Association of Taxation Technicians

Examination

May 2005

PAPER 1 – Personal Taxation

Suggested Solutions

Parts I and II

PART I – SUGGESTED SOLUTIONS

1.

State pension	4,500	
Private pension	8,000	
PA	6,950	
	5,550	
Tax:		
2,020	@ 10%	202
3,530	@ 22%	777
MCA - 5,795	@10%	(579)
		£400

2.

Interest		4,000
Dividend		2,000
PA		(4,745)
		1,255
Tax @ 10%		125
Tax deducted Interest	800	
Tax credit dividend	200	1,000
Repay (restricted)		£800

3.

Class 1A - 19 July 2005
P11D - 6 July 2005

4.

Earnings		41,745
PA		4,745
		37,000
2,020	@10%	202
32,400 - 2,020	@22%	6,684
4,600	@40%	1,840
Tax deducted:		
PAYE		8,906
		£180

Or
Gift Aid 780x100/78 = 1,000
Saving 40 – 22 = 18% £180

5.

Pension £20,000 less 10%		18,000	
PA		(4,745)	
		£13,255	
2,020	@10%	202	
11,235	@22%	2,472	
Tax deducted:			
Foreign (restricted)		2,674	
		£-	

6.

Claim for tax credit - 5 July 2004
Renewal notice - 30 September 2005

7.

31.7.05 – payment on account 2004/05 –		
Liability	7,000	
Less carry back premium tax relief		(1,800)
Amended tax	5,200	
POA paid 31.1.05	7,000	
	£12,200	
31.1.06		
2004/05 balance (12,700-12,200)		500
2005/06 POA ½ x £14,500	£7,250	
	£7,750	

8.

Income		35,745
PA		4,745
		£31,000
Tax		
2,020 @ 10%		202
28,980 @ 22%		6,376
Topslice:		
6,000 / 10 = 600		
400 @ 20%	80	
200 @ 40%	80	
	160 x 10	1,600
		£8,178

9.

	Mary	Margaret
Share of rent	1,400	2,800
Rent-a room	(2,125)	(2,125)
	£ nil	£675

10.

May – 20 x 2 x 10 x .40 = £160

June– 10 x 2 x 10 x .40 = £80

11.

5.7.04	10,000		
5.4.05	6,000		
	16,000	x ½ = 8,000 @ 5% x 9/12 =	£300
5.7.04 to 5.1.05	10,000 @ 5% x 6/12		250
6.1.05 to 5.4.05	6,000 @ 5% x 3/12		75
			£325

12.

Proceeds		250,000
Cost	50,000	
Extension	50,000	
		100,000
		150,000
Taper relief 75%		112,500
Chargeable		£37,500

13.

Gain	25,000
Losses	5,000
	20,000
Taper relief 75%	15,000
	£5,000

14.

Proceeds		90,000
Cost	$360{,}000 \times \frac{90{,}000}{90{,}000 + 450{,}000}$	60,000
		£30,000

15.

Proceeds	7,500	
Less:	6,000	
	1,500	x 5/3 = £2,500

16.

2004/05	
Gain	15,000
Losses	15,000
	nil
2003/04	
Gain	15,000
Losses	7,100
	7,900
Annual exemption	(7,900)
Losses unused	25,000
2004/05	(15,000)
2003/04	(7,100)
	£2,900

17.

Proceeds		150,000
Cost	100,000	
Gain held over	80,000	
		20,000
		£130,000
Chargeable after taper relief 50%		£65,000

18.

Gift to daughter		10,000
AE 03/04	3,000	
AE 04/05	3,000	
		6,000
		£4,000

Small gift exemption for gifts to grandchildren

19.

Before gift (40% + 20%)	300,000	x 40/60	200,000
After gift (20% + 20%)	180,000	x 20/40	90,000
Reduction in estate			£110,000

20.

Due date for Lifetime transfer 30 April 2005
Extra tax due on death 31 July 2005

PART II – SUGGESTED SOLUTIONS

Question 1

Ben Thompson

Salary –				75,000
Car benefit				
25,000 @ 19%		4,750		
Fuel 14,400 @19%		2,736		
Car for wife				
7,500 @ 15% = 1,125 x ½		562		
Medical insurance		1,200		

For not including son's medical costs and wife's fuel

Trip (note 1)		1,125		
Removal costs (note 2)		9,550		19,923
Rental income (note 3)				2,650
Dividends		2,000		
Bank interest		4,000		
Accrued income		400		
				6,400
				103,973
Loss on unquoted shares				(20,000)
				83,973
Personal allowance				(4,745)
				79,228
Income tax	2,020		@ 10%	202
	29,380		@ 22%	6,464
	45,828		@40%	18,331
Dividends	2,000		@ 32.5%	650
				£25,647

Note 1

Trip to Florida

Wife's flight		1,000
Hotel charge	100	
Single charge	75	
Extra re wife	25	
	x 5	125
		£1,125

Note 2

Removal expenses

Agents fees	4,500
Removal costs	750
Stamp duty	10,500
Legal fees	1,800
	17,550
Less allowed	8,000
Assessable	£9,550

Note 3

Rental income

Rent		20,000
Caretaker	2,600	
Heat & Light	1,400	
Interest	7,000	
Wear & tear 10% £20,000	2,000	
	13,000	
PU 4/52	1,000	
	12,000	
travel 3 x 900	2,700	
		14,700
		5,300x ½ = £2,650

Question 2

Knowitall & Co
10 London Road
Newtown
Nearshire

Mr & Mrs Fisher
56 Lower Street
Middleton
Wayshire

May 2005

Dear Susan and Carl

Letter to include following:

Rental of house owned by Susan and Carl -

1. Rental income based on rents accrued less expenses which include rates, insurance, property maintenance, agents letting fees, professional fess

2. If let furnished a claim can be made for renewal of furniture or an annual wear & tear allowance of 10% of gross rents less any payments which are landlord's obligation

3. Improvements to property not allowed against rental income – can be added to cost of property on disposal

4. Interest on loan to purchase property allowed.

5. Will need to apportion income and expenses if rent paid by son less than market rate

6. Rental income classed as investment income – not earned income – so NIC not due -rental income will be taxed as non-savings income – tax due 31 January and 31 July unless less than £2,000 and collected through PAYE coding

Rental of house owned by son -

7. No relief for mortgage interest

8. Son can claim rent-a-room relief if letting out rooms in his own house – gross rental income of up to £4,250 pa exempt

Capital gain on house owned by Susan and Carl

9. CGT due on a gain on disposal or deemed disposal of chargeable asset

10. Gain calculated as proceeds less acquisition cost and taper relief

11. Costs include cost of improvements to property, agents, fees and legal fess of buying & selling

12. Annual exemption of £8,200 deducted from chargeable gain, balance taxed as highest part of income – 20% and/or 40%

Capital gain on house owned by Son

13. Principal Private Residence Relief available – must occupy house for period during ownership

14. PPR is for period of occupation and last three years of ownership

15. The full gain is calculated and then apportioned on basis of qualifying periods to calculate PPR

16. No restriction to PPR if rent-a-room applies

Inheritance Tax

17. IHT charged on reduction in value of estate therefore will only apply if they give son funds to purchase house and are not repaid.

18. Related property rules means assets held by ‘related parties’ (eg husband and wife) are added together for purposes of valuation

19. PET potentially exempt transfers - exempt if death after 7 years

20. Annual exemptions - £3,000 each for each year, can carry forward unused exemption one year.

Yours sincerely

A KNOWITALL

Question 3

Knowitall & Co
10 London Road
Newtown
Nearshire

Sharon Johnson
64 Wytton Way
Button
Wayshire

May 2005

Dear Sharon

Letter to include following:

1. No income tax on difference between cost and market value of shares when option exercised if exercise of option is after five year period for approved SAYE scheme

2. Capital gains tax on difference between cost and disposal proceeds when shares sold.

3. Taper relief available from date option exercised (i.e. date of acquisition of shares).

4. Capital gains tax for Sharon will be £200,000 less £8,200 = £191,800 @ 40% = £76,720 due 31 January 2007

5. Can invest up to £200,000 by subscribing for ‘qualifying’ shares under the enterprise investment scheme and get income tax relief at 20% (i.e. maximum of £40,000)

6. Relief is given in tax year in which shares purchased, but one-half of amount subscribed before 6 October can be carried back for relief in previous tax year.

7. Shares must be held for minimum of three years or income tax relief clawed back.

8. Can defer gain on shares from share option exercise against subscription for EIS shares within one year before and three years after disposal

9. Gain on EIS shares exempt from CGT if held for three years although deferred gain becomes chargeable.

10. Claim for income tax relief cannot be made until a certificate has been received from the company. Overall time limit is five years from 31 January following tax year in which shares were issued

11. Income tax relief can also be obtained on investment up to £200,000 when subscribing for new ordinary shares in Venture Capital Trust (minimum £500)

12. Income tax relief is 40% for shares issued in 2004/05 and 2005/06.

13. Dividends from ordinary shares in VCT are exempt from tax (provided shares acquired were not more than £200,000 in year)

14. Cannot defer gain on shares from share option exercise against VCT shares if they are issued after 6 April 2004.

15. Gain on disposal of VCT shares subscribed for up to limit of £200,000 per year are exempt from CGT

16. No minimum period VCT shares to be held for gain to be exempt

17. If any disposal of EIS shares within three years income tax relief is withdrawn so claw back of up to £40,000 (assuming maximum invested) depending on amount disposed – disposal after three years – no income tax clawback so saving over period £40,000

18. If disposal within three years CGT on deferred gain and any gain on EIS shares – if after three years gain on EIS shares exempt – deferred gain chargeable unless re-invested in further EIS of VCT shares – potential CGT if no re-investment £80,000 (£200,000 @ 40%)

19. If any disposal of VCT shares within three years income tax relief is withdrawn so claw back of up to £80,000 (assuming maximum invested) depending on amount disposed – disposal after three years – no income tax clawback so saving over period £80,000

20. VCT shares exempt from CGT – no minimum period – but no deferred gain so original gain chargeable £80,000 (£200,000 @ 40%) for year of disposal although covered by income tax saving on VCT investment

Yours sincerely

A KNOWITALL

Question 4

Knowitall & Co
10 London Road
Newtown
Nearshire

Mr & Mrs J Field
134 Long Avenue
Highfield
Layshire

May 2005

Dear Lynn and Joe

Letter to include following

1. IHT charged on reduction in value of estate – not on market value of gift.

2. Husband and wife have separate estates and there is a nil band each for Joe and Lynn whether or not they remain married.

3. Related property rules means assets held by 'related parties' (e.g. husband and wife) are added together for purposes of valuation. After divorce this does not apply

4. PET potentially exempt transfers - exempt if death after 7 years

5. Transfers between husband and wife exempt – equalise estates – after divorce - spouse exemption and related parties valuation rules no longer applies.

6. Reservation of benefit – if Lynn wishes to live in house owned by husband and receive dividends from shares – the 'ownership' cannot be transferred to the children for IHT purposes

7. Gifts in previous seven years added to value of estate on death so any gifts made now may be included in their estate if they die within seven years.

8. IHT charged at 40% on the balance of the estate over £263,000

9. Annual exemptions - £3,000 each for each year, can carry forward unused exemption one year.

10. Although if Lynn and Joe divorce, they can no longer rely on transfers being exempt as between spouses, they may be exempt if a transfer of property is made either on divorce or later as a variation of the terms for the maintenance of the other party.

11. Gifts in consideration of marriage – children, grandchildren and others – both Lynn and Joe can make gifts to their children of £5,000 each or grandchildren of £2,500 each

12. Small gifts – any gift over £250 is fully chargeable

13. Business property relief due on the shares if owned for more than two years.

14. To obtain BPR asset must be still be owned by donee at time of death of donor if death is within seven years of gift

15. If donee has sold shares during that time, BPR still available if proceeds re-invested into other business property

16. Taper relief available for tax due on gifts within seven years of death if donor survives more than three years from date of gift

17. Other exempt transfers are gifts to charities and political parties, and a gift/transfer which is normal expenditure out of income

18. To minimise IHT Joe and Lynn should equalise estates and give assets not required to maintain current life style

19. Consider gifts direct to grandchildren if children wealthy

20. Consider gifts out of income – habitual, must leave enough income to maintain standard of living.

Yours sincerely

A KNOWITALL

Question 5

QRC plc shares

Pre 98 shares

	No	Cost	Indexed cost
5.4.90	10,000	40,000	40,000
5.4.98 $\frac{162.6 - 125.1}{125.1}$ =0.29976			11,990
Rights	5,000	10,000	10,000
	15,000	50,000	61,990

Taper – non-business asset – 75% chargeable

Post 98 shares

1.1.03	10,000	30,000
Rights	5,000	10,000
	15,000	40,000

Taper – non-business asset – 100% chargeable

Disposal - September 2004 – Identified with post 98 holding first

Post 98 holding 15,000 @ £5	75,000
Cost	40,000
	35,000
Pre 98 holding 5,000 @ £5	25,000
Indexed cost 61,990 x 5,000/15,000	20,663
	4,337

Taper – non- business asset – 75% chargeable

Father's gifted shares

Proceeds		300,000
Cost (MV of gift)	60,000	
Gain held over	59,000	
		1,000
		299,000

Taper – business asset – 50% chargeable

Suggested answer 5 continued

Vintage Car – exempt

Insurance proceeds

Proceeds	not reinvested		5,000
Cost	30,000 x 5,000 / 5,000 +50,000	2,727	
Cost	10,000 x 5,000 / 5,000 +50,000	909	
			3,636
			£1,364

Taper – non- business asset – 90% chargeable

Summary

	50%	25%	10%	nil	Total
QRC plc		4,337		35,000	
Father's gifted shares	299,000				
Insurance proceeds			1,364		
2003-04 gain				10,000	
Losses			(3,636)	(1,364)	(45,000)
	299,000	701			
Taper 50/25%	149,500	(175)			
	149,500	526			150,026
Annual exemption					(8,200)
					141,826

Tax Calculation:

16,145 @ 20%	3,229
125,681 @ 40%	50,272
Tax payable	£53,501

Note:

Basic rate		31,400
Income	20,000	
PA	4,745	15,255
20%		16,145