Association of Taxation Technicians

Examination

November 2007

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 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. John and Sally are both aged 66 and have been married for 20 years. They are now both resident and domiciled in the UK having spent many years living and working abroad, returning to the UK three years ago.

They have recently asked you to deal with their taxation affairs and have provided the following information to enable you to prepare the tax returns for 2006/07.

John receives a pension from his former employer in Ruritania of £30,000 per annum. It is paid into a bank account in that country and during 2006/07 John transferred £25,000 to his bank account in the UK. He receives interest on the funds in the account in Ruritania which totalled £550 (gross) for 2006/07.

John and Sally received a UK state pension during 2006/07 of £5,500 and £2,200 respectively. John was also paid the winter fuel allowance of £200.

John received dividends from his portfolio of shares in UK quoted companies of £2,700 (net). He also received a distribution of £7,800 (net) from an investment in a company qualifying as a Real Estate Investment Trust. The distribution was made from the company's property income.

During 2006/07, Sally received a payment of £4,000 (net) from the estate of her late mother in respect of her share of bank interest received on the funds held by the Executors.

In March 2006, Sally purchased a house for £300,000. The house had a large garden, part of which was immediately fenced off and subsequently sold in December 2006 for £150,000. At that date, the house with its remaining garden was valued at £450,000.

The house has been let as furnished holiday accommodation and during 2006/07 the income and expenses were:

	£
Rent received	10,500
Agency fees	1,575
Water rates	200
Electricity	200
Council tax	1,500
Interest on loan to purchase property	7,000

Sally also purchased furnishings and fittings from the previous owners for £2,000. She is unsure whether she can claim any allowance for this cost or whether there is a more beneficial claim that can be made to cover replacement of furniture and equipment. She is also worried about the possible future capital gains on the property.

In January 2007, Sally made a payment of £2,700 (net) into a personal pension fund and, in March 2007, John subscribed £10,000 for shares in a qualifying Venture Capital Trust.

You are required to:

1) **Show your computation of John's income and the Income Tax payable (or repayable) for 2006/07.** (7)

2) **Show your computation of Sally's income, the Income Tax payable (or repayable) and the Capital Gains Tax payable for 2006/07.** (7)

3) **Draft a letter to Sally explaining the Income Tax and Capital Gains Tax position if her house qualifies as furnished holiday accommodation throughout the period of ownership. (You are not required to explain the conditions necessary for a property to qualify as furnished holiday accommodation.)** (5)

Total (19)

You should give brief explanations for the treatment of any of the above items you do not include in your computations.

2. Harry Smith is 45 and UK resident and domiciled. He earns £360,000 per annum and has provided you with the following details regarding capital assets.

   1) In June 2006 he sold 3,000 shares in Peaches plc, an unconnected quoted trading company, for £30,000. He had purchased 1,000 shares in March 1990 at £3 per share. In August 1995 there was a 2 for 1 rights issue at £4 per share which he took up in full. In December 2004, there was a bonus issue of shares at 2 for 3.

   2) In November 2006, he sold 10,000 shares in a company which was a qualifying Venture Capital Trust, for £20,000. He had subscribed for the shares at £1 each in September 2005.

   3) In February 2007 he sold 10,000 shares in the company which employs him for £40,000. The shares had been acquired under a qualifying share option savings scheme, the options being exercised at £1 per share in January 2006.

   4) In March 2007, he sold a painting for £4,000 which he had purchased for £8,000 in April 2000.

   At April 2006, Harry had capital losses brought forward of £10,000.

   You are required to calculate the Capital Gains Tax payable by Harry for 2006/07. You should give explanations for omitting any of the above from your computation. (10)

3. Elizabeth Upton has accepted employment overseas in a role which is likely to last for four to six years. She owns her house in the UK which she purchased for £200,000 with a mortgage six years ago. Up to the date of her departure from the UK, the house has been her principal private residence. It is now valued at £400,000 and she is uncertain whether to sell the house or let it as residential accommodation while she is abroad. If let out, she is very unlikely to re-occupy the house on her return to the UK and may either sell it or keep it as an investment property.

   Elizabeth also has several investments in the UK on which there are substantial accrued gains. She is considering selling the assets once she has left the UK as a friend has told her there will be no Capital Gains Tax once she is non-resident. She is also considering purchasing a property to live in abroad and will either sell it before she returns to the UK or shortly after her return.

   She asked for your advice regarding her UK taxation position in respect of her proposals explained above.

   You are required to draft a letter to Elizabeth explaining:

   1) The rules for resident and non-resident status in the UK. (4)

   2) The Income Tax position regarding income from her house in the UK. (3)

   3) The Capital Gains Tax position regarding her house in the UK. (5)

   4) The Capital Gains Tax position regarding her UK investments. (2)

   5) The Capital Gains Tax position regarding the house abroad. (2)

   Total (16)

4. You have acted for Simon, (aged 52) preparing tax returns for several years. He is now sales director of Purplebook Ltd, having been headhunted for the role in April 2006. He had agreed the following terms before he took up employment with the company:

1) A 'golden hello' payment (non-pensionable) of £10,000 made in May 2006 as an inducement to take the new job.

2) An annual salary of £100,000 payable from 6 April 2006.

3) Membership of the company's pension scheme. Contributions of 5% are deducted from gross salary.

4) A bonus of £40,000 to be voted in the company's accounts for the year ended 31 March 2007. The accounts will be approved at a board meeting in May 2007 and the bonus paid in June 2007.

5) The provision of rent-free accommodation for the year ended 5 April 2007 in a house owned by the company. The house was purchased for £500,000 in December 2005 and £20,000 was spent by the company on furniture and fittings. The gross annual value is £4,000. During 2006/07, the company also paid the following expenses in connection with the property:

	£
Council tax	3,500
Water rates	500
Electricity and gas	750
Building insurance	1,000
Cleaning and gardening	1,500

6) An interest free loan of £50,000 made to him on 5 July 2006. Simon repaid £20,000 on 5 December 2006.

7) Two laptops costing £2,500 each provided by the company from 6 April 2006. One is exclusively for business use, the other for private use.

8) Payment of the following expenses incurred in moving house (which took place in March 2007):

	£
Agent's selling fees	4,500
Stamp Duty on purchase of new house	15,000
Legal fees	2,500
Removal costs	2,500

Simon has asked you to calculate his Income Tax liability for 2006/07. During a conversation over lunch, he mentioned that he had sold an investment rental property in March 2006 of which you had no prior knowledge. On the basis of the information he gave you, you estimate that he has undeclared net rental income of £2,000 per annum for three years and an undeclared capital gain for 2005/06 of £50,000. Simon has been a higher rate taxpayer for many years.

Assume that the official rate of interest for 2006/07 is 5%.

You are required to:

1) **Show your calculation of Simon's assessable income for 2006/07, explaining briefly your reason for omitting any items.** (11)

2) **Explain your course of action following the disclosure by Simon of undeclared income and capital gains.** (4)

Total (15)