Answers

1 (a) (i) Vanessa Serve – Income tax computation 2006–07

	£
Trading profit	52,400
Capital allowances (10,400 x 25% = 2,600 x 14,000/20,000)	(1,820)
	50,580
Interest from investment account at NSI Bank	1,100
	51,680
Personal allowance	(5,035)
Taxable income	46,645
Income tax	
2,150 at 10%	215
37,550 at 22%	8,261
6,945 (46,645 – 2,150 – 37,550) at 40%	2,778
46,645	
Income tax payable	11,254

(1) Interest from investment accounts at the National Savings & Investments Bank is received gross.

(2) The personal pension contribution results in Vanessa's basic rate tax band being extended to £37,550 (31,150 + 6,400).

Serene Volley – Income tax computation 2006–07

	£
Employment income	
Salary	26,400
Pension contributions (26,400 x 5%)	(1,320)
	25,080
Car benefit	4,100
Interest from savings certificate	–
	29,180
Personal allowance	(5,035)
Taxable income	24,145
Income tax	
2,150 at 10%	215
21,995 (24,145 – 2,150) at 22%	4,839
24,145	
Income tax liability	5,054
Tax suffered at source – PAYE	(4,790)
Income tax payable	264

(1) The relevant percentage for the car benefit is 25% (15% + 10% (190 – 140 = 50/5)).

(2) The motor car was available throughout 2006–07 so the benefit is £4,100 (16,400 x 25%).

(3) Interest on savings certificates from the National Savings & Investments Bank is exempt from income tax.

(ii) Vanessa Serve

(1) Class 2 NIC for 2006–07 will be £109 (52 x 2·10).

(2) Class 4 NIC for 2006–07 will be £2,451 ((33,540 – 5,035 = 28,505 at 8%) + (50,580 – 33,540 = 17,040 at 1%)).

Serene Volley

(1) Class 1 NIC for 2006–07 will be £2,350 (26,400 – 5,035 = 21,365 at 11%).

(2) Pension contributions are ignored, and benefits are not subject to employee Class 1 NIC.

(iii) Vanessa Serve

(1) The balancing payment for 2006–07 due on 31 January 2008 is £5,000 (11,254 + 2,451 – 8,705).

(2) The payments on account for 2007–08 will be £6,852 (11,254 + 2,451 = 13,705 x 50%). These will be due on 31 January 2008 and 31 July 2008.

Serene Volley

(1) No payments on account have been made, so the balancing payment for 2006–07 due on 31 January 2008 is £264.

(2) Payments on account for 2007–08 are not required because Serene's income tax payable for 2006–07 was less than £500. Also, more than 80% of her income tax liability (5,054 x 80% = £4,043) was met by deduction at source.

(b) (i) VAT Return – Quarter ended 31 March 2007

	£	£
Output VAT		
Sales (18,000 x 17·5%)		3,150
Input VAT		
Telephone (600 x 60% (100 – 40) x 17·5%)	63	
Motor car	–	
Motor repairs (987 x 17·5/117·5)	147	
Equipment (1,760 x 17·5)	308	
Other expenses (2,200 – 400 = 1,800 x 17·5%)	315	
		(833)
VAT payable		2,317

(1) An apportionment is made where a service such as the use of a telephone is partly for business purposes and partly for private purposes.

(2) Input VAT cannot be recovered in respect of the motor car as this was not exclusively for business purposes.

(3) No apportionment is necessary for motor expenses provided there is some business use.

(4) Vanessa can recover the input VAT in respect of the equipment in the quarter ended 31 March 2007 because the actual tax point was the date that the equipment was paid for.

(ii) (1) Vanessa can use the flat rate scheme if her expected taxable turnover for the next 12 months does not exceed £150,000.

(2) In addition, her expected total income (including exempt supplies) for the next 12 months must not exceed £187,500.

(3) The main advantage of the scheme is the simplified VAT administration. Vanessa's customers are not VAT registered, so there will be no need to issue VAT invoices.

(4) If Vanessa had used the flat rate scheme for the quarter ended 31 March 2007 then she would have paid VAT of £1,269 (18,000 + 3,150 = 21,150 x 6%)

(5) This is a saving of £1,048 (2,317 – 1,269) for the quarter.

2 (a) Sofa Ltd – Trading loss for the year ended 31 March 2007

	£	£
Loss before taxation		240,000
Depreciation	87,100	
Legal fees in connection with the issue of share capital	7,800	
Construction of new wall	9,700	
Entertaining suppliers	1,360	
Health and safety fine	420	
Profit on disposal of shares		4,300
Bank interest received		8,400
Interest payable	–	
Capital allowances – Plant and machinery (working 1)		40,680
– Industrial building (working 2)		13,000
	106,380	306,380
	(306,380)	
Trading loss	(200,000)	

(1) The cost of renewing a short-lease (less than 50 years) is allowable as a trading expense.

(2) The cost of obtaining loan finance is allowable as a trading expense under the loan relationship rules as the loan was used for trading purposes.

(3) The new wall is not allowable, being capital in nature.

(4) The only exception to the non-deductibility of entertainment expenditure is when it is in respect of employees.

(5) The costs of counselling services for redundant employees are allowable.

(6) Interest on a loan used for trading purposes is deductible in calculating the trading loss on an accruals basis.

Working 1 – Plant and machinery

		Pool	Motor car	Motor car	Allowances
	£	£	£	£	£
WDV brought forward		16,700	16,400		
Additions – Motor car (1)				22,200	
– Motor car (2)		10,900			
		27,600			
Proceeds – Expensive motor car			(17,800)		
– Lorry		(7,600)			
– Motor car (2)		(8,800)			
Balancing charge			1,400		(1,400)
		11,200			
WDA – 25%		(2,800)			2,800
WDA – Restricted				(3,000)	3,000
		8,400			
Addition qualifying for FYA					
Equipment	11,400				
Fixtures	44,800				
	56,200				
FYA – 40%	(22,480)				22,480
		33,720			
Motor car (3)	13,800				
FYA – 100%	(13,800)				13,800
		–			
WDV carried forward		42,120		19,200	
Total allowances					40,680

(1) The cost of the lorry will have originally been added to the pool, so the disposal proceeds are now deducted.

(2) The sale price put on the fixtures cannot exceed their original cost of £44,800.

(3) First-year allowances are only at the rate of 40% because Sofa Ltd is a medium-sized company.

Working 2 – Industrial buildings allowance

(1) Sofa Ltd can claim IBA based on the purchase price of £266,500 (400,000 – 133,500) as this is less than the original cost.

(2) The showroom qualifies as it cost less than 25% of the relevant cost (266,500 x 25% = £66,625).

(3) The allowance is based on the remaining 246 months (300 – 54) of the 25-year life of the factory.

(4) The 25-year life runs from the date that the factory was first brought into use rather than when construction was completed.

(5) The WDA is therefore £13,000 (266,500 x 12/246).

(b) (1) The accounting periods of Settee Ltd and Sofa Ltd are not coterminous. Therefore, Settee Ltd's profits chargeable to corporation tax and Sofa Ltd's trading loss must be apportioned on a time basis.

(2) For the year ended 30 June 2006 group relief is restricted to £50,000, being the lower of £60,000 (240,000 x 3/12) and £50,000 (200,000 x 3/12).

(3) For the year ended 30 June 2007 group relief is restricted to £67,500, being the lower of £67,500 (90,000 x 9/12) and £150,000 (200,000 x 9/12).

(4) Couch Ltd is not a 75% subsidiary of Sofa Ltd, so no group relief claim is possible.

(5) Futon Ltd did not commence trading until 1 January 2007, so group relief is restricted to £50,000, being the lower of £60,000 and £50,000 (200,000 x 3/12).

3 Jointly owned property

(1) Motor cars are exempt from CGT.

(2) The chargeable gain on the house before taper relief is £33,000 calculated as follows:

	£
Disposal proceeds	381,900
Cost	(86,000)
	295,900
Indexation 86,000 x 0·650	(55,900)
	240,000
Principal private residence exemption	(207,000)
	33,000

(3) David and Angela will each be assessed on £16,500 (33,000 x 50%) of the chargeable gain.

(4) The total period of ownership of the house is 240 months (207 + 33), of which 207 months qualify for exemption as follows:

	Exempt months	**Chargeable months**
1 October 1986 to 31 March 1990 (occupied)	42	
1 April 1990 to 31 December 1993 (working in UK)	45	
1 January 1994 to 31 December 2000 (occupied)	84	
1 January 2001 to 30 September 2003 (unoccupied)		33
1 October 2003 to 30 September 2006 (final 36 months)	36	
	207	33

(5) The exemption is, therefore, £207,000 (240,000 x 207/240).

David Brook – CGT liability 2006–07

			Gain	**Taper %**	**Tapered Gain**
		£	**£**		**£**
House			16,500	65%	10,725
Ordinary shares in Galatico plc					
Deemed proceeds (15,000 x £2·95)		44,250			
Cost		(28,200)			
			16,050	100%	16,050
Chargeable gains					26,775
Annual exemption					(8,800)
Taxable gains					17,975
Capital gains tax	2,150 at 10%				215
	15,825 (17,975 – 2,150) at 20%				3,165
					3,380

(1) The house is a non-business asset, and taper relief is based on nine complete years of ownership (eight years plus the bonus year).

(2) The antique table is a non-wasting chattel, but is exempt from CGT because the gross sale proceeds were less than £6,000.

(3) The transfer of the 20,000 £1 ordinary shares in Bend Ltd to Angela does not give rise to any gain or loss, because it is a transfer between spouses.

(4) The shares in Galatico plc are valued at £2·95 (£2·90 + $^{1}/_{4}$(£3·10 – £2·90)).

(5) The disposal is first matched against the purchase on 24 August 2005, and then against the purchase on 15 June 2005. The cost of the shares disposed of is, therefore, £28,200 (21,600 + (17,600 x 3,000/8,000).

Angela Brook – CGT liability 2006–07

		Gain	Taper	Tapered
			%	Gain
	£	£		£
House		16,500	65%	10,725
Antique clock		2,000	100%	2,000
Ordinary shares in Bend Ltd				
Disposal proceeds	62,400			
Cost (48,000 x 15,000/20,000)	(36,000)			
		26,400	25%	6,600
Chargeable gains				19,325
Annual exemption				(8,800)
Taxable gains				10,525
Capital gains tax 10,525 at 40%				4,210

(1) The antique clock is a non-wasting chattel. The gain is restricted to £2,000 (7,200 – 6,000 = 1,200 x 5/3) as this is less than £3,500 (7,200 – 3,700).

(2) David's original cost is used in calculating the capital gain on the disposal of the shares in Bend Ltd.

(3) The shares in Bend Ltd are a business asset, and taper relief is based on two complete years of ownership. It is the couple's combined period of ownership that is relevant.

4 **(a)** (1) Capital allowances are available on plant and machinery instead of the 10% wear and tear allowance.

(2) Loss relief is available against total income instead of just against property business profits.

(3) The income qualifies as relevant earnings for pension tax relief purposes.

(b) **Edmond Brick – Furnished holiday letting loss 2006–07**

	£	£
Rent receivable (370 x 18)		6,660
Repairs	7,400	
Other expenses:	2,710	
Capital allowances (5,700 x 50%)	2,850	
		(12,960)
Furnished holiday letting loss		(6,300)

(c) **Edmond Brick – Property business profit 2006–07**

	£	£
Premium received for sub-lease		15,000
Less: 15,000 x 2% x (5 – 1)		(1,200)
		13,800
Rent receivable – Property 2 (575 x 12)		6,900
– Property 3 (710 x 7)		4,970
– Property 4		4,600
Furnished room		790
		31,060
Council tax	1,200	
Wear and tear allowance	570	
Impairment losses (710 x 3)	2,130	
Advertising	670	
Loan interest	6,700	
Rent paid	6,800	
Insurance (340 + 290 + 360)	990	
		(19,060)
Property business profit		12,000

(1) The wear and tear allowance for property two is £570 (6,900 – 1,200 = 5,700 x 10%) as the rent receivable is reduced by the council tax paid by Edmond.

(2) Claiming rent-a-room relief in respect of the furnished room (5,040 – 4,250 = £790) is more beneficial than the normal basis of assessment (5,040 – 1,140 = £3,900).

5 **(a)** (1) The rate of income tax or capital gains tax at which relief will be obtained, with preference being given to income or capital gains charged at the higher rate of 40%.

(2) The timing of the relief obtained, with a claim against total income/capital gains of the current year or preceding year resulting in earlier relief than a claim against future trading profits.

(3) The extent to which personal allowances and the capital gains annual exemption may be wasted.

(b)

	2003–04	2004–05	2005–06	2006–07
	£	£	£	£
Trading income	6,100	51,600	–	12,200
Loss relief s.385	–	–	–	(7,000)
	6,100	51,600	–	5,200
Building society interest	–	2,100	3,800	1,500
	6,100	53,700	3,800	6,700
Loss relief s.380	–	(53,700)	–	–
	6,100	–	3,800	6,700
Personal allowance	(5,035)	–	(3,800)	(5,035)
Taxable income	1,065	–	–	1,665
Capital gains	18,800	23,300	–	8,800
Loss relief s.72	–	(23,300)	–	–
	18,800	–	–	8,800
Annual exemption	(8,800)	–	–	(8,800)
Taxable gains	10,000	–	–	–

(1) Loss relief has been claimed against total income for 2004–05 under s.380 ICTA 1988, and then against the capital gains of the same year under s.72 FA 1991, since this gives relief at the earliest date and at the highest rates of tax.

(2) The balance of the trading loss of £7,000 (84,000 – 53,700 – 23,300) is carried forward against future trading profits under s.385 ICTA 1988.

(3) The capital loss for 2005–06 is carried forward and set against the chargeable gains for 2006–07 (12,200 – 3,400 = £8,800).

				Marks	
1	(a)	(i)	**Vanessa Serve**		
			Trading profit	1/2	
			Capital allowances	1 1/2	
			Interest from NSI Bank	1	
			Personal allowance	1/2	
			Extension of basic rate band	1	
			Income tax	1	
			Serene Volley		
			Salary	1/2	
			Pension contributions	1	
			Car benefit	1 1/2	
			Interest from savings certificate	1/2	
			Personal allowance	1/2	
			Income tax	1	
			Tax suffered at source – PAYE	1/2	
					11
		(ii)	**Vanessa Serve**		
			Class 2 NIC	1	
			Class 4 NIC	1 1/2	
			Serene Volley		
			Class 1 NIC	1 1/2	
					4
		(iii)	**Vanessa Serve**		
			Balancing payment	1 1/2	
			Payments on account	1 1/2	
			Serene Volley		
			Balancing payment	1	
			Payments on account not required	1	
					5
	(b)	(i)	Sales	1/2	
			Telephone	1	
			Motor car	1/2	
			Motor repairs	1	
			Equipment	1	
			Other expenses	1	
					5
		(ii)	Limits	2	
			Simplified administration	1	
			VAT saving	2	
					5
					30

			Marks	
2	(a)	Loss before taxation	1/2	
		Depreciation	1/2	
		Professional fees	2	
		Repairs and renewals	1	
		Other expenses	2	
		Profit on disposal of shares	1/2	
		Bank interest received	1/2	
		Interest payable	1	
		P & M – Pool	2 1/2	
		– Expensive motor car sold	1 1/2	
		– Expensive motor car acquired	1	
		– Fixtures	1	
		– FYA	2	
		IBA – Purchase price	1	
		– Showroom	1	
		– 25-year life	1 1/2	
		– WDA	1/2	
				20
	(b)	Settee Ltd	2 1/2	
		Couch Ltd	1	
		Futon Ltd	1 1/2	
				5
				25

3	**Jointly owned property**	
	Motor car	1/2
	House – Proceeds	1/2
	– Cost	1/2
	– Indexation	1
	– Period of exemption	2 1/2
	– Exemption	1
	– Taper relief	1
	– Division of gain	1
	David Brook	
	Antique table	1
	Bend Ltd	1/2
	Galatico plc – Deemed proceeds	1
	– Cost	2
	Annual exemption	1/2
	Capital gains tax	1
	Angela Brook	
	Antique clock	2
	Bend Ltd – Proceeds	1/2
	– Cost	1
	– Taper relief	1 1/2
	Annual exemption	1/2
	Capital gains tax	1/2
		20

				Marks
4	**(a)**	Capital allowances	1	
		Loss relief	1	
		Relevant earnings for pension purposes	1	
				3
	(b)	Rent receivable	$^1/_2$	
		Repairs	1	
		Other expenses	$^1/_2$	
		Capital allowances	1	
				3
	(c)	Lease premium received	$1^1/_2$	
		Rent receivable	$1^1/_2$	
		Furnished room	1	
		Council tax	$^1/_2$	
		Wear and tear allowance	1	
		Impairment losses	$^1/_2$	
		Advertising	$^1/_2$	
		Loan interest	1	
		Rent paid	$^1/_2$	
		Insurance	1	
				9
				15
5	**(a)**	Rate of tax	1	
		Timing of relief	1	
		Personal allowance and annual exemption	1	
				3
	(b)	Trading income	$^1/_2$	
		Loss relief s.385 ICTA 1988	1	
		Building society interest	$^1/_2$	
		Loss relief s.380 ICTA 1988	1	
		Personal allowance	$^1/_2$	
		Capital gains	$1^1/_2$	
		Loss relief s.72 FA 1991	1	
		Annual exemption	1	
				7
				10