Answers

1 (a)

		£
2005–06	(1 January 2006 to 5 April 2006)	
	25,200 x 3/6	12,600
2006–07	(1 January 2006 to 31 December 2006)	
	25,200 + 10,800 (21,600 x 6/12)	36,000
2007–08	(Year ended 30 June 2007)	21,600

(1) In 2006–07 there are overlap profits of £12,600 in respect of the three-month period 1 January 2006 to 5 April 2006.

(2) In 2007–08 there are overlap profits of £10,800 in respect of the six-month period 1 July 2006 to 31 December 2006.

Tutorial note: The assessment for 2006–07 is the first 12 months of trading as the accounting date falling in that year is less than 12 months from the commencement of trading.

(b) Na Style – Trading profit for the year ended 30 June 2008

	£	£
Net profit	22,000	
Depreciation	1,300	
Motor expenses (2,200 x 7,000/8,000)	1,925	
Accountancy	0	
Legal fees in connection with the grant of a new lease	1,260	
Property expenses (12,900 x 1/3)	4,300	
Own consumption	450	
Fine	400	
Donation to political party	80	
Trade subscription	0	
Private telephone (1,200 x 20%)		240
Capital allowances		810
	31,715	1,050
	(1,050)	
Trading profit	30,665	

Tutorial notes

(1) The cost of the grant of a new lease is not allowable.

(2) Goods for own consumption are valued at selling price.

(c) (i) Na Style – Income tax computation 2008–09

	£	£
Trading profit		30,665
Building society interest (560 x 100/80)		700
Interest from individual savings account (exempt)		–
Interest from savings certificate (exempt)		–
Interest from government stocks		370
Dividends (1,080 x 100/90)		1,200
		32,935
Personal allowance		(6,035)
Taxable income		26,900
Income tax		
25,700 (26,900 – 1,200) at 20%		5,140
1,200 at 10%		120
26,900		
Income tax liability		5,260
Tax suffered at source		
Building society interest (700 at 20%)	140	
Dividends (1,200 at 10%)	120	
		(260)
Income tax payable		5,000

(ii) Tax payments

(1) Na's balancing payment for 2008–09 due on 31 January 2010 is £1,800 (5,000 – 3,200).

(2) Her payments on account for 2009–10 will be £2,500 (5,000 x 50%). These will be due on 31 January and 31 July 2010.

(d) (1) Interest is charged where a balancing payment is paid late. This will run from 31 January 2010 to 31 May 2010.

(2) The interest charge will be £45 (1,800 x 7·5% x 4/12).

(3) In addition, a 5% surcharge of £90 (1,800 at 5%) will be imposed as the balancing payment is not made within 28 days of the due date.

2 (a) (i) (1) Companies that are incorporated overseas are only treated as being resident in the UK if their central management and control is exercised in the UK.

(2) Since the directors are UK based and hold their board meetings in the UK, this would indicate that Crash–Bash Ltd is managed and controlled from the UK, and therefore it is resident in the UK.

(ii) Crash–Bash Ltd – Corporation tax liability for the period ended 31 March 2009

		£	£
Trading profit			411,700
Advertising expenditure		12,840	
Capital allowances	– P & M (working 1)	53,910	
	– IBA (working 2)	4,950	
			(71,700)
			340,000
Overseas income (working 3)			20,000
Profits chargeable to corporation tax			360,000
Franked investment income (36,000 x 100/90)			40,000
Profit			400,000
Corporation tax (360,000 at 28%)			100,800
Marginal relief			
7/400 (562,500 – 400,000) x 360,000/400,000			(2,559)
			98,241
Double taxation relief			(5,458)
			92,783

Working 1 – Plant and machinery

	£	Pool £	Allowances £
Additions qualifying for AIA			
Machinery	62,500		
AIA – 100%	(37,500)		37,500
		25,000	
Proceeds – Machinery		(3,600)	
		21,400	
WDA – 20% x 9/12		(3,210)	3,210
Additions qualifying for FYA			
Motor car	13,200		
FYA 100%	(13,200)	–	13,200
WDV carried forward		18,190	
Total allowances			53,910

(1) The annual investment allowance is reduced to £37,500 (50,000 x 9/12) because Crash–Bash Ltd's accounting period is nine months long. The writing down allowance is similarly restricted to 9/12.

Working 2 – Industrial buildings allowance

(1) The cost of the land does not qualify, so the qualifying cost is £220,000 (320,000 – 100,000).

(2) The accounting period is nine months long, so the WDA is £4,950 (220,000 at 3% = 6,600 x 9/12).

Working 3 – Overseas income

	£
Net dividend	14,250
Withholding tax (14,250 x 5/95)	750
	15,000
Underlying tax (15,000 x 25/75)	5,000
Overseas income	20,000

(1) The accounting period is nine months long so the upper limit is reduced to £1,125,000 (1,500,000 x 9/12).

(2) This is then further reduced to £562,500 (1,125,000/2) as Crash–Bash Ltd has one associated company.

(3) The total overseas tax is £5,750 (750 + 5,000), but double taxation relief is restricted to the related UK corporation tax of £5,458 (98,241 x 20,000/360,000).

Tutorial notes

(1) The advertising expenditure incurred during June 2008 is pre-trading, and is treated as incurred on 1 July 2008. It is therefore deductible and an adjustment is required.

(2) Relief for underlying tax is given where a UK holding company owns at least 10% of an overseas company's voting power. The dividend from the overseas subsidiary must therefore be grossed up for both withholding tax and underlying tax.

(iii) (1) Invoicing for the exported crash helmets at less than the market price will reduce UK trading profits and hence UK corporation tax.

(2) A true market price will therefore have to be substituted for the transfer price.

(3) The true market price is the 'arms length' price that would be charged if the parties to the transaction were independent of each other.

(4) Crash–Bash Ltd will be required to make the adjustment in its corporation tax self-assessment tax return.

Tutorial note: Because Crash–Bash Ltd is not a small or medium sized enterprise there is no exemption from the transfer pricing rules.

(b) (i) (1) Traders must register for VAT if at any time they expect their taxable supplies for the following 30-day period to exceed £67,000.

(2) Crash–Bash Ltd realised that its taxable supplies for September 2008 were going to be at least £100,000. The company was therefore liable to register from 1 September 2008, being the start of the 30-day period.

(3) Crash–Bash Ltd had to notify HMRC by 30 September 2008, being the end of the 30-day period.

(ii) (1) Input VAT of £19,005 (108,600 x 17·5%) can be recovered on the stock of goods at 1 September 2008.

(2) The stock was not acquired more than three years prior to registration, nor was it sold or consumed prior to registration.

(3) Input VAT of £9,625 (22,300 + 32,700 = 55,000 x 17·5%) can be recovered on the services incurred from 1 July to 31 August 2008.

(4) This is because the services were not supplied more than six months prior to registration.

(5) The total input VAT recovery is therefore £28,630 (19,005 + 9,625).

(iii) (1) If the net errors totalled less than the higher of £10,000 or 1% of the turnover for the VAT period, then they could have been voluntarily disclosed by simply entering them on the VAT return for the quarter ended 28 February 2009.

(2) If the net errors exceeded the limit, they could have been voluntarily disclosed but disclosure would have been made separately to HMRC.

(3) Default interest would only have been charged where the limit was exceeded and it was therefore necessary to make separate disclosure to HMRC.

3 **(a)** **(i)** (1) Amanda has chargeable gains of £135,000 calculated as follows:

	£
Goodwill (90,000 – Nil)	90,000
Freehold shop (165,000 – 120,000)	45,000
	135,000

(2) The consideration from Ammoon Ltd is entirely in the form of shares, so all of Amanda's chargeable gains can be rolled over.

(3) The base cost of the 300,000 £1 ordinary shares will be £165,000 (300,000 – 135,000).

(ii) (1) The proportion of the gain relating to the consideration taken in the form of cash would not have been rolled over.

(2) Therefore £45,000 (135,000 x 100,000/300,000) of the gain would have still been chargeable to CGT during 2008–09.

(3) The cost of the 200,000 £1 ordinary shares in Ammoon Ltd is £200,000 (300,000 – 100,000), so the base cost will be £110,000 (200,000 – (135,000 – 45,000)).

(b) **(i)** (1) This is a gift, and therefore the market value of the shares sold is used. Bo therefore has a chargeable gain of £116,000 (210,000 – 94,000).

(2) Since no consideration has been paid for the shares, all of Bo's chargeable gain can be held over.

(3) The base cost of the son's 50,000 £1 ordinary shares in Botune Ltd will be £94,000 (210,000 – 116,000).

(ii) (1) The consideration paid for the shares will exceed the allowable cost by £66,000 (160,000 – 94,000). This amount will be immediately chargeable to CGT.

(2) The base cost of the son's 50,000 £1 ordinary shares in Botune Ltd will be £160,000 (210,000 – (116,000 – 66,000)).

(c) **(i)** (1) Charles' chargeable gain on the house is £64,500 calculated as follows:

	£
Disposal proceeds	282,000
Cost	(110,000)
	172,000
Principal private residence exemption	(107,500)
	64,500

(2) The total period of ownership of the house is 144 months (90 + 54), of which 90 months qualify for exemption as follows:

	Exempt months	Chargeable months
1 October 1996 to 31 March 1998 (occupied)	18	
1 April 1998 to 30 September 2005 (unoccupied)	36	54
1 October 2005 to 30 September 2008 (final 36 months)	36	
	90	54

(3) The principal private residence exemption is, therefore, £107,500 (172,000 x 90/144).

Tutorial note: The first 36 months of the unoccupied period is a period of deemed occupation (absence for any reason preceded and followed by a period of actual occupation), as is the whole of the period which falls within the final 36 months of ownership.

(ii) (1) The letting relief exemption will be £40,000, as this is lower than both £107,500 (the amount of the gain exempt under the principal private residence rules) and £64,500 (the amount of the non-exempt gain attributable to the period of letting (172,000 x 54/144)).

(2) Charles' chargeable gain will therefore be reduced to £24,500 (64,500 – 40,000).

4 **(a)** (1) Trading is indicated where the property (subject matter) does not yield an ongoing income or give personal enjoyment to its owner.

(2) The sale of property within a short time of its acquisition is an indication of trading.

(3) Trading is indicated by repeated transactions in the same subject matter.

(4) A trading motive is indicated where work is carried out to the property to make it more marketable, or where steps are taken to find purchasers.

(5) A forced sale to raise cash for an emergency is an indication that the transaction is not of a trading nature.

(6) If a transaction is undertaken with the motive of realising a profit, this is a strong indication of trading.

(b) **Simon House – Income tax and national insurance liabilities for 2008–09**

	£	£
Income		260,000
Cost of property	127,000	
Renovation costs	50,600	
Loan interest (150,000 x 6% x 4/12)	3,000	
Legal fees (1,800 + 2,600)	4,400	
		(185,000)
Trading profit		75,000
Personal allowance		(6,035)
Taxable income		68,965
Income tax 34,800 at 20%		6,960
34,165 at 40%		13,666
		20,626

Class 2 NIC for 2008–09 will be £41 (18 x 2·30).
Class 4 NIC for 2008–09 will be £3,118 ((40,040 – 5,435 = 34,605 at 8%) + (75,000 – 40,040 = 34,960 at 1%)).

(c) **Simon House – Capital gains tax liability for 2008–09**

	£	£
Proceeds		260,000
Cost	127,000	
Enhancement expenditure	50,600	
Loan interest	–	
Incidental costs (1,800 + 2,600)	4,400	
		(182,000)
		78,000
Annual exemption		(9,600)
		68,400
Capital gains tax 68,400 at 18%		12,312

Tutorial note: No relief is available for the interest on the loan used to finance the transaction.

5 **(a)** (1) The rate of corporation tax at which relief will be obtained, with preference being given to profits charged at the marginal rate of 29·75% or the full rate of 28%.

(2) The timing of the relief obtained, with a claim against total profits (under s.393A ICTA 1988) resulting in earlier relief than a claim (under s.393(1) ICTA 1988) against future trading profits.

(3) The extent to which relief for gift aid donations will be lost, since these cannot be carried forward.

(b)

	Period ended 31 December 2004	Year ended 31 December 2005	Year ended 31 December 2006	Period ended 30 September 2007
	£	£	£	£
Trading profit	44,000	–	95,200	78,700
Loss relief (s.393(1))	–	–	(8,700)	–
	44,000	–	86,500	78,700
Property business profit	9,400	6,600	6,500	–
Chargeable gains	5,100	–	–	9,700
	58,500	6,600	93,000	88,400
Loss relief (s.393A)	(58,500)	(6,600)	(23,250)	(88,400)
	–	–	69,750	–
Gift aid donations	–	–	(1,200)	–
Profits chargeable to corporation tax	–	–	68,550	–

(1) The trading loss of £73,800 for the year ended 31 December 2005 is relieved as follows:

	£
Loss	73,800
Year ended 31 December 2005	(6,600)
Period ended 31 December 2004	(58,500)
Year ended 31 December 2006	(8,700)
	–

(2) The trading loss of £146,800 for the year ended 30 September 2008 is relieved as follows:

	£
Loss	146,800
Period ended 30 September 2007	(88,400)
Year ended 31 December 2006	(23,250)
Unrelieved as at 31 December 2008	35,150

(3) For the year ended 31 December 2006 loss relief is restricted to £23,250 (93,000 x 3/12).

				Marks	
1	**(a)**	2005–06		1	
		2006–07	– Assessment	1½	
			– Overlap profits	1	
		2007–08	– Assessment	½	
			– Overlap profits	1	
					5
	(b)	Net profit		½	
		Depreciation		½	
		Motor expenses		1	
		Accountancy		½	
		Legal fees		½	
		Property expenses		1	
		Own consumption		1	
		Fine		½	
		Donation to political party		½	
		Trade subscription		½	
		Private telephone		1	
		Capital allowances		½	
					8
	(c)	**(i)**	**Income tax computation**		
			Trading profit	½	
			Building society interest	½	
			Individual savings account	½	
			Interest from savings certificate	½	
			Interest from government stocks	1	
			Dividends	½	
			Personal allowance	½	
			Income tax	1	
			Tax suffered at source	1	
					6
		(ii)	**Tax payments**		
			Balancing payment	1½	
			Payments on account	1½	
					3
	(d)	Interest		1	
		Calculation		1	
		Surcharge		1	
					3
					25

					Marks
2	**(a)**	**(i)**	Central management and control	1	
			Board meetings held in the UK	1	
					2
		(ii)	Trading profit	$^1/_2$	
			Advertising expenditure	1	
			P & M – AIA	$1^1/_2$	
			– Pool	$1^1/_2$	
			– FYA	1	
			IBA – Eligible expenditure	$^1/_2$	
			– Allowance	1	
			Overseas income	2	
			Franked investment income	1	
			Corporation tax	2	
			Double taxation relief	2	
					14
		(iii)	Reduction in UK corporation tax	1	
			Use of market price	1	
			Definition of market price	1	
			Adjustment under self assessment	1	
					4
	(b)	**(i)**	Registration limit	1	
			Taxable supplies for September 2008	1	
			Notification	1	
					3
		(ii)	Stock of goods – Calculation	$^1/_2$	
			– Explanation	1	
			Services – Calculation	1	
			– Explanation	1	
			Total input VAT recovery	$^1/_2$	
					4
		(iii)	Net errors less than the limit	1	
			Net errors exceeding the limit	1	
			Default interest	1	
					3
					30

				Marks	
3	(a)	(i)	Goodwill	1	
			Freehold shop	1	
			Gains rolled over	1	
			Base cost of shares	1	
					4
		(ii)	Gain chargeable – Explanation	1	
			– Calculation	1	
			Base cost of shares	1	
					3
	(b)	(i)	Chargeable gain	1	
			Gain held over	1	
			Base cost of shares	1	
					3
		(ii)	Gain chargeable	1	
			Base cost of shares	1	
					2
	(c)	(i)	Proceeds	$^1/_2$	
			Cost	$^1/_2$	
			Period of exemption	3	
			Principal private residence exemption	1	
					5
		(ii)	Letting relief exemption	2	
			Revised chargeable gain	1	
					3
					20

				Marks
4	(a)	The subject matter	1/2	
		Length of ownership	1/2	
		Frequency	1/2	
		Work done	1/2	
		Circumstances responsible for realisation	1/2	
		Motive	1/2	
				3
	(b)	Income	1/2	
		Cost of property	1/2	
		Renovation costs	1/2	
		Loan interest	1	
		Legal fees	1	
		Personal allowance	1/2	
		Income tax liability	1	
		Class 2 NIC	1 1/2	
		Class 4 NIC	1 1/2	
				8
	(c)	Proceeds	1/2	
		Cost	1/2	
		Enhancement expenditure	1/2	
		Incidental costs	1	
		Loan interest	1/2	
		Annual exemption	1/2	
		Capital gains tax	1/2	
				4
				15

5	(a)	Rate of corporation tax	1	
		Timing of relief	1	
		Impact on gift aid donations	1	
				3
	(b)	Trading profits	1/2	
		Property business profits	1/2	
		Chargeable gains	1/2	
		Loss relief – Year ended 31 December 2005	2	
		– Year ended 30 September 2008	2	
		Gift aid donations	1	
		Unrelieved trading losses	1/2	
				7
				10