Association of Taxation Technicians

Examination

November 2004

PAPER 1 – PART II

PERSONAL TAXATION

TIME ALLOWED - 3 HOURS
(for Part I and Part II)

You are required to answer **all** questions in Part I (printed separately) and any **three** out of five questions in Part II.

The maximum number of marks for each question in Part II is shown in brackets.
For Part II, start each answer on a fresh sheet.
All workings should be shown and made to the nearest month and pound unless the question requires otherwise.
Marks are specifically allocated for good presentation.

1. Clive Alderley is 55 and is managing director of Alderley Marketing Ltd (an unquoted, trading company). He owns 30% of the share capital of the company, having purchased the shares from his father.

During 2003/04 Clive received director's remuneration of £75,000 (tax deducted £36,950). The company makes up accounts to 31 December and for the year ended 31 December 2003 voted Clive a bonus of £50,000. The accounts were approved on 20 February 2004 and the bonus was paid to Clive (after deduction of Income Tax at 40%) on 30 April 2004.

Clive often entertains customers and is paid an allowance of £250 per month to cover expenses. During 2003/04 the actual cost incurred was £2,250.

Clive also uses his own car for business and during 2003/04 claimed business mileage of 15,000 miles. The company pays mileage at a flat rate of 30p per mile.

Clive and his family live in a house owned by the company, paying rent of £500 per month. The house was purchased in March 1985 for £200,000 and has a gross annual value of £4,000. Clive moved into the house in March 2000 at which time it was valued at £750,000. During 2003/04 the company paid the following expenses in connection with the accommodation:

	£
Council Tax	1,500
Water rates	500
Building insurance	1,000
Decoration	2,000
Gardener	2,500

Clive has a bank loan taken out to finance the purchase of the shares in the company. During 2003/04 he paid interest of £7,500 on this loan and he also paid a gift aid donation of £3,900 (net) to a registered charity.

Clive's only other source of income for 2003/04 was a dividend of £9,000 (net) paid by Alderley Marketing Ltd on 25 April 2003.

Assume that the official rate of interest is 5%.

You are required to:

1) **Show your computation of Clive's net assessable income and resulting tax repayment due for 2003/04.** (14)

2) **Explain the tax rules for assessment of the bonus for the year ended 31 December 2003.** (2)

3) **Briefly explain the type of documentary record to be provided in support of the different sources of income and expenses and how the relevant details are shown on Clive's self assesment tax return.** (4)

Total (20)

2. Jim and Dot have been married for 55 years and lived and worked on Honeybee Farm since January 1950 when the farm was inherited by Jim from his father with a value at the time of death of £50,000.

The farmhouse and land are now valued at £2,000,000. Jim and Dot wish to retire and pass the property and land to their son who already works on the farm. They have planning permission to build a house on a plot they own in the next village and are considering selling the farmhouse and land to their son for £400,000 and using the funds to build their new home. The value of the farmhouse excluding the farm land is £400,000, and a friend has suggested that they will save tax if they sell the farmhouse and gift the land.

They are concerned about the Capital Gains Tax and Inheritance Tax implications of the proposed transactions and have asked for your advice.

You are required to draft a letter to Jim and Dot explaining:

1) The Capital Gains Tax implications; and (12)

2) The Inheritance Tax implications (8)

of the proposed transactions. You should state any further information which would be required and any assumptions you make in giving the advice.

Total (20)

3. Stewart Anderson is managing director of Anderson Sweets Ltd and has been advised by the Inland Revenue that a PAYE inspection is to take place next month.

He has asked you to review the recent accounts and cashbook and you have noticed the following:

Mileage payments to all employees at 50p per mile; these payment are made to cover the excess cost of travel to the company's factory which is 10 miles away from its original site. The company moved sites five years ago but has continued to make the payments to encourage staff retention. Staff are also paid mileage for business travel but there is no checking of the claims made.

Stewart regularly runs short of funds to cover his personal credit card and so has the company pay the bill in full. He also takes lump sums out in advance of his salary. At present his current account with the company is overdrawn by £10,000.

The company reimburses employees' mobile phone bills. It finds it easier for each employee to subscribe for their own mobile phone and the company pays the bill (which will include private calls) in full each month.

There have been three staff parties during the year, the first cost £50 per head, the second £80 per head and the third was £40 per head.

The company has 30 employees.

Stewart has asked you to write to him highlighting any areas for concern and explaining the correct procedures which should be followed in the future and the consequences of the errors being noticed during the PAYE inspection.

You are required to draft a letter to Stewart explaining:

1) The correct PAYE treament of each of the above items. (14)

2) The likely outcome of the PAYE inspection. (6)

Total (20)

4. Rachel Glover (age 54) owns four properties which have been let furnished for several years. Seaview is let on a five year tenant repairing lease, Hilltop and Daleview are let on six monthly landlord repairing leases. She lets Sunnyside as furnished holiday accommodation.

Rachel has provided you with the following information in connection with 2003/04.

	Seaview	Hilltop	Daleview	Sunnyside
	£	£	£	£
Rental receipts (note 1)	6,000	7,150	3,205	13,500
Expenditure:				
Agent's fees (note 2)		780	225	4,500
Building insurance	200	225	250	375
Water & electricity				700
Gardener		200	200	200
Council tax				450
Builder's charges (note 3)	1,000	2,000	1,500	9,500
Furniture & equipment (note 4)		400	900	650
Mortgage interest (note 5)	3,500	3,700	2,000	5,000

1) Rent in respect of Seaview, Hilltop and Daleview is received monthly in advance. The rental income from Sunnyside includes £1,000 received as deposit for next summer's season. The amount received as deposit prior to 5 April 2003 for 2003/04 holiday lets was £750.

   The monthly rental for Hilltop has been £650 since March 2003.There was a change of tenant at Hilltop on 25 March 2004. The incoming tenant paid two months' rent in advance, one month's rent being held as a deposit. The outgoing tenant was in arrears and had not paid the rent due on 25 January and 25 February 2004, although they had paid a month's rent as deposit when taking the lease in March 2003. Rachel is taking action to recover the unpaid rent but it is unlikely that she will succeed.

   For the six months to 30 September 2003, Daleview was let at a full commercial rent of £375 per month. From 1 October 2003 it was let to Rachel's grandmother at a rent of £190 per month.

2) The agent's fees for Daleview relate to the period of commercial letting only.

3) The builder's charges were in respect of the following:

   Seaview - £1,000 for repairs to the roof due to storm damage not covered by the tenant's obligations under the lease.

   Hilltop - £2,000 for re-fitting of bathroom.

   Daleview - £1,500 for a new boiler fitted in January 2004.

   Sunnyside - £5,000 for building a new conservatory onto the back of the house, £2,500 for redecoration, and £2,000 for laying a concrete parking space at the front of the house to replace the original worn gravel drive.

4) The furniture and equipment purchased were as follows:
   Hilltop - £400 for a new carpet.
   Daleview - £900 for a new bed and sofa purchased in November 2003.
   Sunnyside - £650 for conservatory furniture.

   Wear and tear allowance has previously been claimed where applicable.
   The capital allowances pool for Sunnyside at 6 April 2003 was £2,400.

(Continued)

4. (Continuation)

5) All mortgages are interest only. The mortgage outstanding on Sunnyside is £100,000. The original mortgage taken out to purchase the property in 2000 was for £75,000, but an additional £25,000 was taken out on a re-mortgage in 2002 to provide the deposit for the purchase of Hilltop.

6) In January 2004 Rachel paid your accountancy fees for the previous year of £360. Your estimate of the fees for 2003/04 is £400.

Rachel's only other source of income for 2003/04 was from her employment. She earned £35,000 and tax deducted was £6,450.

You are required to:

1) **Show the computation of the rental income/losses for the four properties. You should indicate the reason for adjusting any item of income or expenditure.** (14)

2) **Show your computation of the tax payable (repayable) for 2003/04 and explain the basis for any loss relief shown.** (6)

Total (20)

5. Martin Heal (aged 59) has been a client for several years during which time you have prepared his self assessment tax returns. He provided you with details of his income from employment for 2003/04 of £49,615 (tax deducted £12,275) and the tax return for 2003/04 was prepared and submitted on 5 July 2004.

Last week you had lunch with Martin and during your discussions he mentioned the following:

1) In January 2004 he gave 5,000 shares in a quoted UK company to a registered charity. They were valued at £5 per share at the date of gift and had been purchased at £3 per share in June 2003.

2) In March 2004 Martin sold 10,000 shares in Wonder Fabrications Ltd, an unquoted trading company at 20p per share. He had subscribed for the shares in October 1996 at £2 per share.

3) During February 2004 Martin sold 7,000 shares in BetterBuild Ltd, an unquoted UK trading company for £70,000. He had purchased the shares in January 2002 for £20,000.

Martin had failed to mention the capital transactions to you as he thought there would be no Capital Gains Tax liability and therefore no need to show the details on the tax return.

You explained to Martin that all transactions must be considered and undertook to write to him explaining the Income Tax and Capital Gains Tax position for 2003/04 and what actions, if any, need to be taken.

You are required to draft a letter to Martin explaining:

1) The basis for calculating the Income Tax and Capital Gains Tax position in respect of each transaction showing your calculations where appropriate.
(16)

2) The rules regarding omissions from tax returns and correcting the position.
(4)

Total (20)