

**ATX (UK) Practice Paper 1
(new format from June 2023)**

Prepared under FA2022

Section A – This question is compulsory and MUST be attempted

QUESTION 1

You should assume that today's date is 1 March 2024.

You are an ACCA student working for a firm of accountants. Your manager has had a meeting with Corey, a client of your firm, and requires your assistance to draft a memorandum to deal with the issues raised. A diagram summarising the relationships between the parties is set out in Exhibit 5.

Corey has recently returned to the UK after a period of living overseas in the country of Medora.

In addition to some ethical considerations which have been raised by your manager, Corey requires advice in respect of:

- clarification of his UK residence status;
- the capital gains treatment of some disposals which have occurred;
- the inheritance tax consequences of certain gifts which his mother is proposing to make;
- the deductibility, for tax purposes, of certain costs which are to be incurred by Quod Ltd, a new company which will be established; and
- the availability of tax losses within Quod Ltd and the extent to which they can be relieved.

Your manager has prepared a memorandum summarising his meeting with Corey – relevant extracts from this memorandum, as well as an email detailing what you are required to do, are contained in the exhibits available on the left hand side of the screen.

1. Corey's personal situation
2. Disposals made by Corey
3. Proposed gifts by Emer (Corey's mother)
4. Quod Ltd
5. Manager's email - outlining what you are required to do

This information should be used to answer the question **requirements** within your chosen **response option(s)**.

1. Corey's personal situation

Extracts from the memorandum prepared by your manager dated 1 March 2024

Background

Corey had always lived in the UK until, on 6 April 2020, he sold his home in the UK and moved to the country of Medora with his wife, Dana, and their daughter, aged 10. They always planned to return to the UK at some point, such that they continued to be domiciled in the UK. Corey began working for a company in Medora on 1 May 2020.

In March 2023, Corey's sister, Florence, became seriously ill. Consequently, Corey and his family returned to live in the UK on 6 April 2023.

Period from 6 April 2020 to 5 April 2023

Corey was not resident in the UK for tax purposes during this period. However, he visited the UK (staying in hotels) as follows:

<u>Tax year</u>	<u>Days in the UK</u>
2020/21	49
2021/22	105
2022/23	74

Since 6 April 2023

On 1 June 2023, Corey and Dana purchased a new family home in the UK. On the same date, Dana started a new full-time job in the UK and became UK resident. Corey and Dana have retained their home in Medora because Corey has continued working there and does not work in the UK. It is envisaged that Corey will have been in the UK for 115 days in the tax year 2023/24.

2. Disposals made by Corey

Extracts from the memorandum prepared by your manager – dated 1 March 2024

Disposals of assets in the tax year 2022/23

- On 1 December 2022, Corey sold a statue situated in the garden of his home in Medora. He had purchased the statue for £17,000 on 1 September 2020. The sale resulted in a capital loss of £7,400.
- On 1 February 2023, as a result of a commercial takeover, Corey received 4,000 shares in TW plc (a holding of less than 1%) and £12,000 in cash in exchange for 2,000 shares in SQ plc. One share in TW plc was worth £3.50 on that day. Corey had purchased his 2,000 shares in SQ plc (a holding of less than 1%) for £13,500 on 1 June 2015. SQ plc and TW plc are quoted companies.

Disposals of assets in the tax year 2023/24

- On 1 August 2023, Corey sold a house situated in Medora. This house was purchased on 1 July 2020 and has always been rented out. The sale realised a gain of £34,500.
- On 1 December 2023, Corey gave his sister, Florence, 700 of the 4,000 shares he owned in TW plc. One share in TW plc was worth £4.50 on that day.

Note:

I have subsequently carried out some research on the system of taxation in Medora and can confirm that:

- there is no capital gains tax in Medora, and
- there is no double tax treaty between the UK and Medora.

3. Proposed gifts by Emer (Corey's mother)

Extracts from the memorandum prepared by your manager dated 1 March 2024

Paintings owned by Corey's mother

Corey has asked for advice on the inheritance tax (IHT) advantages of his mother, Emer, who is UK domiciled, making lifetime gifts to Corey of either, or both, of the following paintings.

	Current market value	Anticipated change in value
	£	
Watercolour	41,000	Falling in value
Portrait	37,000	Increasing in value

4. Quod Ltd

Extracts from the memorandum prepared by your manager dated 1 March 2024

Joint Venture

Corey owns 100% of the share capital of Porth Ltd, an unquoted trading company with annual profits of around £100,000. On 1 April 2024, Porth Ltd will invest in a new company, Quod Ltd. Quod Ltd will be resident in the UK for tax purposes and will begin to trade immediately. It will develop a range of products over the next few years.

The planned ownership of the ordinary share capital of Quod Ltd is as follows:

Porth Ltd	60%
Either Mr Berm or Mr Berm's company, BJB Ltd	30%
CX Ltd	10%

Porth Ltd, BJB Ltd, CX Ltd and Mr Berm are all UK resident for tax purposes.

Quod Ltd – financial information

Corey has calculated Quod Ltd's budgeted tax adjusted trading loss for the year ending 31 March 2025 to be £44,000.

When calculating this loss, Corey has deducted £1,000, being the annual amortisation charge included in the accounts, in respect of the Cloque brand (note 1). He was unsure how to treat this but a friend of his, with some knowledge of corporation tax, advised him that it was fully deductible.

The loss also includes a deduction for the whole of the costs attributable to a scientific research project amounting to £74,500 (note 2).

Note 1: Purchase of the Cloque brand

On 1 April 2024, Quod Ltd will acquire a brand (the Cloque brand) for £35,000 and begin to trade. The brand will have a 35-year life and will be written off for accounts purposes on a straight-line basis.

Note 2: Scientific research costs

	£
Materials	21,000
Rent	17,400
Electricity and water	6,600
Staff costs	<u>29,500</u>
	<u>74,500</u>

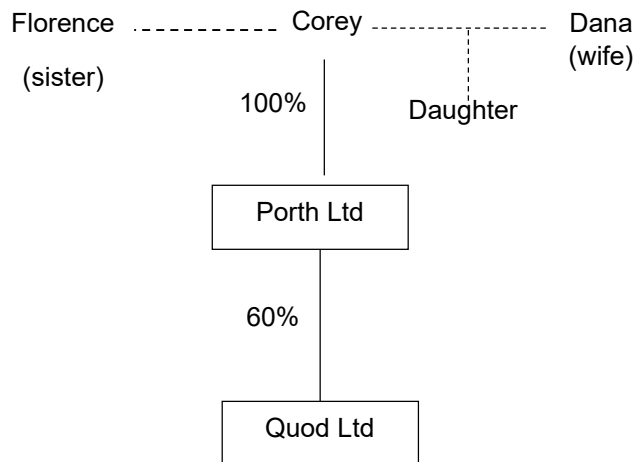
- The rent is an appropriate allocation of the rent payable for Quod Ltd's premises for the year.
- All of the staff costs relate to employees of Quod Ltd, with the exception of £7,000, which was paid to an external contractor provided by an unconnected company.
- Quod Ltd will be a small or medium sized enterprise for the purposes of the additional tax relief available for expenditure on research and development.
- I have already established that the research to be carried out by Quod Ltd will qualify for this relief.
- Quod Ltd will NOT surrender any part of the loss in return for a cash refund from HM Revenue and Customs (HMRC).

5. Manager's email

To: Tax Senior
From: Tax Manager
Subject: Corey
Date: 1 March 2024

Hi

The relationships between the parties are set out below.



I would like you to prepare a memorandum for the client file consisting of the work set out below.

(a) Corey's UK residence status for the tax year 2023/24 (Exhibit 1)

- Explain how Corey's UK residence status for the tax year 2023/24 will be determined and conclude on his likely residence status for that year. I have already confirmed that none of the automatic overseas or automatic UK test have been met for 2023/24 and you therefore DO NOT need to consider these further.
- State how becoming UK resident would affect Corey's liability to UK income tax.

For the purposes of this part, you are NOT required to consider the availability of split year treatment.

(6 marks)

(b) Corey's disposals of assets in the tax years 2022/23 and 2023/24 (Exhibits 1 and 2)

For this part of the work, you should assume Corey is UK resident for the whole of the tax year 2023/24 and will receive taxable income in that year of £42,320, before deduction of his personal allowance.

- Explain how each of Corey's disposals in the tax year 2022/23 will be treated for the purposes of capital gains tax (CGT).
- Calculate Corey's CGT liability for the tax year 2023/24.

(11 marks)

(c) Lifetime gifts of paintings by Emer (Exhibit 3)

- Explain, with respect to the amount of inheritance tax (IHT) payable ONLY, whether it would be beneficial for Emer to make a lifetime gift of either or both of her paintings (as opposed to retaining them until her death).

There is no need to address the annual exemption, as Emer makes use of this every year.

You should assume there will be no nil rate band available regardless of when the transfer takes place.

(6 marks)

(d) Quod Ltd (Exhibit 4)

- Given that Corey is keen to maximise the company's trading loss for the year ending 31 March 2025, explain whether you agree with the advice given by his friend concerning the tax treatment of the proposed purchase of the Cloque brand (an intangible fixed asset) for £35,000.
- Explain the tax deduction which will be available to Quod Ltd in respect of the scientific research costs of £74,500 to be incurred in the year ending 31 March 2025.
- Calculate the amended budgeted tax adjusted trading loss for Quod Ltd for the year ending 31 March 2025, taking into account the explanations requested above.
- Explain how much of Quod Ltd's amended budgeted trading loss will be available for use by Porth Ltd.

(12 marks)

(e) Refund of income tax

I have become aware that, a few months ago, Corey received a refund of income tax from H M Revenue and Customs (HMRC) in respect of the tax year 2019/20. He has not been able to determine why the refund was made.

In respect of the income tax refund, set out the actions which our firm should take and the matters which should be brought to Corey's attention.

(5 marks)

Regards

Tax Manager

Requirements:

You should assume that today's date is 1 March 2024.

Respond to the instructions in the email from your manager.

Note: The split of the mark allocation is shown in Exhibit 5 – Manager's email.

(40 marks)

Professional marks will be awarded for demonstration of skill in communication, analysis and evaluation, scepticism, and commercial acumen in your answers.

(10 marks)

(50 marks)

Section B – BOTH questions are compulsory and MUST be attempted

QUESTION 2

You should assume that today's date is 1 May 2023.

Tomas and his wife, Ines, require advice in connection with the following;

- the tax implications of commencing to trade;
- the choice of accounting date for a new business;
- voluntary registration for value added tax (VAT) purposes and the implications of purchasing services from overseas; and
- the tax implications of selling shares in respect of which enterprise investment scheme (EIS) relief has been obtained.

The following **exhibit**, available on the left-hand side of the screen, provides information relevant to the question.

1. Tomas and Ines

This information should be used to answer the question **requirements** within your chosen **response option(s)**.

Tomas and Ines

Tomas:

- Is UK resident and domiciled.
- Uses his capital gains tax (CGT) annual exempt amount every year.
- Receives dividends of £2,000 every year.

Tomas – sale of sporting memorabilia:

- Tomas started selling items of sporting memorabilia from his collection during the tax year 2022/23.
- HM Revenue and Customs (HMRC) agreed that these sales should be subject to CGT in the tax year 2022/23.
- In April 2023, Tomas started purchasing and selling more items of sporting memorabilia, such that HMRC have said that he will be regarded as trading with effect from 6 April 2023.
- Tomas will not be required to register for value added tax (VAT) for the foreseeable future.
- Tomas will, however, consider registering voluntarily for VAT if it is financially beneficial for him to do so.

- Tomas will obtain advice on how to develop his business through the use of social media, and has been recommended a company based overseas (in a country where the rate of VAT is 9%) to complete this work.

Tomas – expected trading results from the sale of sporting memorabilia:

- Tomas is considering either a 31 March or 30 April year end for his business.
- Tomas estimates that his total income less expenditure for the 12 months ending 31 March 2024 will be £14,000.
- Each item of memorabilia is purchased and sold for no more than £1,000.
- All of the costs he incurs are deductible for tax purposes.
- Tomas expects his profits to increase steadily after 1 April 2024.

Ines:

- Is UK resident and domiciled.
- Is a higher rate taxpayer.
- Has made/will make no disposals for CGT purposes, other than as described below.

Ines – sale of painting:

- Ines sold a painting on 4 July 2020 for proceeds of £196,000.
- The sale gave rise to a gain of £86,000.

Ines – acquisition of shares in Tavira Ltd:

- Ines subscribed £72,000 for 20,000 shares in Tavira Ltd on 8 October 2020.
- These shares are qualifying enterprise investment scheme (EIS) shares.
- Ines elected to defer the maximum possible amount of the gain on the sale of the painting against the acquisition of these shares.
- Ines obtained EIS relief of £18,600 against her income tax liability for the tax year 2020/21.
- Ines intends to sell all of the shares in Tavira Ltd for £95,000 on 1 June 2023.
- If undertaken, this sale would qualify for business asset disposal relief.

Requirements:

You should assume today's date is 1 May 2023

- (a) (i) **On the assumption that Tomas prepares his first set of accounts to 31 March 2024, explain, with supporting calculations, the difference in the total amount of tax payable by him for the tax year 2023/24 as a result of the profit on the sales of sporting memorabilia being treated as trading income, rather than chargeable gains.**
- (ii) **State TWO advantages, for tax purposes, if Tomas were to make up his accounts to 30 April each year, as opposed to 31 March.**

(7 marks)

- (b) (i) **Explain TWO matters which Tomas should consider when deciding whether or not it will be financially beneficial to voluntarily register for VAT.**
- (ii) **Assuming Tomas DOES voluntarily register for VAT, explain the implications of purchasing advice from the overseas supplier, rather than using one based in the UK.**

(6 marks)

- (c) **Explain the tax implications for Ines of her intended sale of the Tavira Ltd shares on 1 June 2023, and calculate her after-tax proceeds from this sale.**

(7 marks)

Professional marks will be awarded for the demonstration of skill in analysis and evaluation and commercial acumen in your answer.

(5 marks)

(25 marks)

QUESTION 3

You should assume today's date is 1 March 2024.

Pedro lets out a holiday cottage which he was given by his aunt. He requires advice in respect of the following;

- the inheritance tax implications of the gift of the cottage;
- furnished holiday lettings; and
- the income tax implications of making a contribution into his personal pension scheme.

The following **exhibit**, available on the left-hand side of the screen, provides information relevant to the question.

1. Pedro

This information should be used to answer the question **requirements** within your chosen **response option(s)**.

Pedro

Pedro:

- Was given a holiday cottage in the UK by his aunt, Marina, on 4 March 2013.
- Paid inheritance tax personally, in respect of this gift of the holiday cottage, following Marina's death on 8 June 2023.
- Inherited a portfolio of UK unfurnished residential properties, valued at £670,000 on Marina's death.

Gift of the holiday cottage in the UK by Marina:

- Marina and Pedro agreed that she could stay in the house for two months each year, rent-free, which she did every year until her death.
- For the remainder of each year, Marina lived in her main home.

Pedro - property income:

- The cottage (which is fully furnished), has been available for rental on a commercial basis continuously since 1 July 2023, and will have a 70% occupancy rate for the first year of letting.
- No tenant will have stayed in the cottage for more than 14 consecutive days during the first year of letting.
- The taxable rental income from the cottage in the tax year 2023/24 will be £14,500.
- In the tax year 2023/24 Pedro will also receive taxable rental income of £32,000 from the unfurnished residential properties which he inherited from Marina.

Employment income:

- Pedro has been employed by Loule Ltd since 6 April 2022.
- Pedro receives an annual gross salary of £75,000 from Loule Ltd.
- Loule Ltd has contributed £8,000 in each of the tax years 2022/23 and 2023/24 to its occupational pension scheme on behalf of Pedro.

Personal pension scheme:

- Pedro had never been a member of a pension scheme prior to taking up employment with Loule Ltd.
- Pedro wishes to start contributing to a personal pension scheme in the tax year 2023/24.
- Pedro intends to make his first contribution into the new personal pension scheme, of £85,000 (gross), on 31 March 2024.
- The annual allowance available to Pedro was not restricted in any previous tax year.
- Pedro's income tax liability for the tax year 2023/24, before taking into account the planned contribution into his personal pension scheme, is £40,332.

Requirements:

- (a) Explain the inheritance tax implications of the gift of the cottage to Pedro at the time the gift was made, and as a result of Marina's death.**

(5 marks)

- (b) Explain, by reference to the relevant conditions, why the holiday cottage will qualify as a furnished holiday letting for the first 12-month period of letting.**

(5 marks)

- (c) Calculate the reduction in Pedro's income tax liability for the tax year 2023/24 as a result of making the planned contribution of £85,000 (gross) into his personal pension scheme on 31 March 2024. Your answer should include an explanation of the amount of the personal allowance available to Pedro in this case.**

(10 marks)

Professional marks will be awarded for the demonstration of skill in analysis and evaluation and commercial acumen in your answer.

(5 marks)

(25 marks)

Suggested solutions

Q1 Suggested Solution

Memorandum

For The files
Client Corey
Subject Personal and company tax matters
Prepared by Tax Senior
Date 1 March 2024

(a) Corey's UK residence status for the tax year 2023/24

Corey's residency will be determined by reference to the statutory residency test, which requires we apply a number of prescribed tests to determine whether he is a UK resident for the relevant tax year.

As you have already confirmed, Corey's status cannot be determined automatically, and therefore it will be determined by the number of ties he has with the UK. He was not UK resident in any of the three tax years prior to 2023/24, and he will have been in the UK for between 91 and 120 days in the tax year 2023/24. He will therefore be UK resident if he satisfies three or more UK ties.

The ties to be considered are:

	Satisfied?
— In the UK for more than 90 days in either or both of the tax years 2021/22 and 2022/23	Yes
— Spouse/civil partner or children under 18 who are resident in the UK	Yes
— Working in the UK for 40 days or more	No
— Accommodation available in the UK for a continuous period of more than 90 days	Yes

Corey will satisfy three of the UK ties such that he will be a UK resident in the tax year 2023/24.

As a UK tax resident, Corey will be subject to UK income tax on his overseas income in addition to his UK income. He will however be able to obtain relief in the UK for any tax suffered in Medora. This relief is the higher of, the tax paid in the UK on his overseas income, and the tax paid on that same income in Medora.

(b) Corey's disposals of assets in the tax years 2022/23 and 2023/24

Disposals in the tax year 2022/23

For the purposes of UK capital gains tax (CGT), Corey will be regarded as only temporarily non-UK resident whilst living in Medora. This is because:

- he was absent from the UK for less than five years; and

- having always lived in the UK prior to moving to Medora, he was UK resident for at least four of the seven tax years immediately prior to the tax year of departure.

As a temporary non-UK resident, Corey will be subject to UK CGT on any assets sold whilst he was living overseas, which he owned at the date of his departure from the UK. Any such gains or losses are subject to CGT in the tax year in which Corey returned to the UK, in this case 2023/24.

- The statue was both bought and sold while Corey was living in Medora. Accordingly, the capital loss on the sale is not available for relief in the UK.
- The gain resulting from the takeover of SQ plc will be subject to tax in 2023/24, rather than the year of the takeover, under the temporary non-resident rules.

CGT liability for the tax year 2023/24

	Residential property	Other gains
	£	£
Chargeable gains:		
Shares in SQ plc (W1)		5,769
House in Medora	34,500	
Shares in TW plc (W3)		1,878
Less: annual exempt amount	(12,300)	
Taxable gains	<u>22,200</u>	<u>7,647</u>
Basic rate band		37,700
Gross taxable income	42,320	
Less: personal allowance	<u>(12,570)</u>	
		(29,750)
Basic rate band remaining		<u>7,950</u>
CGT		
Residential property:		
£7,950 x 18%		1,431
£14,250 x 28%		3,990
Other gains:		
£7,647 x 20%		1,529
CGT liability		<u>6,950</u>

Tutorial note: The order in which the gains are subject to CGT makes no difference to the final liability, i.e. calculating CGT on the 'other gains' and then on the residential property will result in the same tax liability.

Workings

1. Disposal of 2,000 shares in SQ plc on 1 February 2023

	£
Proceeds in cash	12,000
Less: cost (W2)	(6,231)
Chargeable gain	<u>5,769</u>

2. Allocation of cost of shares in SQ plc following takeover by TW plc

	Consideration		Cost
	£		£
Shares in TW plc (4,000 x £3.50)	14,000	£13,500 x £14,000 / £26,000	7,269
Cash	12,000	£13,500 x £12,000 / £26,000	6,231
Total	<u>26,000</u>		<u>13,500</u>

3. Gift of 700 shares in TW plc on 1 December 2023

	£
Proceeds at market value (700 x £4.50)	3,150
Less: cost (700/4,000 x £7,269 (W2))	(1,272)
Chargeable gain	<u>1,878</u>

(c) Lifetime gifts of paintings by Emer

The advantages of making a lifetime gift are:

- As the gifts would be potentially exempt transfers (PETs), no inheritance tax (IHT) will be charged if Emer survives the gift by a minimum of seven years.
- If Emer dies before the expiration of seven years but after at least three years have elapsed, any IHT due will be reduced by taper relief. The relief is 20% of the tax if she survives the gift by three years with a further 20% relief for each additional year.
- The value of a lifetime gift is determined at the time of the gift rather than at the date of death. Accordingly, one of the benefits of making a lifetime gift of the portrait is that, if the gift becomes

chargeable, IHT will be charged on the value at the time of the gift rather than the value as at the date of death (which is expected to be higher).

The watercolour is expected to fall in value. However, if its value at the time of death is lower than at the time of the gift, fall in value relief would be available (provided Corey still owns the painting or has sold it at arms' length). As a result, the value of the painting at the time of death would be used to calculate any IHT due, resulting in a lower tax charge.

However, the fall in value relief would only affect the IHT due on the watercolour itself. When calculating the IHT on subsequent gifts and on the death estate, the value of the watercolour at the time of the gift, i.e. the higher amount, would be used.

In view of the above, it is likely that both paintings should be the subject of a lifetime gift.

(d) Quod Ltd

Tax treatment of the purchase of the Cloque brand

- Corey's friend is correct that the amount of £1,000 charged to the profit and loss account in respect of this expenditure would be allowable for the purposes of calculating taxable trading profit.
- Alternatively, Quod Ltd can make a claim to receive tax relief at a rate of 4% on a straight-line basis. This claim would mean that relief of £1,400 (£35,000 x 4%) is available each year, which would clearly be beneficial compared to the actual amortisation charged.

Tax deduction available in respect of the scientific research costs

- As Quod Ltd will be considered a small or medium enterprise for research and development purposes, certain categories of revenue expenditure which are directly related to research and development activities will qualify for an additional 130% deduction when calculating the company's taxable trading income.

This additional deduction is not available in respect of the rental costs.

Only 65% of amounts paid to external contractors qualify for this additional deduction.

- Tax deduction available

	£	£
Total research costs	74,500	74,500
Less:		
Rent	(17,400)	
Staff costs (£7,000 x 35% (100% – 65%))	(2,450)	
Amount qualifying for additional deduction	<u>54,650</u>	
Additional deduction (£54,650 x 130%)		<u>71,045</u>
Tax deduction available		<u>145,545</u>

Amended tax adjusted trading loss for the year ending 31 March 2025

	£
Budgeted tax adjusted trading loss	(44,000)
Additional deduction in respect of research costs	(71,045)
Amortisation of Cloque brand	
(£1,400 (£35,000 x 4%) – £1,000)	(400)
Amended tax adjusted trading loss	<u>(115,445)</u>

Amount of trading loss available for use by Porth Ltd

- Porth Ltd will not be able to use the trading loss of Quod Ltd unless Quod Ltd is a consortium company. Quod Ltd will be a consortium company if at least 75% of its ordinary share capital is owned by companies, each of which own at least 5% but less than 75%.
- Accordingly, for consortium relief to be available, BJB Ltd must own the 30% holding rather than Mr Berm.
- The maximum amount which could be surrendered to Porth Ltd as consortium relief is £69,267 (£115,445 x 60%), reflecting Porth Ltd's holding of 60% of the ordinary share capital of Quod Ltd.

(e) Refund of income tax

- We should review Corey's tax return for 2019/20 in order to determine whether there is a valid reason for the refund.
- If we conclude that the refund was made as a result of an error on the part of HM Revenue and Customs (HMRC), we should tell Corey to repay the money immediately. We should inform him that failing to return the money in these circumstances may well be a civil and/or a criminal offence.
- HMRC should be informed of their error as soon as possible, as this will minimise any interest and penalties which may otherwise become payable. We should inform HMRC if our letter of engagement authorises us to do so. Alternatively, we should advise Corey to do so.
- If Corey is unwilling to return the money, we would have to consider ceasing to act as his tax adviser. We would then have to notify HMRC that we no longer act for him, although we would not provide them with any reason for our action.
- Finally, we should consider whether it is necessary to make a report under the money laundering rules.

Q1: Detailed Marking Guide

		Available	Maximum
1 (a)	UK ties		
	Number of ties required	1	
	Consideration of each tie (1 mark each)	4	
	Conclusion	1	
	Liability to UK income tax	2	
		<hr/>	6
		<hr/>	
(b)	Explanations		
	Disposals in 2022/23	4	
	Calculations		
	Sale of house	0.5	
	Sale and gift of shares	4	
	Capital gains tax	3.5	
		<hr/>	11
		<hr/>	
(c)	Potentially exempt transfers and taper relief	2.5	
	Valuation and exemptions	3	
	Conclusion	1	
		<hr/>	6.5
		<hr/>	
(d)	Amortisation of brand	3	
	Research costs		
	Notes	3	
	Calculation	2	
	Calculation of available loss	2	
	Consortium relief	4	
		<hr/>	14
		<hr/>	
(e)	If caused by HMRC error, inform HMRC and refund	2	
		<hr/>	

Offence, penalties/ interest, money laundering

Corey unwilling to return the money

2

2

6

5

Professional skills marks (see below)

10

10

10

Total Marks

50

Question 1 - Analysis of professional skills marks

Communication

- General format and structure of memorandum (e.g. use of headings/sub-headings, easy to refer to)
- Style, language and clarity (tone of memorandum, presentation of calculations, appropriate use of the tools, easy to follow and more than a negligible amount of content)
- Effectiveness of communication (answer is relevant, specific rather than general and focused to the requirement)
- Adherence to specific instructions made in the scenario (e.g. ignoring the availability of the annual exemption/ nil rate band in part (c) or provision of explanatory comment in support of calculations performed in part (d))

Analysis and evaluation

- Appropriate use of the facts in the scenario when seeking to apply sufficient ties test to Corey's situation in part (a)
- Relevant reference to the facts of the scenario when analysing Corey's capital gains position for the tax year 2022/23 in part (b)
- Appropriate use of the information and adoption of a logical approach when establishing the cost of the TW plc shares disposed of in part (b)
- Reasonable calculation of amended trading loss in part (d) supported by previous analysis and argument
- Reasonable consideration of the impact of consortium relief rules in part (d)

Scepticism

- Critical assessment of Corey's residency position in part (a) and any potential information that should be clarified before finalising the position
- Critical assessment of friend's advice in part (d)

Commercial acumen

- Demonstration of an understanding of the need to make the most efficient use of the annual exempt amount when providing the calculations in part (b)
- Distinction made between the two different asset profiles (one increasing in value and one decreasing in value) when providing recommendations in respect of part (c)
- Recognition of viable alternative treatment of the Cloque brand in part (d)

Q2 Suggested Solution:

(a)(i) Tax treatment of the sale of sporting memorabilia

As Tomas is carrying on a trade of selling sporting memorabilia, the following liabilities will arise:

	£
<u>Income tax</u>	
£14,000 - £12,570 = £1,430 x 20%	286
No tax will arise on the dividends, as they are covered by the dividend nil rate band	0
<u>National insurance contributions (NIC)</u>	
Class 2: £3.15 x 52	164
Class 4: (£14,000 - £12,570) x 10.25%	<u>146</u>
<u>Total tax payable</u>	<u>596</u>

If the sales were treated as capital disposals, there would be no capital gains tax to pay as the memorabilia are chattels, with cost and proceeds both less than £6,000.

The difference in the total tax which will be payable by Tomas for 2023/24 is an increase of £596.

(a)(ii) Tax advantages of adopting a 30 April year end

The advantages of adopting a 30 April year end are as follows:

- A 30 April year end maximises the interval between earning profits and paying the tax on those profits.
- A 30 April year end is financially beneficial for Tomas as the profits of his business are expected to rise each year. This will mean that less tax will be paid in the early years of the business as the assessments for those years will be based on earlier, and thus lower, profits.
- 30 April is near the start of a tax year whereas 31 March is at the end. So, with a 30 April year end, there is more time for planning before the return needs to be submitted.

Tutorial note: *Although three advantages have been explained here, candidates were only required to state TWO to gain full marks.*

(b)(i) Matters to be considered by Tomas in deciding whether it is financially beneficial to register voluntarily for value added tax (VAT)

The VAT status of his suppliers. If Tomas' suppliers are VAT registered, Tomas will be charged VAT on his purchases, which he will only be able to reclaim if he is registered for VAT himself. However, if he purchases from non-VAT registered businesses, or members of the public, he will not suffer any input VAT, so there will be no financial benefit from registering.

The VAT status of his customers. If Tomas' customers are registered for VAT they will be able to reclaim the VAT charged by Tomas on the memorabilia. However, if they are not registered, the VAT will represent an additional cost for them, which may make Tomas' prices uncompetitive, or Tomas will have to bear the burden of the VAT himself.

Tutorial note: Marks were also awarded where candidates made other sensible comments.

(b)(ii) VAT implications of purchasing advice from the overseas supplier

- The provision of this advice will be a business to business (B2B) service. It will be treated as supplied in the UK, because that is where Tomas' business is established.
- Tomas will be required to pay VAT at the UK standard rate of 20% to HM Revenue and Customs (HMRC) under the 'reverse charge' principle. The rate of VAT in the overseas country is irrelevant.
- The input VAT can be reclaimed on this expense in the same way as any other input tax incurred by the business.
- Accordingly, Tomas' VAT position will be the same as if the services had been purchased from a UK supplier.

(c) Sale of shares in Tavira Ltd

If the shares in Tavira Ltd are sold on 1 June 2023, Ines will have owned them for less than three years. The following consequences will therefore arise:

- A chargeable gain of £23,000 (£95,000 - £72,000) will arise on the sale; and
- The enterprise investment scheme (EIS) income tax relief obtained when the shares were acquired will be withdrawn. As the shares will be sold at a profit, the full amount of the tax credit originally given of £18,600 will be reclaimed by HM Revenue and Customs (HMRC).

In addition, the sale of the Tavira Ltd shares will result in the gain on the sale of the painting, which was deferred on the acquisition of the shares, being brought back into charge. The gain on this disposal was £86,000, but the maximum amount of the gain deferred was restricted to the qualifying expenditure of £72,000.

Ines will have a capital gains tax (CGT) liability in the tax year 2023/24, calculated as follows:

	Gain eligible for business asset disposal relief £	Gain not eligible for business asset disposal relief £
Gain on Tavira Ltd shares	23,000	
Deferred gain on painting		72,000
Less: annual exempt amount (best use)	<u>0</u>	<u>(12,300)</u>
Taxable gains	<u>23,000</u>	<u>59,700</u>

Ines' CGT liability is £14,240 ((£23,000 x 10%) + (£59,700 x 20%)).

There will also be the clawback of the income tax relief previously obtained of £18,600.

Accordingly, Ines' after-tax proceeds from the sale of the Tavira Ltd shares will be £62,160 (£95,000 - £14,240 - £18,600).

Q2 Detailed Marking Guide:

	Available Marks	Maximum Marks
(a) Income tax implications	2	
National insurance implications	2	
Capital gains tax – chattels < £6,000	1	
Difference in tax payable	0.5	
Two advantages of 30 April year end date	<u>2</u>	
	<u>7.5</u>	7
(b) VAT status of suppliers	2	
VAT status of customers	2	
VAT on overseas services supplied	<u>3</u>	
	<u>7</u>	6
(c) Consequences of sale	5	
Tax liabilities	3	
After-tax proceeds	<u>0.5</u>	
	<u>8.5</u>	7
Professional skills marks (see below)		<u>5</u>
Total		<u>25</u>

Question 2 - Analysis of professional skills marks

Analysis and evaluation

- Appropriate use of information to summarise the net difference in tax cost between treating the profit as trading vs capital in part (a)
- Consideration of both income tax and NIC in part (a)
- Appropriate use of information to compare treatment of services provided by overseas supplier to treatment of services provided by a UK supplier in part (b)
- Recognition of more than one tax consequence of disposal of shares in part (c)
- Use of information to support discussion with respect to the implications of the sale of the Tavira Ltd shares

Commercial acumen

- Recognition of the need to consider the impact of voluntary registration for VAT on both suppliers and customers in part (b)
- Demonstration of the ability to make the most efficient use of the annual exempt amount when providing calculations in part (c)

Q3 Suggested Solution:

(a) Inheritance tax (IHT) implications of the gift of the holiday cottage to Pedro.

The gift of the holiday cottage was a potentially exempt transfer (PET), and therefore no tax was payable in Marina's lifetime. Although Marina died more than seven years after making this gift, IHT was payable as a result of her death as the gift constituted a gift with reservation. This is because Marina continued to derive benefit from the use of the holiday cottage following the gift, as she did not pay a market rent for staying in the cottage.

The reservation was not lifted prior to her death, and therefore the IHT payable would have been calculated as the higher of (1) the total IHT payable if the cottage was included in her death estate at its value on death, and (2) the total IHT payable if the cottage was taxed as a PET made in March 2013. As the latter liability is £nil, due to the date of the PET being more than seven years before Marina's death, the cottage would have been included in Marina's death estate.

As the value of her death estate exceeded the nil rate band of £325,000 (as it included a portfolio of properties valued at £670,000), IHT was payable on the estate. The IHT attributable to the cottage, being a gift with reservation, was payable by the recipient of the gift, which in this case, was Pedro.

(b) Why the holiday cottage will qualify as a furnished holiday letting

The letting of the holiday cottage satisfies all the conditions to qualify as a furnished holiday letting as follows:

Availability – the cottage is available continuously for commercial letting from 1 July 2023 onwards, so will meet the condition to be available for at least 210 days in the first 12-month period.

Actual letting – the cottage will have a 70% occupancy rate throughout the period it is available for letting, such that it will be let for at least 105 days in the first 12-month period.

Pattern of occupation – no tenant will stay in the cottage for more than 14 consecutive days during the first year for which it will be available for letting, so there is no possibility of the number of days of 'longer term occupation' (more than 31 consecutive days) exceeding 155 in the first 12-month period.

The cottage is situated in the UK, has been let furnished, and on a commercial basis.

(c) Reduction in Pedro's income tax liability for the tax year 2023/24 as a result of making the planned contribution of £85,000 (gross) to a personal pension scheme.

Income tax liability with the pension contribution

	£
Employment income (£75,000 + £0)	75,000
Property income (£14,500 + £32,000)	<u>46,500</u>
Total/net income	121,500
Less: personal allowance (see note below)	<u>(12,570)</u>
Taxable income	<u>108,930</u>

Income tax liability (W1)		
£108,930 x 20%		21,786
Add: pension contribution additional charge (W3)		
£13,770 x 20%	2,754	
<u>£7,230 x 40%</u>	<u>2,892</u>	<u>5,646</u>
<u>£21,000</u>		
Income tax liability		<u>27,432</u>

Payment of the pension contribution leads to a reduction of £12,900 (£40,332 - £27,432) in Pedro's income tax liability for 2023/24.

Personal allowance

The pension contributions which qualify for tax relief cannot exceed Pedro's relevant earnings for the tax year. Pedro's relevant earnings for 2023/24 are £89,500, (employment income of £75,000, plus income from furnished holiday lettings of £14,500). The whole of the £85,000 contribution is therefore eligible for tax relief.

Adjusted net income is £36,500 (£121,500 - £85,000), so there is no restriction of the personal allowance.

Workings:

1 Increase in basic rate band

The basic rate band threshold is increased to £122,700 (£37,700 + £85,000).

2 Annual allowance charge

	£
Contribution by Pedro (gross)	85,000
Contribution by Loule Ltd to occupational scheme	<u>8,000</u>
Total contributions 2023/24	93,000
Less: annual allowance available – 2023/24 (W3)	(40,000)
2022/23 (W4)	<u>(32,000)</u>
Annual allowance charge	<u>21,000</u>

3 Annual allowance available 2023/24

Threshold income	£
Net income	121,500
Less: pension contributions (gross)	<u>(85,000)</u>
Threshold income	<u>36,500</u>

As Pedro's threshold income does not exceed £200,000, the annual allowance for 2023/24 is not restricted. It is not necessary to calculate Pedro's adjusted income for the year.

4 Unused annual allowance brought forward

The annual allowance brought forward from 2022/23 is £32,000 (£40,000 - £8,000).

The annual allowance is not available to bring forward from 2020/21 or 2021/22 as Pedro was not a member of a pension scheme in these years.

Question 3 – Detailed Marking Guide:

	Available Marks	Maximum Marks
(a) Gift treated as a PET and impact of GWR	3	
Implications of gift with reservation	<u>3</u>	
	<u>6</u>	5
(b) Availability	1.5	
Actual days let	1.5	
Pattern of occupancy	2	
Furnished/Commercial basis/UK	<u>1</u>	
	<u>6</u>	5
(c) With pension contribution		
Total income	2	
Personal allowance note	2	
Tax calculation	1	
Annual allowance charge	4	
Tax on annual allowance charge	1	
Impact on tax liability	<u>0.5</u>	
	<u>10.5</u>	10
Professional skills marks (see below)		<u>5</u>
Total		<u>25</u>

Question 3 - Analysis of professional skills marks

Analysis and evaluation

- Appropriate use of relevant information to determine that there are two alternative charges to IHT in part (a)
- Demonstration of ability to consider the availability of the personal allowance in part (c)
- Adoption of a logical approach to prepare suitable calculations in part (c)

Commercial acumen

- Appropriate use of information in the question to identify gift with reservation in part (a)
- Effective application of the general rules to the specific facts of the scenario in part (b)
- Recognition of the relevance of the property portfolio in part (a)