



Association of Taxation Technicians

Examination

November 2006

PAPER 1

PERSONAL TAXATION

SOLUTIONS
(without marking guide)

THE ASSOCIATION OF TAXATION TECHNICIANS

PAPER 1 NOVEMBER 2006 - PART I – ANSWERS

1.

Pension		20,500	
PA	7,090		
Less: 20,500- 19,500			
= 1,000 x ½	(500)	(6,590)	
	—	—	
		£13,910	
		—	

2.

Income	7,000	
PA	(4,895)	
	—	
	£2,105	
	—	

- 3.
- i) 15 March 2006
 - ii) 15 February 2006

4.

Rent 52 x 2 x £50	5,200	ie gross rent
Rent a room relief	<u>4,250</u>	
	<u>£950</u>	

5.

14,400 @ 20% x 6/12	<u>£1,440</u>
---------------------	---------------

6.

Loan at 5.6.05	10,000		
Loan at 5.4.06	<u>8,000</u>		
	<u>£18,000</u>	x ½	= £9,000 x 5% x 10/12 = <u>£375</u>

7.	Income - £6,000 x 100/60		10,000
	Personal allowance		<u>(4,895)</u>
			<u>5,105</u>
	2,090 @ 10%		209
	3,015 @ 22%		<u>663</u>
			872
	Tax deducted		<u>4,000</u>
	Repayment		£3,128

8.	Late filing penalty	£100	
	Surcharge - £5,000 @ 5%	£250	
9.	1 mark each for stating winter fuel payment and attendance allowance is not assessable		
10.	100,000 @ 3% x 5/12		<u>£1,250</u>
11.	Vouchers 12 x £250	3,000	
	Limit 52 x £50	<u>2,600</u>	
		<u>£400</u>	
12.	Proceeds		100,000
	Cost	80,000	
	Gain held over	<u>50,000</u>	<u>30,000</u>
	Chargeable		<u>£70,000</u> no taper relief
13.	Painting		5,000
	Cost		<u>8,000</u>
	Loss		<u>£3,000</u>
	Restricted to: 6,000 less 8,000		<u>£2,000</u>

14.				
	Gain			20,000
	AE			8,500
				<hr/>
				£11,500
				<hr/>
	Tax: 2,090 @ 10%			209
	9,410 @ 20%			1,882
				<hr/>
				£2,091
				<hr/>
15.				
	Proceeds	440,000		
	Cost	<u>140,000</u>		
		<u>300,000</u>		
	Non-business use		taper 85%	<u>£255,000</u>
16.				
	Purchase 5.4.06	250	1,000	
	Purchase 5.12.98	250	500	
17.				
	Gain			90,000
	Losses			10,000
				<hr/>
				£80,000
				<hr/>
	Taper 25%			<u>£20,000</u>
18.				
	Gift to son		375,000	
	Nil rate		<u>275,000</u>	
			<u>£100,000</u>	
	IHT 40%		<u>£40,000</u>	
	Taper relief 60% - payable		<u>£16,000</u>	

19.	400/800 of 80% holding	200,000
	200/600 of 60% holding	<u>96,000</u>
		<u>£104,000</u>

20.	Date for extra tax on lifetime gift	30 November 2006
	Date for IHT following death	30 November 2006

Part II - Suggested answers

Suggested Answer 1.

i)	Employment			18,000	
	Car benefit	12,500 X 17%	2,125		
			<u>625</u>	<u>1,500</u>	19,500
	Rent	4 x 1,500		6,000	
		7 x 1,650		<u>11,550</u>	
				17,550	
	Insurance		500		
	Agents fees		1,800		
	Gardener		250		
	Interest		2,500		
	Cleaning		250		
	Carpet		50		
			<u>5,350</u>		
				<u>12,200</u>	
	Estate income				1,250
	Dividends				10,000
	Foreign interest				3,500
					46,450
	Personal allowance				(4,895)
					<u>41,555</u>
	Income tax	2,090	@ 10%	209	
		24,715	@ 22%	5,437	
		4,750	@ 20%	950	
	Dividends	845	@ 10%	85	
		9,155	@ 32.5%	2,975	
				<u>9,656</u>	
ii)	Less:				
	PAYE		3,000		
	Estate tax credit		250		
	Dividend tax credit		<u>1,000</u>	<u>4,250</u>	
	Payable 31.1.07			<u>£5,406</u>	

For calculation of balance of tax payable

Payments on account due - each instalment £2,703

Suggested answer 1 continued

iii)

- a) Interest is allowed if the loan is for 'business' purposes
- b) Interest on a loan taken out to pay off credit cards, purchase car etc not normally allowed
- c) Interest on loan taken out to enable withdrawal of capital introduced into business allowed
- d) The first property was introduced into the rental 'business' at a value of £250,000 so Lionel can withdraw capital up to that amount.
- e) If it can be demonstrated that the loan was for the above purpose it is not relevant what the money is subsequently used for
- f) Interest on loan allowed against rental income not general income so if creates a loss can only be carried forward for relief against future rental income

Suggested answer 2

Knowitall & Co
120 London Road
Newtown
Nearshire

Mr T Smith and Mr D Jones
23 Fiddle Way
Middleton
Wayshire

November 2006

Dear Tom and Don

Letter to include following:

HMRC have produced booklet IR56/NI39 which gives rules for determining employment / self-employment.

Self-employment indicated by:

- g) *Individual has final say in how business is run, eg can refuse work, set own time limits for completion of work, decide on payment terms.* Tom works on a regular basis but Don only works when required and can refuse the work if necessary. Tom is paid a salary by the company but Don invoices for time worked. The indication from this point is that Tom is an employee but Don is self-employed.

- ii) *Risks own money in business (buys stationery, tools etc).* Tom uses his own computer equipment but Don uses the company's equipment – this would indicate Tom is self-employed but Don employed
- iii) *Is responsible for meeting the losses as well as taking profits, for example, sets a price for a job and if it takes longer to complete cannot pass on the 'loss'* Tom works regular hours and does not appear to have to work extra if there is a problem, Don works as required but it appears that he does not have to put right any mistakes in his own time and is paid for any extra time taken.
- iv) *Provides the major items of equipment needed to do job (not just small tools which many employees provide for themselves – as for (ii) above – Tom uses his own equipment, Don uses the company's.*
- v) *Free to hire other people on terms of own choice to do the work sub-contracted, and pays them out of own pocket – It would appear that neither Tom nor Don hire other people.*
- vi) *Must correct unsatisfactory work in own time and at own expense – As for (iii) above.*

Employment would usually be indicated by:

- vii) *Must do the work himself, rather than hire someone else to do it for him.* – Both Tom and Don perform the work themselves
- viii) *Told what to do, when and how to do it – Tom and Don are both under the supervision of the company*
- ix) *Paid on an hourly, weekly or monthly rate and maybe paid overtime and/or holiday pay – Tom is paid a regular salary, Don invoices based on the hours worked*
- x) *Works an agreed number of set hours, or given number of hours a week or month – Tom works regular hours, Don works only when required.*
- xi) *Works at 'employers' premises or at a place 'employer' decides.* – Both Tom and Don work at the company's premises

Suggested answer 2 continued

H M Revenue & Customs will also consider whether the individual is registered with their local Tax Office as self-employed and pays class 2 NIC – which Tom is for his other work but Don has not yet registered.

They may also look to see if the individual has other customers, which Tom has but Don has not.

It is unlikely that Tom's employment status with the company is incorrect. Although he provides his own computer equipment, this is the only indication of self employment and all other matters point to employment.

Don needs to establish his employment status quickly. Anyone in work can get a written decision on their employment status from H M Revenue & Customs.

If it is accepted that he is self-employed he must register with H M Revenue & Customs as self-employed.

He will be fined £100 for late notification which should have been within three months of the start of self-employment.

If he is deemed to be an employee, the company will be asked to the tax and national insurance contributions which it should have deducted and there maybe interest and penalties charged on the company for failure to operate PAYE.

If the company does not pay, HMRC will seek to recover the tax and national insurance contributions from Don.

Yours sincerely

A KNOWITALL

Impression and effort

Note: The above is an indication only as to the points to be covered in an answer and any other relevant points made will be marked appropriately.

Suggested answer 3

Knowitall & Co
10 London Road
Newtown

Mr B Hill and Ms S Valley
45 Rundown Road
Slowtown

November 2006

Dear Boyd and Sally

Letter to include following:

1. Gain on a property used as only or main residence is exempt from capital gains tax, subject to rules covering period of actual occupation and part use of property for other purposes.
2. Last 36 months of ownership always counts as period of occupation
3. Husband and wife can only have one main residence between them
4. If more than one property available for occupation (includes rented property), an election can be made within two years of second property being acquired to specify which property is to be the main residence
5. If no election is made, main residence determined by facts (eg how much time is spent in each property)
6. To qualify as Furnished Holiday Lettings the property must be let on a commercial basis
7. HMRC may ask for business accounts in support of the contention that the letting is on a commercial basis not just to cover expenses
8. It must be available to the public as holiday accommodation for at least 140 days in the tax year, and actually let for at least 70 of those days.
9. Accommodation is not normally regarded as holiday accommodation for any period during which it is in the same occupation for a continuous period of more than 31 days. Any such periods of longer term occupation must in any event not exceed 155 days in the tax year.
10. Rental income based on rents accrued less expenses
11. Expenses allowable include rates, insurance, property maintenance, agents letting fees, professional fees
12. 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 although capital allowances may be claimed instead.
13. Improvements to property not allowed against rental income – can be added to cost of property on disposal
14. Interest on loan to purchase property allowed
15. Where there is private use of the property, the allowable expenditure will be restricted based on the proportion of private use.

16. Income from qualifying furnished holiday lettings of UK property is treated as trading income.

Suggested answer 3 continued

17. As a consequence of it being treated as trading income, the income qualifies as relevant earnings for personal pension purposes and any losses may be set against other sources of income.
18. The property qualifies as a business assets for capital gains tax taper relief
19. The property is also eligible for capital gains tax rollover relief, both the gain on a disposal and as an assets against which gains on other assets may be set.
20. It also qualifies for business gift holdover relief so an election may be made for any gain arising on the gift of the property to be held over reducing the cost of the asset acquired by the donee.

Yours sincerely

A KNOWITALL

Suggested answer 4

Knowitall & Co
10 London Road
Newtown
Nearshire

Mr and Mrs G Williams
14 Willow Way
Newtown
Wayshire

November 2006

Dear George and Jayne

Letter to include following:

1. IHT charged on reduction in value of estate.
2. Husband and wife have separate estates
3. Nil band for each husband and wife (£275,000 2005/06)
4. Related property rules means assets held by 'related parties' (eg husband and wife) are added together for purposes of valuation
5. PET potentially exempt transfers – value of transfer exempt if death after 7 years from date of transfer
6. Annual exemptions - £3,000 each for each year, can carry forward unused exemption one year.
7. Transfers between husband and wife exempt – this allows couples to equalise their estates.
8. Gifts in previous seven years added to value of estate on death.
9. Taper relief available for tax due on gifts within seven years of death if donor survives more than three from date of gift
10. Gifts in consideration of marriage to children , grandchildren and others, may qualify for relief at different rates depending on the relationship of the donee/donor – both George and Jayne can make gifts to either party of the marriage.
11. Small gifts – any gifts to an individual in any year over £250 are fully chargeable
12. Agricultural property relief available on agricultural value of land.
13. Business property relief may be due on the non agricultural value of the land.
14. To obtain APR or BPR asset must be still be owned by donee at time of death of donor if within seven years of gift
15. If sold during that time, proceeds re-invested can into other agricultural property which if held at death will still qualify for the exemption.
16. Donee responsible for paying any additional tax which may become payable on lifetime transfer or on a PET which becomes liable to tax.

Suggested answer 4 continued

17. Personal representatives liable for tax on estate on death
18. Ensure that George's and Jayne's estates are of equal value and not left to the surviving spouse unless required to maintain future life style
19. Give assets now not required to maintain current life style – the money to be inherited from Jayne's parents could be passed directly to her children to avoid a potential double charge to IHT on her subsequent death
20. Gifts with reservation of benefit (eg gift of the holiday home which George and Jayne continue to use) will still fall to be taken into account in the estate on death.
21. Consider gifts to grandchildren if children wealthy
22. Consider gifts out of income – habitual, but must leave enough income to maintain standard of living.

Yours sincerely

A KNOWITALL

Impression and effort

Note: The above is an indication only as to the points to be covered in an answer and any other relevant points made will be marked appropriately.

Suggested answer 5

Insurance receipt

Proceeds				20,000
Cost	10,000 x	$\frac{20,000}{30,000 + 20,000}$	=	4,000
Indexation		$\frac{162.6 - 126.2}{126.2} = 0.288$	x 4,000	1,152
				<u>5,152</u>
				14,848

Taper – non business asset – held at 6 April 1998 7 + 1 = 8 years – amount chargeable - 70%

XYZ Ltd

Negligible value claim - £5,000

ABC plc employee shares

Proceeds	15,000
Cost	<u>500</u>
Gain	<u>14,500</u>

Taper – business asset – held 2 years – amount chargeable - 25%

ABC plc – other shares

Proceeds	85,250
Cost	<u>1,250</u>
Gain	<u>84,000</u>

Total period of ownership – 7 years = 84 months

Taper – non business asset to 6.4.00 – 18 months $84,000 \times 18/84 =$ 18,000

Held for 7 years – amount chargeable - 75%

Taper – business asset – 66 months $84,000 \times 66/84 =$ 66,000

Taper – amount chargeable - 25%

Suggested answer 5 continued

Painting

Proceeds				30,000
Cost			20,000	
Indexation	<u>162.6-153.0</u>	.063	<u>1,260</u>	<u>21,260</u>
	153.0			<u>8,740</u>

Taper NBA – held at April 1998 – extra year

Taper – amount chargeable - 70%

Venture Capital Trust – exempt

Summary

	<u>25%</u>	<u>70%</u>	<u>75%</u>	<u>Total</u>
Insurance		14,848	-	
ABC plc (employee scheme)	14,500	-		
ABC plc (other)	66,000		18,000	
Painting		8,740		
Negligible value			(5,000)	
	-----	-----	-----	
	80,500	23,588	13,000	
Taper 75%/ 30% /25%	<u>(60,375)</u>	<u>(7,076)</u>	<u>(3,250)</u>	
	20,125	16,512	9,750	46,387
Annual exemption				<u>(8,500)</u>
				<u>37,887</u>

Tax Calculation:

7,295 @ 20%	1,459
30,592 @40%	<u>12,237</u>
	<u>£13,696</u>

Due date for payment: 31 January 2007

Note:

Basic rate		32,400
Income	30,000	
PA	<u>4,895</u>	<u>25,105</u>
20%		<u>7,295</u>