Answers

1 (a) Flick Pick – Taxable income 2011–12

		£
Employment income		
Salary		23,700
Living accommodation	– Annual value	4,600
	– Additional benefit (working 1)	2,760
	– Furniture (9,400 x 20%)	1,880
		32,940
Trading profit (working 2)		8,220
Property business profit (working 3)		5,940
		47,100
Personal allowance		(7,475)
Taxable income		39,625

Working 1 – Living accommodation additional benefit

(1) The benefit is based on the market value when first provided.

	£
Market value	144,000
Limit	(75,000)
	69,000

(2) The additional benefit is therefore £2,760 (69,000 at 4%).

Tutorial note: *The property was purchased more than six years before first being provided, so the benefit is based on the market value when first provided.*

Working 2 – Trading profit

(1) Flick's share of the partnership's trading profit for the period ended 30 April 2012 is £10,960 calculated as follows:

	£
Trading profit	29,700
Capital allowances	(300)
	29,400
Salary paid to Art (6,000 x 4/12)	(2,000)
	27,400
Profit share 27,400 x 40%	10,960

(2) Flick's trading income assessment for 2011–12 is £8,220 (10,960 x 3/4).

(3) The partnership's period of account is four months long so the capital allowances in respect of the motor car are £300 calculated as follows:

	Special rate pool £		Allowances
Addition	15,000		
WDA – 10% x 4/12	(500)	x 60%	300
WDV carried forward	14,500		

Tutorial notes:

(1) Flick's assessment for 2011–12 is for the period 1 January 2012 to 5 April 2012.

(2) The partnership's motor car has CO_2 emissions over 160 grams per kilometre and therefore qualifies for writing down allowances at the rate of 10%.

Working 3 – Property business profit

(1) The property business profit is calculated as follows:

	£	£
Rent receivable (660 x 12)		7,920
Council tax	1,320	
Wear and tear allowance	660	
Furniture	0	
		(1,980)
Property business profit		5,940

(2) The wear and tear allowance is £660 (7,920 – 1,320 = 6,600 x 10%) as the rent receivable is reduced by the council tax paid by Flick.

Tutorial note: *No deduction is available for replacement furniture where the wear and tear allowance is claimed.*

(b) (1) 3D Ltd will be responsible for paying class 1 NIC (both primary and secondary contributions) in respect of Flick's salary.

(2) 3D Ltd will be responsible for paying class 1A NIC in respect of Flick's taxable benefits.

(3) Flick will be responsible for paying class 2 NIC in respect of her trading income.

(4) Flick will be responsible for paying class 4 NIC in respect of her trading income.

(c) Advantages

(1) The interval between earning profits and paying the related tax liability will be 11 months longer. This can be particularly beneficial where profits are rising.

(2) It will be possible to calculate taxable profits well in advance of the end of the tax year, making it much easier to implement tax planning and make pension contributions.

Disadvantages

(1) The application of the basis period rules is more complicated.

(2) The amount of profit assessed in the year of cessation could potentially be quite high as the basis period will be up to 23 months in length. Although overlap profits are deductible, these might be insignificant if the opening years' profits are low.

(d) (i) (1) Using the flat rate scheme to calculate its VAT liability the partnership will have paid VAT of £7,164 (59,700 x 12%) for the quarter ended 31 March 2012.

(2) If the partnership had used the normal basis it would have paid VAT of £5,400 (59,700 – 27,300 = 32,400 x 20/120).

(3) It was therefore not beneficial to use the flat rate scheme as the additional cost of £1,764 (7,164 – 5,400) for the quarter would appear to outweigh the advantage of simplified VAT administration.

(ii) (1) The partnership's sales are all to members of the general public, who cannot recover the input VAT.

(2) It may not therefore be possible to pass the output VAT on to customers in the prices charged. To the extent this is not possible the partnership would have had to absorb all or some of this amount itself as a cost.

(3) It was therefore not beneficial for the partnership to have voluntarily registered for VAT from 1 January 2012. For the quarter ended 31 March 2012 voluntary registration reduced the partnership's profits by a maximum of £7,164 (£5,400 if the normal basis had been used).

(iii) (1) Output VAT must be accounted for according to the VAT period in which the supply is treated as being made. This is determined by the tax point.

(2) The basic tax point is the date when the service is completed, which will be the date that a film is screened.

(3) Where payment is received before the basic tax point, then this date becomes the actual tax point. The tax point for each 25% deposit is therefore the date that it is received.

(4) Invoices are issued on the same day as the basic tax point, so this is the tax point for the balance of 75%.

2 (a) Heavy Ltd – Corporation tax computation for the year ended 31 December 2011

	£
Operating profit	433,100
Depreciation	12,880
Amortisation	9,000
Deduction for lease premium (working 1)	(7,380)
Capital allowances (working 2)	(27,600)
Trading profit	420,000
Chargeable gain	0
Taxable total profits	420,000
Franked investment income	30,000
Augmented profits	450,000
Corporation tax	
FY 2010 420,000 x 3/12 = 105,000 at 28%	29,400
Marginal relief	
7/400 (750,000 – 450,000) x 420,000/450,000 x 3/12	(1,225)
FY 2011 420,000 x 9/12 = 315,000 at 26%	81,900
Marginal relief	
3/200 (750,000 – 450,000) x 420,000/450,000 x 9/12	(3,150)
	106,925

(1) Franked investment income is £30,000 (18,000 + 9,000 = 27,000 x 100/90). The dividend from Soft Ltd is not franked investment income as it is a group dividend.

(2) Heavy Ltd has one associated company, so the upper limit is reduced to £750,000 (1,500,000/2).

Tutorial notes:

(1) The sale of the office building does not give rise to a chargeable gain as Soft Ltd is a 75% group company.

(2) As far as Paper F6 (UK) is concerned all overseas dividends are exempt from UK corporation tax. They are included as franked investment income when calculating a company's augmented profits in exactly the same way as UK dividends.

(3) The taxable total profits must be apportioned between the financial years 2010 and 2011 because of the change in the main rate of corporation tax.

Working 1 – Deduction for lease premium

(1) The amount assessed on the landlord is £73,800 calculated as follows:

	£
Premium received	90,000
Less: 90,000 x 2% x (10 – 1)	(16,200)
	73,800

(2) This is deductible over the life of the lease, so the deduction for the year ended 31 December 2011 is £7,380 (73,800/10).

Tutorial note: *The office building has been used for business purposes, and so the proportion of the lease premium assessed as income on the landlord can be deducted, spread over the life of the lease.*

Working 2 – Capital allowances

		Main pool	Motor car [1]	Motor car [2]	Motor car [3]	Special rate pool	Allowances
	£	£	£	£	£	£	£
WDV brought forward		900	15,100	8,800	13,200	21,700	
Addition qualifying for AIA							
Office equipment	22,400						
AIA – 100%	(22,400)						22,400
Proceeds					(14,600)	(12,300)	
Balancing charge					1,400		(1,400)
						9,400	
WDA – 100%		(900)					900
WDA – Restricted			(3,000)				3,000
WDA – 20%				(1,760)			1,760
WDA – 10%						(940)	940
WDV carried forward		0	12,100	7,040		8,460	
Total allowances							27,600

Tutorial notes:

(1) *The balance on the main pool is less than £1,000 so a writing down allowance equal to the unrelieved expenditure can be claimed.*

(2) *Motor cars [1] and [2] were owned at 1 April 2009 and therefore qualify for writing down allowance at the rate of 20% subject to a maximum of £3,000. The private use of motor car [2] is irrelevant, since such usage will be assessed on the managing director as a benefit.*

(3) *Although all of the items included in the special rate pool have been sold, there is no balancing allowance as the business has not ceased.*

(b) Soft Ltd – Corporation tax liabilities for the 16-month period ended 31 December 2011

	Year ended 31 August 2011	Period ended 31 December 2011
	£	£
Trading profit	90,150	30,050
Capital allowances	(4,800)	(1,020)
	85,350	29,030
Chargeable gain	16,650	0
Taxable total profits	102,000	29,030
Corporation tax		
FY 2010 102,000 x 7/12 = 59,500 at 21%	12,495	
FY 2011 102,000 x 5/12 = 42,500 at 20%	8,500	
FY 2011 29,030 at 20%		5,806
	20,995	5,806

(1) Trading profits are allocated on a time basis: £90,150 (120,200 x 12/16) to the year ended 31 August 2011 and £30,050 (120,200 x 4/16) to the period ended 31 December 2011.

(2) Separate capital allowance computations are prepared for each accounting period as follows:

	Pool	Allowances
	£	£
Year ended 31 August 2011		
WDV brought forward	24,000	
WDA – 20%	(4,800)	4,800
WDV carried forward	19,200	
Period ended 31 December 2011		
Proceeds	(3,900)	
	15,300	
WDA – 20% x 4/12	(1,020)	1,020
WDV carried forward	14,280	

(3) The capital loss of £2,900 for the period ended 31 December 2011 is carried forward.

(4) Soft Ltd has one associated company, so the lower limit for the year ended 31 August 2011 is £150,000 (300,000/2) and for the period ended 31 December 2011 it is £50,000 (300,000/2 = 150,000 x 4/12). The small profits rate of corporation tax is therefore applicable to both periods.

Tutorial note: *The taxable total profits for the year ended 31 August 2011 must be apportioned between the financial years 2010 and 2011 because of the change in the small profits rate of corporation tax.*

3 (a) (i) An individual is subject to capital gains tax (CGT) on the disposal of chargeable assets during any tax year in which they are either resident or ordinarily resident in the UK.

(ii) A company is subject to corporation tax on gains from the disposal of chargeable assets if it is resident in the UK.

(b) (i) Winston King – CGT liability 2011–12

		£
Chargeable gain on painting		45,860
Annual exempt amount		(10,600)
		35,260
CGT liability:	12,600 at 18%	2,268
	22,660 at 28%	6,345
		8,613

(1) Winston has £12,600 (35,000 – 22,400) of his basic rate tax band unused.

(ii) Winston King – Revised CGT liability 2011–12

		£
Gain qualifying for entrepreneurs' relief		
Freehold shop (140,000 – 80,000)		60,000
Other gains		
Painting		45,860
Capital loss on freehold warehouse (102,000 – 88,000)		(14,000)
		31,860
Annual exempt amount		(10,600)
		21,260
CGT liability:	60,000 at 10%	6,000
	21,260 at 28%	5,953
		11,953

Tutorial notes:

(1) The capital loss on the sale of the freehold warehouse and the annual exempt amount are set against the chargeable gain from the sale of the painting as this saves CGT at the higher rate of 28%.

(2) The unused basic rate tax band of £12,600 is set against the gain qualifying for entrepreneurs' relief of £60,000 even though this has no effect on the 10% tax rate.

(c) (i) Wiki Ltd – Chargeable gain on disposal of warehouse

	£	£
Disposal proceeds		312,000
Incidental costs of disposal		(3,400)
		308,600
Cost	171,000	
Incidental costs of acquisition	2,200	
		(173,200)
		135,400
Indexation allowance (173,200 x 0·313)		(54,212)
Chargeable gain		81,188

(1) The indexation factor is 0·313 (228·0 – 173·6)/173·6.

(ii) Freehold factory

(1) No rollover relief is available as the amount not reinvested of £142,600 (308,600 – 166,000) exceeds the chargeable gain.

(2) The base cost of the factory will be £166,000.

Freehold office building

(1) The net sale proceeds are not fully reinvested, and so £12,600 (308,600 – 296,000) of the chargeable gain cannot be rolled over.

(2) The base cost of the office building will be £227,412 (296,000 – (81,188 – 12,600)).

Tutorial note: *Equivalent marks will be awarded if the gross proceeds of £312,000 are used instead of the net proceeds of £308,600.*

4 (a) (i) Saving is encouraged by offering individuals tax incentives such as tax-free individual savings accounts and tax relief on pension contributions.

(ii) Charitable support is encouraged by giving individuals tax relief on donations made through the gift aid scheme or by payroll deduction.

(iii) Entrepreneurs are encouraged to build their own businesses through various capital gains tax reliefs such as entrepreneurs' relief.

Investment in plant and machinery is encouraged through capital allowances.

(b) Michael

(1) The loss of £24,600 for 2010–11 can be claimed against total income for the three preceding years (under s.72 ITA 2007), earliest first, since it is incurred in the first four years of trading.

(2) The loss relief claim will therefore be £16,800 in 2007–08 and £7,800 (24,600 – 16,800) in 2008–09.

(3) For 2007–08 this will waste Michael's personal allowance, with the balance of the claim of £9,325 (16,800 – 7,475) saving income tax at the basic rate of 20%.

(4) For 2008–09 Michael has income of £8,125 (50,600 – 7,475 – 35,000) subject to income tax at the higher rate of 40%, so the claim of £7,800 will save tax at the higher rate.

(5) Alternatively, Michael could have carried the trading loss forward against future trading profits (under s.83 ITA 2007), but the trading profit of £7,100 for 2011–12 is less than the personal allowance, and there is no information regarding future trading profits.

Tutorial note: *A claim against total income (under s.64 ITA 2007) for 2010–11 and/or 2009–10 is not possible since Michael does not have any income for either of these years.*

Sean

(1) The unused overlap profits brought forward are added to the loss for the year ended 31 December 2011, so the total loss for 2011–12 is £26,700 (23,100 + 3,600).

(2) The whole of the loss can be claimed as a terminal loss (under s.89 ITA 2007) since it is for the final 12 months of trading. The claim is against trading income for the year of the loss and the three preceding years, latest first.

(3) The terminal loss claim will therefore be £3,700 in 2010–11, £18,900 in 2009–10 and £4,100 (26,700 – 3,700 – 18,900) in 2008–09.

(4) The property business profits are sufficient to utilise Sean's personal allowance for each year, so the loss relief claims will save income tax at the basic rate of 20%.

(5) Alternatively, Sean could have initially claimed loss relief against his total income (under s.64 ITA 2007) for 2011–12 and/or 2010–11, but this would have wasted his personal allowance for either or both of those years.

5 (a) (1) Ning's personal representatives could claim her deceased husband's unused nil rate band of £227,500 (325,000 x 70%).

(2) The total amount of nil rate band is therefore £552,500 (325,000 + 227,500).

(3) The potentially exempt transfer on 7 November 2011 will utilise £220,000 of the nil rate band, so only £332,500 (552,500 – 220,000) is available against the death estate.

(4) The potentially exempt transfer on 14 August 2001 is exempt from inheritance tax as it was made more than seven years before 20 March 2012.

(b) (i) Ning Gao – Inheritance tax (IHT) on death estate

		£	£
Property (674,000 + 442,000)			1,116,000
Repayment mortgage		160,000	
Endowment mortgage		0	(160,000)
			956,000
Motor cars			172,000
Investments (47,000 + 36,000 + 69,000)			152,000
			1,280,000
Bank loan		22,400	
Legal fees		0	
			(22,400)
Chargeable estate			1,257,600
IHT liability	332,500 at nil%		0
	925,100 at 40%		370,040
			370,040

(1) The personal representatives of Ning's estate will be responsible for paying the inheritance tax.

Tutorial notes:

(1) There is no deduction in respect of the endowment mortgage as this will be repaid upon death by the life assurance element of the mortgage.

(2) The promise to pay the nephew's legal fee is not deductible as it is purely gratuitous (not made for valuable consideration).

(ii) (1) If Ning were to live for another six years until 20 March 2018 then the inheritance tax payable in respect of her estate would not alter, as the potentially exempt transfer on 7 November 2011 will still be made within the previous seven years.

(2) If Ning were to live for another seven years until 20 March 2019 then the potentially exempt transfer will become exempt, and the inheritance tax payable in respect of her estate would therefore decrease by £88,000 (220,000 at 40%).

(c) (1) Gifts of income will be exempt if they are made as part of Ning's normal expenditure out of income.

(2) This is provided the gifts do not affect her standard of living.

(3) To count as normal, gifts must be habitual.

				Marks	
1	**(a)**	Salary		½	
		Living accommodation	– Annual value	½	
			– Additional benefit	2	
			– Furniture	1	
		Trading profit	– Profit share	2	
			– Assessment	1	
			– Capital allowances	2	
		Property business profit	– Rent receivable	½	
			– Council tax	½	
			– Wear and tear allowance	1	
			– Furniture	½	
		Personal allowance		½	
					12
	(b)	Class 1 NIC		1	
		Class 1A NIC		1	
		Class 2 NIC		1	
		Class 4 NIC		1	
					4
	(c)	Interval		1	
		Tax planning		1	
		Basis period rules more complicated		1	
		Profit assessed in year of cessation		1	
					4
	(d)	**(i)**	Flat rate scheme	1	
			Normal basis	1	
			Conclusion	1	
					3
		(ii)	No recovery of VAT by customers	1	
			Possible need to absorb output VAT	1	
			Conclusion	1	
					3
		(iii)	VAT period	1	
			Basic tax point	1	
			Deposit	1	
			Balance	1	
					4
					30

				Marks	
2	**(a)**	Operating profit		½	
		Depreciation		½	
		Amortisation		½	
		Lease premium	– Assessable amount	1½	
			– Deduction	1	
		Capital allowances	– AIA	1	
			– Main pool	1	
			– Motor car [1]	1	
			– Motor car [2]	1	
			– Motor car [3]	1½	
			– Special rate pool	1½	
		Chargeable gain		1	
		Franked investment income		2	
		Corporation tax	– Upper limit	½	
			– Apportionment to tax years	½	
			– Main rates	1	
			– Marginal reliefs	2	
					18
	(b)	Trading profits		1	
		Capital allowances	– Year ended 31 August 2011	1	
			– Period ended 31 December 2011	1½	
		Chargeable gains		1	
		Corporation tax	– Year ended 31 August 2011	1½	
			– Period ended 31 December 2011	1	
					7
					25
3	**(a)**	**(i)**	Resident in the UK	½	
			Ordinarily resident in the UK	½	
					1
		(ii)	Resident in the UK	1	
					1
	(b)	**(i)**	Annual exempt amount	1	
			Unused basic rate tax band	½	
			Capital gains tax	1½	
					3
		(ii)	Freehold shop	½	
			Painting	½	
			Capital loss	1	
			Annual exempt amount	½	
			Capital gains tax	1½	
					4
	(c)	**(i)**	Proceeds	½	
			Costs of disposal	½	
			Cost	½	
			Costs of acquisition	½	
			Indexation allowance	1	
					3
		(ii)	Freehold factory	1½	
			Freehold office building	1½	
					3
					15

					Marks
4	**(a)**	**(i)**	Saving		1
		(ii)	Charitable support		1
		(iii)	Businesses	1	
			Plant and machinery	1	
					2
	(b)	**Michael**			
		Relief against total income		1	
		Claims		1	
		Rate of tax saved – 2007–08		1	
		– 2008–09		1	
		Carry forward		1	
		Sean			
		Available loss		1	
		Terminal loss relief		1	
		Claims		1	
		Rate of tax saved		1½	
		Relief against total income		1½	
					11
					15
5	**(a)**	Husband's nil rate band		1	
		Total nil rate band		1	
		PET on 7 November 2011		1	
		PET on 14 August 2001		1	
					4
	(b)	**(i)**	Property	1	
			Repayment mortgage	½	
			Endowment mortgage	½	
			Motor cars	½	
			Investments	1	
			Bank loan	½	
			Legal fees	1	
			IHT liability	1	
			Payment responsibility	1	
					7
		(ii)	Live for six more years	1	
			Live for seven more years	1	
					2
	(c)	Exemption		1	
		Standard of living		½	
		Habitual		½	
					2
					15