Association of Taxation Technicians

Examination

May 2006

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 new sheet of paper.
- 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. Richard Williams is 56 and a full-time working director of RWA Ltd.

In June 2005, he and two colleagues subscribed for a third each of the share capital of the company which was formed on 20 June 2005. Richard borrowed £100,000 from his bank to finance the purchase of his shares and was charged interest of £5,000 on the loan during 2005/06.

Richard was appointed director on 1 July 2005 and earns £5,000 per month. The company awards bonuses half yearly and in January 2006 Richard was voted a bonus of £10,000 for the six months to 31 December 2005. This was paid to him in March 2006. His bonus for the half year to 30 June 2006 is estimated to be £12,000 but is subject to approval at the board's meeting in July 2006. Tax deducted under PAYE for 2005/06 was £18,000.

As part of his remuneration package, the company provides Richard with a car for both business and private use. The car had a list price of £30,000 when first provided on 6 July 2005 and has emissions of 240g/km (petrol). All fuel used by Richard is paid for by the company on a company charge card. The company also provides a car for use by his daughter who works in the office as a receptionist. All other employees on the same grade are not provided with a car. The car had a list price of £7,500 on 6 September 2005 when first provided and emissions of 140g/km (petrol). Richard's daughter pays for all fuel personally.

The company has a pension scheme and Richard contributes 5% of his salary and bonuses into the scheme. The company contributes an additional 3%.

During August 2005, Richard visited Paris on a business trip for three days and, as he was accompanied by his wife who had come for a holiday, stayed on for another three days with his wife. The cost of the train to Paris was £120 each return and the hotel room was £75 each per night. The room had been booked for three nights for the business trip and Richard extended the booking for a further three nights for the holiday. The hotel bill and train fares were paid for by the company.

Richard had been suddenly made redundant by his previous employer in April 2005. He received no salary for that month but was given an ex-gratia redundancy payment of £28,000 and an outstanding interest-free loan of £4,500 by the employer to Richard was written off as part of the redundancy package. His former employer suffered financial problems and was placed into liquidation in December 2005. Richard had subscribed for shares in that company (which was an unquoted trading company) in 2004 at a cost of £10,000. As there will be nothing returned to the shareholders on completion of the liquidation, HM Revenue & Customs have agreed they are of negligible value.

Richard received a dividend of £13,500 from RWA Ltd in March 2006.

In March he also received £12,000 proceeds from a UK non-qualifying life assurance policy. He has been advised that the gain on the chargeable event is £4,000 and the number of policy years is four.

Richard and his wife jointly own a shop unit which is let at a quarterly rental of £5,000 due each quarter in advance. The tenant left in December 2005 without giving a quarter's notice due under the lease and without paying the rental due on 25 December. In view of this, the deposit of £5,000 held by the agents was paid to Richard in lieu of the outstanding rent. They also paid the following expenses during 2005/06 in connection with the property:

(Continued)

1. *(Continuation)*

	£
Agents fees	2,000
Building insurance	500
Loan interest	4,000
Small extension to create new kitchen	7,500

You are required to:

1) **Show your computation of Richard's net assessable income and tax chargeable for 2005/06.** (15)

2) **Show the balance of tax payable for 2005/06, the due date for payment and the amount (if any) of the payments on account due for 2006/07.** (3)

3) **Explain whether or not the balance of tax payable can be collected through the notice of coding for 2006/07.** (2)

Total (20)

2. Michael Smith is a client for whom you have been acting for three years. He is a highly paid corporate executive who earns £200,000 per annum and has a large investment portfolio.

You have just received a letter from HM Revenue & Customs stating that they are opening an enquiry into his 2004/05 tax return and requesting copies of all supporting documentation. He has sent to you all the documents requested which include several different bank accounts. You have noticed that there are funds transferred from one account to an account held overseas and have queried this with him. His reply is that he has had this account for ten years and received around £1,000 interest each year on the money deposited. He thought that as the account was overseas it was not subject to UK taxation. Michael is UK domiciled and has always been UK resident.

Michael appears to want to ignore the overseas income and has no understanding of the procedures and consequences of an enquiry. You have discussed the matter with the senior partner in your firm and are now drafting a letter to Michael explaining the position together with a covering note to the senior partner explaining any matters not covered in the letter

You are required to draft a letter to Michael and a brief covering note to the senior partner explaining:

1) **Your responsibility as Michael's tax adviser.** (4)

2) **The enquiry procedures, including appeal to the commissioners.** (11)

3) **The likely charge to interest and penalties and any mitigation possible.** (5)

Total (20)

3. Dennis and Sarah are separating and will be seeking a divorce.

Dennis runs the family business which is jointly owned by both of them. They also jointly own the house in which they are currently both living and another property which has been let as residential accommodation. The tenants are leaving next month and Dennis will be moving into that house to live permanently.

They are considering an appropriate split of assets and have given you the following estimates:

Value of business - £300,000 – gain accrued £250,000
Value of main house - £450,000 – gain accrued £250,000
Value of rented house - £225,000 – gain accrued £125,000

They have two children aged five and seven who are looked after by a registered childminder after school and in the holidays. Their joint income at present is £75,000 but after the divorce it is likely that Sarah will receive £25,000 as maintenance for the children and will work full-time earning £20,000.

They are both worried about the Capital Gains Tax consequences of the split of the assets on divorce and are considering continuing to own the assets jointly until they decide to sell in the open market. They would make joint wills leaving the assets to each other in the event of the death of either to ensure a forced sale is not necessary.

Sarah has also asked whether she will be due any child tax credit once they are separated.

You are required to draft a letter to Dennis and Sarah explaining:

1) **The Income Tax consequences on separation and subsequent divorce.** (2)

2) **The Capital Gains Tax consequences on separation and subsequent divorce.** (11)

3) **The Inheritance Tax consequences on separation and subsequent divorce.** (5)

4) **Sarah's entitlement to child tax credit on separation and subsequent divorce.** (2)

Total (20)

4. Eva is French and has lived all her life in Paris. She is now 55 and has met John who is resident and domiciled in the UK. She has decided to move to London to live with him but will retain her flat in Paris and rent it to tourists. She will also retain her French bank accounts into which her French pension and investment income is paid.

She has inherited some money from her parents and is considering buying a property in the UK which she may either live in or rent as residential accommodation. Eva and John are considering their future; they do not want to get married as they both have adult children from their first marriages and want their children to inherit their own estates. Eva is concerned that she will be liable to taxation in the UK on her worldwide assets and has asked you to write to her explaining her position.

You should ignore double taxation relief.

You are required to draft a letter to Eva explaining:

1) The rules for determining UK residence and domicile status. (8)

2) Her potential liability to UK Income Tax, Capital Gains Tax and Inheritance Tax on UK and foreign assets. (12)

Total (20)

5. Anne-Marie is 69 and has provided you with the following information in connection with her 2005/06 tax return:

1) In June 2005 she sold 4,000 shares in ABC plc (a public quoted company) at £10 per share. She had purchased 1,000 shares at £3 per share in June 1980. In May 1984 she purchased a further 500 shares at £3.50 per share and then in August 1986 took up her full entitlement to a rights issue of 1 for each 2 shares held at £4 per share. In December 2000 she purchased 1,000 shares at £5 per share. A bonus issue of 1:1 was made in August 2002.

   No election under s.35(5) TCGA 1992 has been made and the value of ABC plc shares at 31 March 1982 was £3 per share.

2) In September 2005 her £10,000 holding of 3% loan stock issued by XYZ plc in March 2000 was repaid. She had purchased the stock in May 2003 for £8,500.

3) On 30 November 2005 she gave a building she had purchased on 30 November 1995 for £50,000 to her son. Its market value at the date of the gift was £300,000. The building was used by her for trading purposes until 30 November 2003 but was then empty until her son acquired the property. Anne-Marie and her son wish to jointly elect under TCGA 1992 s.165 to hold-over as much of the gain as possible.

Anne-Marie had capital losses brought forward at 6 April 2005 of £30,000 and her total income for 2005/06 was £15,000.

You are required to show your computation of Anne-Marie's net chargeable gains for 2005/06, her Capital Gains Tax liability and the due date for payment of that liability. (20)