



THE LAW SOCIETY OF SCOTLAND EXAMINATIONS

TAXATION

Thursday 19 MAY 2005

**0900 – 1200
(Three Hours)**

**Candidates should attempt THREE questions in
each of Sections A and B**

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Candidates should attempt **THREE** questions from Section A and **THREE** questions from section B. All questions are of equal value.

SECTION A

1. DISCUSS and EXPLAIN the meaning of the distinction between capital and income for tax purposes, with reference to both statute and case law.

2. Adam is a highly paid employee, aged 62. He also has income from investments. He is married to Susan, aged 65. He seeks your advice as to whether any of the following can be used to reduce his income tax liability.
 - (a) The fact that although Susan currently has no income, she does have a personal allowance for income tax purposes;
 - (b) The fact that Susan is partially blind;
 - (c) The fact that Adam has incurred considerable expenditure in fitting out his garage at home as a study, which he uses mostly (but not exclusively) in connection with his employment. The expense includes redecoration and building a small extension;
 - (d) The fact that over the last year Adam has spent a great deal of money on smart business suits, which his boss considers to be very important in his work;
 - (e) The fact that he uses his car, both to travel to and from work and for journeys to see customers;
 - (f) The fact that he has to pay out large sums of money to care for Susan each month, which enables him to go to work.

3. Brown Communications Limited is a successful private company. In its financial year ending on 31 March 2005, it made trading profits of £400,000. It also received dividends of £90,000 from its minority shareholding in another successful private trading company. Brown paid a dividend of £135,000 to its own shareholders, who are four individuals.

However, Green Machines Limited, which is a wholly owned subsidiary of Brown Communications Limited (the only one) made trading losses of £50,000 in the same period, as well as a capital gain of £25,000.

ADVISE in relation to the following:-

- (a) How the dividends received by Brown Communications Limited affect its tax position;
 - (b) The rate of corporation tax which will be payable by Brown Communications Limited and how that rate will be calculated and affected by the facts given above;
 - (c) The effect of Green Limited being a subsidiary of Brown in relation to the facts given above;
 - (d) The tax effects for the individual shareholders of receiving their dividends from Brown Communications Limited.
4. EXPLAIN the tax issues which arise for an individual in relation to the profits which he or she receives from:-
- (a) interest on a building society account held directly;
 - (b) income profits and capital gains from shares held through an Individual Savings Account;
 - (c) interest received from National Savings Certificates;
 - (d) income received from Government Stock;
 - (e) income received from a Unit Trust, which invests in UK and European companies;
 - (f) profits made from betting on horses;
 - (g) income from a UK state pension.

END OF SECTION A

SECTION B

1. Alice has just died, aged 86. In terms of her will, her estate was to be split equally between her husband Stephen and her daughter Joan. Alice's estate at death included a house worth £200,000, a shop (run by Alice until her death) worth £100,000, the shop business worth £60,000 and investments and other moveable estate worth £150,000.

Five years before her death, Alice had given her holiday home (the worth £300,000 but worth £375,000 at the date of Alice's death) to her niece Evelyn. Alice continued to spend one month each year at this home, until her death.

In addition, Alice had made regular annual gifts of £5,000 to each of three grandchildren for four years before her death.

EXPLAIN the possible inheritance tax consequences of all of the above; and what would be the position if Joan were to sign a deed of variation directing her share of Alice's estate to Stephen.

2. Joseph's father Paul had bought a painting in 1976. Paul died in 1980, leaving the painting to Joseph. Joseph then gave the painting to his wife Gillian in 1994. Gillian spent considerable sums having the painting restored and obtaining a new and more appropriate frame in 2000. Gillian sold the painting in December 2004.

The painting had risen considerably in value throughout the above period and at the time of each transaction, there was a considerable capital gain as compared to the previous one. When the painting was eventually sold, the sale price was £150,000, with £15,000 payable in commission to the auctioneer.

ADVISE on the capital gains tax position in relation to each of the events above, explaining what else you might need to know. You should deal with any reliefs that might be relevant. What difference would it have made if the painting had been of much more modest value, eventually selling for only £10,000 (with £1,000 commission)?

3. EXPLAIN
 - (a) How the self-assessment system works for individuals in relation to income tax, including the powers available to the Inland Revenue (now known as HM Revenue and Customs); and
 - (b) How an individual may appeal against or otherwise object to decisions taken by the Inland Revenue.

4. A building company has bought some land and is in the process of constructing a building. The building will consist of offices on the ground floor, which will be let out to commercial businesses; and residential flats on the upper floors, which will be sold to individual occupiers. The offices will be fitted out to a very high standard, with high quality flooring and carpets, lighting, computer systems, office dividers, artwork on the walls and a security system, the exact fittings to be discussed with the commercial tenants.

On the basis of the information supplied, EXPLAIN

- (a) The VAT consequences of what the building company has already done and what it intends to do; and
- (b) What will happen in relation to capital allowances on the expenditure on the office fittings.

END OF SECTION B