of the cottage is a sale at undervalue and furnished holiday letting property is specifically listed as a qualifying business asset under s165 (2)(a) CGTA 1992. **(½)**

*Notes:*

*(i)* *It is assumed that both Tania and Sarah are UK resident individuals.*

*(ii)* *Per the question, entrepreneurs' relief is not available. As Tania is a higher rate taxpayer and the cottage is residential property, the appropriate rate of CGT is 28%.*

*(iii)* *The CGTA section number is not required, but is given for reference*

4 marks

## 9. Vincent

**Disposal of remaining field Z – 2017/18**

| | £ | |
|---|---|---|
| Gross sale proceeds for field | 120,000 | ½ |
| Less: Incidental selling expenses – Professional fees | (5,400) | ½ |
| Net sale proceeds | 114,600 | |
| Less: Cost of the remaining field Z | | |
| (£66,820 + £668) – £56,603 cost of part disposal (see working) | (10,885) | 1 |
| Chargeable gain | 103,715 | |
| | ======= | |

**Working: Cost of part disposal in 2007/08**

$$= (£66,820 + £668) \times \frac{£390,000}{(£390,000 + £75,000)} \qquad £56,603 \quad 2$$

=======

4 marks

*Note: The **gross** sale proceeds received (not the net sale proceeds) on the part disposal are used to calculate the cost of the part disposed of.*

## 10. Khalid

| | | | £ | Total benefits £ | |
|---|---|---|---|---|---|
| **Use of asset benefits** | | | | | |
| 2015/16 | Benefit | (£4,200 x 20% x 9/12) | 630 | | ½ |
| 2016/17 | Benefit | (£4,200 x 20%) | 840 | | ½ |
| 2017/18 | Benefit | (£4,200 x 20% x 7/12) | **490** | 490 | ½ |
| | | | 1,960 | | |
| | | | ====== | | |
| **Gift of asset in 2017/18** | | | | | |
| Benefit | | | | | |
| = Higher of | | | | | ½ |
| (i) | MV at date of gift | | 2,000 | | ½ |
| | | | ====== | | |
| (ii) | Original MV | | 4,200 | | ½ |
| | Less: Amounts assessed for use of asset (above) | | (1,960) | | ½ |
| | | | **2,240** | 2,240 | |
| | | | ====== | | |
| Total benefits re-office furniture – 2017/18 | | | | 2,730 | ½ |
| | | | | ====== | |

4 marks

## 11. Ulrike

The income tax due on the life insurance gain is calculated as follows:

| | £ | | | £ | |
|---|---|---|---|---|---|
| Life insurance bond gain (£48,650 – £15,000) | | | | 33,650 | 2 x ½ |
| | | | | ====== | |
| Income tax: | | | | | |
| Savings nil rate band | 500 | x | 0% | 0 | 1 |
| Higher rate | 33,150 | x | 40% | 13,260 | 1 |
| | 33,650 | | | | |
| | ======= | | | | |
| Less: Notional tax on life insurance policy gain (£33,650 x 20%) | | | | (6,730) | 1 |
| Income tax payable on life-insurance gain | | | | **6,530** | |
| | | | | ====== | |

4 marks

*Notes:*

*The answer calculates the tax on the life insurance gain using the marginal rates of tax applicable. Without the life insurance gain, Ulrike is a higher rate taxpayer as her taxable income would be £36,500 (£48,000 – £11,500) which exceeds the basic rate band limit of £33,500.*

*Life insurance gains are treated as income (not a capital gain), and taxed as the top slice of Ulrike's income as if it were savings income.*

*The savings nil rate band can apply to these gains.*

*There is no need to write the above as part of the answer, the marks will be given if it is clearly demonstrated in the calculations that these principles have been applied.*

*The same answer could be derived if a full income tax computation is produced, however this approach is time consuming and involves calculating figures that are not required to answer the specific question asked.*

## 12. DOTAS

The DOTAS rules applies to tax planning schemes **(½)** which will, or might be expected to, enable any person to obtain a tax advantage **(½)**, and that advantage is the sole benefit or one of the main benefits of the scheme. **(½)**

Failure to disclose will result in penalties **(½)** unless the promoter **(½)** has a reasonable excuse **(½)** and the failure is remedied within a reasonable time. **(½)**

Max 3 marks

# May 2018 Examination

## PAPER 1

### Personal Taxation

Part II Suggested Answers

**Seresh Income Tax computation 2017/18**

1.

| | Non-savings income | |
|---|---|---|
| | £ | |
| Employment income | 47,000 | (½) |
| Rental income (W3) | 9,975 | (½) |
| Total income | 56,975 | |
| Less: | | |
| Personal allowance | (11,500) | (½) |
| Taxable income | 45,475 | |

| | | | | |
|---|---|---|---|---|
| | | | £ | |
| **Tax** | Non-savings income (W4) | 33,950 @ 20% | 6,790 | (½) |
| | Non-savings income | 11,525 @ 40% | 4,610 | (½) |
| Tax liability | | | 11,400 | |
| Less: | | | | |
| Tax reduction for interest (W1) | | | (300) | (½) |
| Less: Tax deducted at source: | | | | |
| PAYE deducted | | | (9,800) | (½) |
| Income Tax payable for 2017/18 | | | 1,300 | |

This is due for payment by 31 January 2019. (½)

*Workings*

*(W1) The Gables*

| | | £ | |
|---|---|---|---|
| Rental income | £1,250 x 12 | 15,000 | (½) |
| Less: | | | |
| Mortgage interest | £6,000 x 75% (N1) | (4,500) | (½) |
| Rental profit / (loss) | | 10,500 | |

See (N1) – mortgage interest allowable as a basic rate tax reduction:-
£6,000 x 25% = £1,500 (½) x 20% = £300 (½)

*Notes*

*(N1) Mortgage interest for The Gables*

For 2017/18, only 75% of the mortgage interest relief for a residential property is allowable as a deduction from income when calculating taxable property income. (½) The remaining 25% of the interest is eligible for basic rate tax relief. (½)

*(W2) Harbour View*

| | | £ | |
|---|---|---|---|
| Rental income | £500 x 8 | 4,000 | (½) |
| Less: | | | |
| New garage (capital) (N2) | | Nil | |
| Washer dryer (N3) | | (575) | (½) |
| Bathroom suite (N4) | | (3,600) | (½) |
| Kitchen sink (N5) | | (350) | (½) |
| Rental profit / (loss) | | (525) | |

(W3)

All profits and losses are pooled from the property business:

| | £ |
|---|---|
| The Gables (W1) | 10,500 |
| Less: | |
| Harbour View | (525) |
| Taxable rental profit | 9,975 (½) |

(W4)

| | £ | £ |
|---|---|---|
| Basic rate band for 2017/18 | | 33,500 |
| Plus: grossed up gift aid donations | | |
| Regular monthly contributions (12 x £30) (½) | 360 x 100/80 (½) | 450 |
| Revised basic rate band | | 33,950 |

*Notes*

*(N2) New garage*

This is a capital expense and so it is not allowable to be set against the property income. (½)

*(N3) Washer dryer*

Allowable expense as relief is available for the cost of replacing domestic items – it is free standing and has not become part of the building. (½) However, there is an element of improvement (½), so the allowable cost is restricted to the cost of an equivalent replacement washing machine of £575. (½)

*(N4) Bathroom suite*

As it is a like for like replacement and there is no element of an improvement, even though the repairs are substantial, this is an allowable expense as a repair. (½)

*(N5) Kitchen sink*

As this is attached to the building it is considered part of the building and therefore treated as a repair. (½) The cost of delivering the kitchen sink is incidental expenditure and therefore an allowable expense. (½)

**14 marks**

**2)**

At the pre-contract stage, buyers must satisfy themselves as to what they are buying and should therefore:

- Make the usual searches of the local authority and other bodies. (½)
- Raise enquiries through the seller's solicitors about aspects of the land. (½)
- Inspect the seller's title (office copies in the case of registered land or the title deeds if the land is unregistered). (1)
- Have the land and the buildings on it surveyed to confirm value, to ascertain structural defects and for environmental purposes. (1)

**3 marks**

***SCOTS LAW VARIANT***

*A transaction for the sale of land in Scotland normally passes through the following legal stages:*

- *The contract of purchase and sale is completed. This stage is called concluding 'missives'. (½)*
- *Then, the purchaser examines title, (½) after which*
- *'Settlement' takes place - this is the date on which the disposition is delivered by the seller to the purchaser. (1)*
- *Finally there is the transfer of ownership. The date of registration of the disposition is the date on which the purchaser actually becomes owner. (1)*

**3)**

When filing tax returns electronically, a taxation technician should consider:

- changing passwords periodically in order to keep access credentials safe from unauthorised use (1)
- the terms which they agree with HM Revenue & Customs in order to use electronic filing, (1) which may include provisions around the security of access credentials or different deadlines, (1) and
- whether the process of electronic filing creates any different obligations for them from paper filing. (1)

**Max 3 marks**

**2.**

**1)** Under the EMI scheme it is possible to select specific individuals to whom options are granted **(½)**. However, the recipients do need to meet certain conditions and, in relation to Joe's proposals:

- Alistair will not be able to participate in the scheme **(½)** as he owns, together with an associate **(½)** (his son, James), more than 30% of the shares in Hambles Ltd **(½)**.
- Ben will be able to participate **(½)** as, although he works less than 25 hours a week **(½)** for Hambles Ltd, the time that he does work is at least 75% of his total working time **(½).** He could receive EMI options over shares up to a maximum value of £250,000 **(½)**; in this case, this would amount to the receipt of options over a maximum of 62,500 shares (£250,000/£4) **(½)**.
- James will not be able to participate for the same reason as Alistair. **(½)**
- David will be able to participate **(½)** and could receive EMI options over shares up to a maximum value of £230,000 as the £20,000 of CSOP options at grant use up an element of his maximum £250,000 EMI entitlement **(½)**. In this case, this would amount to the receipt of options over a maximum of 57,500 shares (£230,000/£4) **(½)**.

Max 6 marks

**2)**

| | | | 10p exercise price | £4 exercise price |
|---|---|---|---|---|
| **On grant** | | There is never a tax charge on the grant of EMI options (½) | | |
| **On exercise** | Lower of MV at grant & exercise (½) | 62,500 x £4 (½) | 250,000 | No amount subject to tax if exercise price = MV at grant (½) |
| | Exercise price | 62,500 x 10p (½) | (6,250) | |
| | Subject to Income Tax (½) | | 243,750 | |
| **On sale** | Proceeds | 62,500 x £10 | 625,000 (½) | 625,000 (½) |
| | Amount paid for shares | 62,500 x 10p (½) | (6,250) | (250,000) (½) |
| | Amount subject to Income Tax on exercise (½) | | (243,750) | - |
| | Subject to Capital Gains Tax (½) | | 375,000 | 375,000 |

**3)**

The recipient of EMI options would be able to benefit from Entrepreneurs' Relief if:

- The options are exercised within 10 years of grant, **(½)**
- The option was granted at least one year before the sale of the shares **(½)**, and
- For at least one year prior to disposal **(½)**:
    - The company was a trading company **(½)**, and
    - The recipient was an officer or employee of the company **(½)**.
- The recipient had not already exceeded their lifetime Entrepreneurs' Relief limit **(½)** of £10m**.**
- Unlike non-EMI share disposals, there is no need for the individual to hold at least 5% of the ordinary shares. **(½)**

Max 3 marks

**3.** **To:** Ada

**From:** Candidate

**Date:** Today

**Subject:** Basis of UK taxation

**[Top & tail – 1 mark]**

Dear Ada

A non-UK domiciled individual is usually required to make a claim if they wish to be taxed on the remittance basis of taxation **(½)**. This can reduce the amount of UK tax you have to pay. However, the effect of the remittance basis varies over time and between your two sources of income and your potential gains.

Employment income

As you have been non-UK tax resident for the three tax years prior to your arrival **(½)**, a claim for the remittance basis enables you to claim Overseas Workday Relief ("OWR") **(½)** for the first three tax years in the UK **(½)** – i.e. for 2017/18, 2018/19 & 2019/20.

By claiming OWR, you will pay UK income tax on an arising basis on the proportion of your salary related to your UK duties **(½)** but only on the proportion relating to your overseas duties **(½)** if you remit those to the UK **(½)**. For these years it would be sensible to have all of your employment income paid into a non-UK bank account so that you can benefit from this relief **(1)**.

After those first three years, you will pay UK income tax on all of your employment income on an arising basis **(½)**.

Dividend income

As the dividends received from Green Ltd have a non-UK source **(½)**, a claim for the remittance basis means that you will only pay UK tax on those dividends that you remit to the UK **(½)**. The remitted dividends will be taxed at the normal income tax rates of 20%, 40% and 45% rather than the dividend rates **(½).** The dividend allowance cannot be set against remitted dividends **(½).**

Capital gains

As the Green Ltd shares are non-UK shares **(½)**, a claim for the remittance basis means that you will only pay UK tax on any gains realised that you remit to the UK **(½)**.

Once you have been UK tax resident for 7 of the previous 9 tax years **(½)**, you will need to pay a £30,000 **(½)** Remittance Basis Charge ("RBC") in order to access the remittance basis **(½)**. This RBC will increase to £60,000 **(½)** once you have been UK tax resident for 12 of the previous 14 tax years **(½).**

If you pay the RBC you also need to nominate **(½)** an amount of overseas **(½)** income and/or gains **(½)**; these nominated amounts are effectively deemed to have been taxed on the arising basis, giving rise to the RBC **(½)**.

However, claiming the remittance basis of taxation results in a loss of your income tax personal allowance **(½)** and capital gains tax annual exempt amount **(½).**

Max 12 marks

Proposed actions

I understand that you are proposing to use some of your offshore funds to buy a painting for your son.

The purchase of the painting for your son will not itself impact on your UK tax liability **(½)**.

As an adult, your son is not a "relevant person" **(½)** for remittance purposes, otherwise his bringing the painting to the UK would be deemed to be a remittance by you **(½)**. Although the painting represents the overseas dividend income **(½)**, the act of your son bringing it to the UK will not be deemed to be a remittance of that income by you **(½)** as long as you do not benefit from the painting in the UK **(½)**.

Please let me know if you have any queries.

Regards

Candidate

4.

**1)**

| | **Gain/(loss)** |
|---|---|
| | **£** |
| Gains on Elastica plc shares | 85,000 (½) |
| Less: | |
| SEIS exemption due to Phonic Ltd investment (N2) | (21,000) (½) |
| | 64,000 |
| Less: Losses in the year | |
| Opta Ltd (W1) | (3,000) (½) |
| Net gains | 61,000 |
| Annual exempt amount | (11,300) (½) |
| Taxable gains | 49,700 |
| | |
| Capital Gains Tax at 20% | 9,940 (½) |

The Capital Gains Tax is due for payment by 31 January 2019. (½)

*(W1) Opta Ltd*

| | £ | £ |
|---|---|---|
| Proceeds | | 8,000 (½) |
| Cost | 22,000 (½) | |
| Less: Income Tax relief (N1) | (11,000) (½) | |
| | | (11,000) |
| Allowable loss in 2017/18 | | (3,000) |

*(N1)*

Income Tax relief is not withdrawn (½) as the shares were sold after more than 3 years. (½)
This means the Income Tax relief retained reduces the allowable base cost of the shares. (½)

*(N2) Phonic Ltd*

As less than £100,000 was invested, (½) the amount of the exempt gain is 50% of the available SEIS expenditure. (½) This is the lowest of (½):

- The gain )
- The amount reinvested ) (1)
- The amount claimed )

and so the amount of the exempt SEIS gain is 50%, ie £42,000 x 50% = £21,000 (½)

As it is an investment in an SEIS company, the gain is exempt from CGT, not deferred. (½)

Max 8 marks

**2)**

Losses on unquoted trading company shares, such as James' SEIS shares, can be relieved against net income of the current or preceding year. (1)

As James is a higher rate taxpayer, this would have been more beneficial to him as he would receive relief at the income tax rate of 40% rather than the capital gains tax rate of 20%. (1)

2 marks