Association of Taxation Technicians

Examination

November 2005

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. Daniel Radhill is 40 and Sales Manager for a multi-national company.

For the year 2004/05 he earned a salary of £45,000 from which tax of £13,390 was deducted.

He lives in a house purchased by his employer for £350,000 in 2002, the annual value of which is £3,500. The house was furnished by the company at a cost of £7,500 and Daniel pays his employer rent of £1,000 per month.

On 6 October his employer provided him with an interest free loan of £10,000. At 5 April 2005 the balance outstanding on the loan was £8,000.

In April 2004, Daniel had inherited a house on the death of his grandfather and decided to let it as furnished holiday accommodation. The property was in very poor condition and required work to make it habitable. The income and expenses passing through the bank account opened for the property for 2004/05 were:

	£
Rent received	18,000
Land registry fees on transfer	100
Re-wiring and structural repairs	2,500
Water rates	600
Agents booking fees	1,800
Cleaner	1,260

He has decided to claim wear and tear allowance.

In March 2005 Daniel received interest of £2,500 on an offshore bank account. During 2004/05 he also received UK dividend income of £450 (net).

Daniel's employer does not provide a pension scheme so Daniel pays an annual premium of £4,680 (net) into a personal pension scheme. He also has £100 a month deducted from his salary by his employer under an approved share incentive plan. In December 2004 he made a payment of £780 to a registered charity under gift aid.

His notice of coding for 2004/05 included an adjustment for £500 underpaid tax from a previous year.

Assume that the official rate of interest for 2004/05 is 5%.

You are required to show:

1) **Your computation of Daniel's net assessable income and tax chargeable for 2004/05.** (16)

2) **The payment due on 31 January 2006 assuming no adjustment is made to the notice of coding to collect any under payment.** (2)

3) **The criteria for adjusting the coding for 2005/06 in respect of any balance due for 2004/05.** (2)

Total (20)

2. Christopher Kirk is 58 and has just been made redundant by his employer. He received an ex-gratia payment of £75,000 which was paid after he left employment and therefore had basic rate tax deducted from the balance over £30,000, and will be receiving an annual pension from his former employer of £35,000. He has decided to use the ex-gratia lump sum as a deposit on a house to be rented out to give another source of income. He will obtain a buy-to-let mortgage to fund the balance.

His accountant (who also acts for his employer) has told him that there is no need to tell the Inland Revenue about the ex-gratia money as it already has tax deducted. He has also said that the rental property can be ignored as the mortgage repayments will be more than the rent received. The mortgage is a normal repayment mortgage so the payments will include both interest and capital.

He is not happy with the advice given by his former accountant and has therefore decided to appoint you to act for him. He is concerned that there may be further tax to pay on the ex-gratia payment and is worried that the accountant has not given the correct advice. He knows that under the terms of his contract of employment he was to receive six months salary (£30,000) if dismissed without notice.

As you will shortly be going on holiday and may not have time to deal with his affairs before you go, you have decided to draft a detailed file note setting out the action needed which can be passed to your junior to deal with in your absence.

You are required to draft a memo explaining:

1) The actions to be taken on taking on a new client. (8)

2) The reporting liabilities regarding the ex-gratia receipt and rental income. (8)

3) The income tax consequences of the ex-gratia receipt and rental income. (4)

Total (20)

3. Darren Richards is International Marketing Director of Ruston Green plc earning £100,000 per annum. He is due to leave the UK in November 2005 to set up and run a new subsidiary company based in Hong Kong. The appointment will be for at least five years, and if successful, may lead to a transfer to a European country.

Although his employer will pay for his travel expenses of leaving the UK and that of his wife and family, they will not pay for the expenses of visiting the UK for holidays to see friends and family.

His wife and children will follow next year once he is settled and has found suitable accommodation. They are considering whether they should sell their home or rent it as residential accommodation. They may sell the house in a few years' time if they do not return to the UK or if they relocate to a different part of the country.

He has asked you to explain his liability to UK taxation under the above circumstances.

You are required to draft a letter to Darren explaining:

1) The liability to Income Tax on employment and rental income for the year of departure and following years of absence. (4)

2) The tax relief available for travel expenses. (4)

3) The basis of calculating rental income. (7)

4) The potential Capital Gains Tax liability on the disposal of the house. (5)

Total (20)

4. Mark Knapton is 55 and married to Janine, 53. He earns £65,000 from employment and Janine earns £12,500. They have provided you with the following information in connection with their 2004/05 tax returns:

1) A jointly owned house which was purchased in March 2002 for £185,000, was sold in October 2004 for £310,000. It was let as residential accommodation throughout the period to a local trading company which used it as accommodation for employees relocating to the area. Mark and Janine have never lived in the property.

2) In May 2004 Mark exercised share options on 3,000 shares in his employer company at £4.50 per share. In June 2004 when they were £5.00 per share, he transferred 1,500 shares to his wife, and in November 2004 both share holdings were sold for £6 per share.

3) On 5 September 2004 Janine sold a flat inherited from her mother in March 1980 at a probate value of £50,000 to her son for £100,000. Its open market value at 31 March 1982 was £75,000 and at 5 September 2004 was £225,000. Janine has let the property throughout her period of ownership.

4) In October 2004 Mark sold 50,000 shares in a company qualifying as a venture capital trust for £100,000 which he had subscribed for in May 2003 at £1.50 per share and claimed income tax relief.

5) In December 2004, Mark was advised that the Inland Revenue had agreed that shares in Longbridge Ltd, an unquoted trading company which had gone into liquidation, were of negligible value. Mark had subscribed for 20,000 shares at £1 per share in May 2000.

Mark and Janine have asked you to calculate their Income Tax and Capital Gains Tax liabilities for 2004/05 and to suggest any claims which may be made to reduce the overall liability. Mark has also asked for advice on the taxation consequences of the sale of the shares in the company qualifying as a venture capital trust.

You are required to:

1) Explain the taxation consequences of the sale of the shares in the company qualifying as a venture capital trust. (3)

2) Explain any claims which may be made in respect of the shares in Longbridge Ltd. (1)

3) Show your computation of Mark and Janine's net assessable income, net chargeable gains and resulting Income Tax and Capital Gains Tax liabilities for 2004/05. (16)

Total (20)

5. Heather and Guy are both 61 and have lived together for 25 years. They are each 50% shareholders in a very successful family trading company which has been valued at around £1 million. They have a child each from their previous relationships and a child together. At some time in the future, they wish to pass their business onto the children in equal shares.

They each own a house; Guy's is the larger and the one in which they have lived. Heather's has been rented out as residential accommodation since they started living together but was her main residence for ten years prior to that.

They have been considering their affairs and are wondering whether getting married will be beneficial from a taxation point of view.

They know very little about Inheritance Tax and Capital Gains Tax and are concerned that marriage may increase any potential charge on any disposal. They have made wills leaving their respective estates to each other, and then on the second death to their children, but wondered whether being married would affect the potential Capital Gains Tax and Inheritance Tax liabilities on gifting any assets to their children during their lifetime to take advantage of PETS and on their deaths. They have asked you to explain to them the difference being married is likely to make to any potential future liability.

You are required to draft a letter to Heather and Guy explaining:

1) The basis of charge to Inheritance Tax and Capital Gains Tax. (9)

2) Any available relief to which they may be entitled. (7)

3) Ways to mitigate the potential future liability on their estates on death. (4)

Total (20)