



Association of Taxation Technicians

Examination

November 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. In March 2004, Lionel inherited a house on the death of his mother at a value of £250,000.

He obtained a bank loan of £50,000 and used the money to build a small extension and refurbish the house. It was first let unfurnished in August 2004 at a monthly rental of £1,500 (payable in advance on the 1st of each month). It was let until 31 July 2005 when the first tenants left and remained empty until 1 September 2005 when it was let again at £1,650 per month.

During 2005/06, Lionel paid the following:

	£	
Building insurance	500	
Agents fees	1,800	
Gardener	250	
Loan repayments	5,000	(Loan interest charged in year £2,500)
Professional cleaning between tenants	250	

A carpet had to be replaced at a cost of £300 during the change of tenancy but Lionel received a contribution from the outgoing tenant of £250 as they had been responsible for the damage.

Lionel had earnings from employment for 2005/06 of £18,000 from which tax of £3,000 was deducted under PAYE. His employer provided him with a car for private use which was available throughout the year. The car was first registered in 2004 and its list price when new was £12,500. The car has emissions of 150g/km and Lionel pays his employer £625 each year as a contribution towards the cost of the private use of the car.

Lionel's other income for the year was net dividend income from a portfolio of UK listed companies of £9,000, and interest of £3,500 gross from a bank account based overseas. He also received £1,000 (net) from the income arising during the administration of his mother's estate which had been paid from interest received on monies held by the Executors.

He has decided to take out another loan of £100,000 secured on the property on which the annual interest charge will be £6,000. He is unsure whether he will use this loan to pay off credit card debts, buy a new car or pay for the refurbishment of his home. Lionel is not sure whether the interest on the new loan will be allowed as a deduction against his income and is worried that he will not get any tax relief.

Lionel has asked you to calculate his tax liability for 2005/06 and explain in detail whether the interest on the new loan and any excess rental expenses will be allowed against his future income.

You are required to:

- 1) Show your computation of Lionel's net assessable income and tax chargeable for 2005/06.** (12)
- 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 in detail whether or not the interest on the new loan will be allowed as a deduction from his income in the future.** (5)

Total (20)

2. Tom and Don are friends who both work as computer software programmers for the same IT company. They are confused over their taxation position and have asked your advice.

Tom works at the company's premises one day a week on a regular basis using his own computer equipment. He is paid one-fifth of a comparative full salary through the payroll and paid for the equivalent days in holiday. However, he works for other businesses on the other four days of the week and has his own professional indemnity insurance.

Don works on average one day a week for the same company but the work is not regular. He uses the company's own computers and is paid on invoices he submits which are based on time sheets. He has no other sources of work at present but is hoping to build up a client base through contacts from friends and colleagues. However, he is currently free to work for the company whenever they require him to, is under the supervision of the department manager while there and has to attend during normal working hours.

They are unsure whether their taxation position is correct. Tom has tax deducted under PAYE but completes a tax return showing his other sources of income as from self-employment.

Don has not yet notified HM Revenue & Customs that he is self-employed as he only has one client but has realised (after six months) that, as the company is not deducting tax, he should be arranging to pay any tax liability himself.

You are required to draft a letter to Tom and Don explaining:

- 1) **The criteria used to establish whether or not Tom's income is from employment.** (6)
- 2) **The criteria used to establish whether or not Don's income is from employment.** (6)
- 3) **The likely consequences for both Tom and Don of the incorrect treatment of their income for Income Tax purposes.** (8)

Total (20)

3. Boyd and Sally are about to get married. They each own their own homes in which they have lived for many years. Boyd's house is valued at £300,000 and Sally's at £400,000. They will split their time between both houses and wish to take a loan to buy a house to be owned jointly which they wish to let as furnished holiday accommodation.

They have asked you to write to them explaining the Income Tax and Capital Gains Tax implications of their proposed change in residence and the purchase and letting of the holiday home.

You are required to draft a letter to Boyd and Sally explaining:

- 1) **The rules for determining principal private residence, and any possible elections to be made.** (5)
- 2) **The criteria to be met for a property to be classified as a furnished holiday home.** (4)
- 3) **How the net taxable income from the lettings is calculated.** (6)
- 4) **The Income Tax and Capital Gains Tax consequences of any future income or gains from the holiday home.** (5)

Total (20)

4. George is 68 and married to Jayne who is 65.

George recently inherited £500,000 on the death of his father, and Jayne has elderly parents who will leave an estate of £750,000 on their death.

George and Jayne are farmers and jointly own a farm with land valued for agricultural purposes at £1.5 million. They also own a holiday home in Wales which is let out for 40 weeks of the year as furnished holiday lettings.

They have three children and six grandchildren but none of their family will continue farming.

George and Jayne are going to visit their solicitor to review the terms of their wills. They wish to leave their estate between the children and grandchildren, but ensuring that the surviving spouse is not left impoverished, and that Inheritance Tax on their estate is minimised. They have asked you to write to them before the visit to the solicitor explaining Inheritance Tax and suggesting ways of mitigating any future liabilities.

You are required to draft a letter to George and Jayne explaining:

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|------------------------------------------------|------|
| 1) The charge to Inheritance Tax. | (5) |
| 2) The reliefs and exemptions available. | (10) |
| 3) Ways of mitigating the potential liability. | (5) |

Total (20)

5. John (aged 59) has supplied you with the following information in connection with his tax return form for 2005/06:

- 1) In May 2005, he received £20,000 from an insurance company in respect of a claim for damage to an antique piece of furniture which had cost £10,000 in May 1990. He decided not to use the money to repair the damage. The furniture is valued at £30,000 in its damaged state but would be valued at £40,000 if repaired.
- 2) In July 2005, he received notice that 5,000 shares in XYZ Ltd were now of negligible value. They had been purchased in January 2000 at £1 per share.
- 3) John is employed by ABC plc and in August 2005 he sold 1,000 shares in the company for £15,000. He had acquired the shares under an approved employee share savings scheme in July 2003 at 50p a share.
- 4) In October 2005, he sold a further 5,000 shares in ABC plc for £85,250. He had acquired these shares in October 1998 at 25p a share in the open market. He has been employed by ABC plc throughout his period of ownership.
- 5) In February 2006 he sold a painting for £30,000 which he had inherited from his mother at a value of £20,000 in June 1996.
- 6) In March 2006 he received £10,000 from the sale of 1,000 shares in an approved Venture Capital Trust. He had subscribed for the shares at £3 per share in October 2003.

John's income from employment for 2005/06 was £30,000 and he has asked you to calculate his Capital Gains Tax liability for that year.

You are required to show your computation of John's net chargeable gains for 2005/06, showing your treatment of each asset, his Capital Gains Tax liability and the due date for payment of that liability. (20)