Institution **CIOT - CTA**
Course **Adv Tech Owner-Managed Business**

Event **NA**

Exam Mode **OPEN LAPTOP + NETWORK**

Answer-to-Question-_1_

Part 1)

Taxable Trading Profit - YE 30 APril 2024

	Note	£	
PBT		90,300	
Add back:			
Cost of services for personal use	N1	200	
Pension contribution	N4	675	
Wages accrual	N5	10,000	
Lease costs	N6	2,940	
Car running costs	N7	1,360	
Utility costs of cafe	N9	2,475	
Training costs	N10	2,400	
Depreciation	N11	19,000	
Less:			
Rental income	N2	(17,200)	
Capital allowances	W1	(37,090)	
Tax adjusted profit		75,060	

Assessable Trading Profit 23/24

Stefan is a continuing trader for 23/24 so he will be taxed using the transitional basis rules. He will be taxed from 1/5/22 to 30/4/24.

		£	
Step 1 - profits for YE 30 April 2023		65,000	
Step 2 - Profits for 1.5.23-5.4.24	11/12 x 75,060	68,805	

Step 3: Less overlap profits	68,805 - 6,000	62,805	
Step 4: sum of s1 & s3		127,805	
No negative amounts so amount of assessable profit for 23/24 is the profits for YE 30 APril 2023 plus 20% of the transitional profits	65,000 + (20% x 62,805)	77,561	
Assessable trade profits for 23/24		**77,561**	

N1 - the cost of the provision of services for a sole trader's personal use must be added back. The cost of providing the course of £200 is added back. No amendment required for the standard price that would usually be charged.

N2 - the rental income is deducted from trade profits and this would be taxed as property income for Stefan.

N3 - the bonuses do not need to be disallowed as they are paid within nine months of the end of the period.

N4 - the pension contribution is to be disallowed as it was not paid during the period.

N5 - salary to Stefan's son is to be disallowed as it is not paid within nine months of the end of the period.

N6 - the car is used 60% for business purposes so 40% of the lease costs (not maintenance costs) are to be disallowed. The co2 emissions exceed 50g/km so there is an additional 15% restriction. The following amounts should be disallowed:

Private use - £6,000 x 40% = £2,400
High emissions - (£6,000 - £2,400) x 15% = £540

N7 - private use of running costs must be disallowed (40% x £3,400 = £1,360)

N8 - the private use of the van by the employee does not need to be disallowed as the employee will be taxed on this private use.

N9 - 25% of the electricity and water charges will relate to the rental income so will need to be disallowed. (25% x £9,900 = £2,475)

N10 - training to develop a new skill or trade is classed as capital expenditure and so the training cost of £2,400 will need to be disallowed.

N11 - depreciation must be disallowed as it is capital in nature.

N12 - the second hand sailing equipment will qual-ify as plant and machinery and Stefan can claim 100% AIA on this expenditure.

W1 - CAs for the YE 30 APril 2024

	General Pool	SRP	AIA		CAs claimed	
	£	£	£			
TWDV b/f	15,000	6,500				
Additions:						
Hand sailing equipment (n12)			34,000			
	15,000	6,500	34,000			

WDAs@18/ 6%	(2,700)	(390)			3,090	
AIA@100%			(34,000)		34,000	
TWDV c/f	12,300	6,110	nil			
					37,090	

Part 2)

From 24/25 tax year, the tax year basis will apply with all profits arising between 6 April and the following 5 April being taxed. As his accounting period does not tie in with the tax year, he will need to apportion his taxable trade profits arising in the the YE 30 April 2024 (by 1/12) and the YE 30 April 2025 (by 11/12) and the sum of these two amounts will taxable in the tax year.

Additionally, he will need to include 20% of the transitional profits arising in the 23/24 transitional period (20% of £62,805). This will continue for the next four tax years from the 24/25 tax year.

As the tax year does not tie with Stefan's accounting period, he may need to use provisional figures to work out the apportionment which HMRC will accept. However, he must ensure that the final correct assessable profits are included in an amended tax return by the first anniversary of the 31 January following the tax year. If this results in additional tax, then late payment interest will arise. Stefan could therefore choose to change his accounting period to tie in with the tax year, and could use a 31 March YE instead.

Stefan could elect to tax more of the transitional profits in any particular tax year. This would not be useful based on his current taxable income as he is a higher rate taxpayer, but could be useful if has a tax loss in a particular tax year or he is a basic rate tax payer.

Part 3)

As Stefan is a sole trader, he is liable to class 2 and class 4 NICs.

Stefan did not reach pensionable age before the start of the 23/24 tax year and so he will be liable to class 4 NICs on his entire trade profits arising in the 23/24 tax year.

However, once Stephan reached pensionable age on 1 January 2024, he will no longer be required to pay class 2 NICs. He will therefore pay class 2 NICs of £3.45 per week for approximately 36 weeks, meaning that his class 2 NIC liability will be £124.

No NIC is payable on the rental profits that he makes during the period.

--------------ANSWER-1-ABOVE---------------

--------------ANSWER-2-BELOW---------------

Answer-to-Question-_2_

Part 1)

Capital Gain and BADR

As Sally is disposing of a chargeable asset to her sister, who is connected to Sally, a chargeable gain will arise based on the market value of the store at the date of disposal. This would result in a chargeable gain of £190,000 (being £275,000 - £85,000). Without any relief, this would result in a CGT liability of £18,400 after deducting the annual exempt amount of £6,000, as the gain will qualify for business asset disposal relief (BADR).

Sally would qualify for business asset disposal because:

- she is making a material disposal of a part of her sole trade business
- she has owned the business for at least two years
- the business is a trading business and has been for at least two years prior to disposal.

It is important to get clarification on whether the sale of the store is classed as a part of a business. Previous case law has decided that if the disposal is made up of assets that could be used to carry on a separate distinct trade, then this would be classed as disposing of a part of a business. It does not matter if her sister does not carry out this business, simply whether Sally is disposing of part of her business. This should be therefore classed as a disposal of part of a business, as the Devon store could be operated as a separate business.

BADR can be claimed up to the lifetime limit of £1m, and she must make the claim for BADR to apply to the gain by the first anniversary of the 31 January following the tax year of disposal (i.e. 31 January 2026).

Gift Relief

As Sally is making a sale at undervalue and the asset being disposed of is an asset that she has used in her sole trade business, she can also claim gift relief on the disposal of the Devon store to her sister. However, as the actual proceeds still exceed the original cost, the amount of gift relief will be restricted. The excess cash proceeds of £65,000 (£150,000 - £85,000) will remain as a chargeable gain, and after deducting the annual exempt amount of £6,000 and applying BADR, a chargeable gain of £5,900 will arise. The gift relief will be the market value of the asset less the actual sales proceeds (£275,000 - £150,000 = £125,000), and the gift relief is rolled over against the base cost of the asset for her sister, resulting in a larger capital gain when she comes to sell the asset in the future.

BAse cost for sister = MV of asset - gift relief = £275,000 - £125,000 = £150,000

A joint election must be made within four years of the end of the disposal (i.e. by September 2027).

Rollover Relief

Another option for Sally is to claim rollover relief on the disposal of the store to her sister, as she has disposed of one qualifying asset used in her trade and purchased another qualifying asset, being the 55 year lease, within 36 months of the disposal of her store. Land and buildings are qualifying assets for rollover relief.

She would be using her entire sales proceeds from the sale of the store, so full rollover relief would be available. As she is purchasing a depraciating asset (i.e. a lease of less than 60 years), the gain arising on the sale of the store would be frozen and would be chargeable on the earliest of:

- the sale of the lease
- ceasing to use the lease in her business
- ten years of purchasing the lease

However, as she is intending to then look for a replacement freehold property afterwards, she could park the gain of the Devon store against the lease, and then once the freehold property is purchased, she could subsequently roll over this gain against the base cost of the new freehold property once it is purchased.

PArt 2)

As per below, Sally's IT liability for 23/24 is £21,582. As she made POA of £13,000, she will need to amke a balancing payment of £8,582 on 31 January 2025.

Additionally, she will also need to make POA for the 24/25 tax year based on the 23/24 liability (£21,582 x 50% = £10,791). A POA of this amount will need to be paid on 31 July 2024 and 31 Januaryb 2025.

As she expects her tax liability to be lower in 24/25, she can apply to make lower payments on account but if this leads to a large balancing payment then late payment interest will arise.

She will also need to pay class 2 & 4 NICs for 23/24 as she is a sole trader. The class 2 NICs will be paid as part of her balancing payment, and her class 4 NICs will need to be paid with her balancing payment for 23/24 and also two POA for the 24/25 tax year.

Income Tax Liability for 23/24

		Non-savings	Dividend
	£	£	£
Trade Profit		85,000	
Dividend income			5,000
Less: PA		(12,570)	
Taxable Income		72,430	5,000
IT @ 20% (N1)	43,700 x 20%	8,740	
IT @ 40%	(72,430 - 43,700) x 40%	11,492	
IT @ 0%	1,000 x 0%		nil
IT @ 33.75%	4,000 x 33.75%		1,350
Total IT Liability	**21,582**		

N1 - the pension contributions and gift aid donations made by Sally are made net of basic rate income tax and her basic rate and higher rate tax thresholds are increased by the gross amount of the amounts paid. Her new income tax band thresholds will therefore be:

New basic rate band = £37,700 + (100/80 x (360+40)x12) = £43,700

New higher rate band = £125,140 + (100/80 x (360+40)x12) = £131,140

N2 - her accounting period ties in with the tax year for 23/24 so all trade profits for the YE 31 March 2023 are taxable in the 23/24 tax year.

--------------ANSWER-2-ABOVE---------------

--------------ANSWER-3-BELOW--------------

Answer-to-Question-_3_

Capital Allowances - YE 30 September 2023

	Main Pool	SRP	AIA	Enhanced FYAs		CAs claimed
	£	£	£	£		£
TWDV /bf (n3)	42,400	27,368				
Additions:						
computer equipment (n1)				3,000		
electric car and charging point (n2)			31,300			
Disposals:						
electric car (n4)		(10,800)				
	42,400	16,568	31,300	3,000		
TWDV @ 18/6%	(7,632)	(994)				8,626

AIA@100%			(31,300)			31,300
Enhanced FYAs at 115%				(3,000)		3,450
TWDV c/f	34,768	15,574	nil	nil		
Total CAs to claim						43,376

N1 - the computer equipment will qualify for the super deduction at an enhanced rate of FYAs. However, as the accounting period spans 1 April 2023, the enhanced percentage will be restricted as follows:

100% + (N/AP)*30% = 100% + (6/12)*30% = 115%

N2 - the electric car and the electric charging points will both qualify for 100% first year allowances. However, the AIA at 100% can be claimed to avoid a balancing charge from arising.

N3 - the company has claimed the AIA or enhanced FYAs on P&M, computer equipment in the past, so no TWDV b/f will will be available for the general pool or special rate pool for these assets. However, the company would have had to include the the car with co2 emissions of 190 g/km in the special rate pool in the YE 30 September 2021, as co2 emissions exceeded 110g/km (purchased before 1 APril 2021).

Additionally, the car purchased on 8 August 2021 would have had to have been included in the main pool as the co2 emissions are less than 50g/km and was purchased after 1 April 2021. No AIA is available for the cars.

Therefore, the company would have claimed writing down allowances at 18% and 6% for these two cars for both the YE 30 September

2021 and 2022. The TWDV b/f for the pool would therefore be:

		Main Pool	SRP
		£	£
Additions		63,057	30,973
WDAs YE 30 September 2021	18/6%	(11,350)	(1,858)
TWDV at 1 October 2022		51,707	29,115
WDAs YE 30 September 2022	18/6%	(9,307)	(1,747)
TWDV c/f to 1 October 2022		42,400	27,368

N4 - the sale of the car with high co2 emissions will be deducted from the SRP with the sales proceeds being deducted of £10,800.

N5 - for the P&M being disposed of on 30 June 2023, a balancing charge will arise at 115% (same working as above) of the sales proceeds. This is because the super deduction was claimed at 130% of the cost, and the asset is being disposed of during an accounting period that is spanning 1 April 2023. A balancing charge of £17,250 will therefore arise (115% x £15,000).

N6 - SBAs will have been claimed on the price paid for the unused factory, as the building was constructed after 29 October 2018 and has been used in the company's trade. The price paid to the developer (excluding the cost of the land of £100,000) is the qualifying cost, and the actual construction costs are ignored.

The company can therefore claim the following for the YE 30 September 2023:

3% x (£228,000 - £100,000) = £3,540

Capital Allowances - PE 31 December 2023

	General Pool	SRP				Balancing adjustment

	£	£				£
TWDV b/f	34,7 68	15,574				
Disposals:						
Low emission car (n3)	(19, 000)					
P&M and computer (n4)	(322 ,000)					
Electric car and charging equipment (n6)	(24, 500)					
	(330 ,732(	15,574				
Balancing adjustment	330, 732					(330,732)
Balancing adjustment		(15,57 4)				15,474

An overall balancing charge of £315,258 will therefore arise in the period of cessation which will be added to taxable profits.

Additionally, the SBAs that have been claimed on the factory must be added to the proceeds when calculating thee chargeable gain arising.

N1 - no WDAs are available in the period of cessation and

balancing charges and allowances will arise instead.

N2 - the balance of the SRP for the high emission car disposed of in the previous period will result in a balancing allowance of £15,574.

N3 - the sales proceeds for the low emission car will be deducted from the main pool.

N4 - for the P&M and computer equipment that the AIA was previously claimed on, these will be main pool assets and the disposal proceeds will need to be deducted from the main pool.

N5 - for the computer equipment purchased in the prior period, a balancing charge oat 100% of the disposal proceeds (period of disposal begins after 1 April 2023). This will result in a balancing charge of £2,200 which will be included in the trade profits in the tax computation.

N6 - the sales proceeds of the electric car and the charging point are also deducted from the main pool.

--------------ANSWER-3-ABOVE---------------

--------------ANSWER-4-BELOW---------------

Answer-to-Question-_4_

Part 1)

The termination package can be split as follows:

	Exempt Income	Taxable as Regular Earnings	Taxed Under s.401
	£	£	£
Bonus (N2)		10,000	
Ex gratia payment (N2 & N3)		45,000	
COntribution to pension (N1)	10,000		
Gift of car (N4)			25,000
Total	10,000	55,000	25,000

N1 - the contribution to Jack's pension will be exempt from income tax for Jack, with no PAYE or NICs payable on this amount.

N2 - Jack's bonus of £10,000 and the payment of £7,500 are both contractual and therefore they are taxed as normal earnings for Jack. PAYE will need to be applied to these amounts and class 1 primary and secondary NICs will be payable by the company and Jack. It does not matter that the £7,500 is being replaced by the additional amount, as this amount is still the contractual amount.

N3 - the ex gratia payment of £37,500 (£45,000 - £7,500) will partially be made up of post employment notice pay as Jack is not required to work his three month notice. The PENP is the amount of salary that Jack would have received if he was to work his full notice period. His PENP is calculated as:

(£150,000/12) x 3 = £37,500

This amount will also be taxed as employment income for Jack as normal, and PAYE will need to be applied to the payment, as well as class 1 primary and secondary NICs being payable on this amount.

N4 - the value of the car at the date it is gifted is classed as an ex gratia payment to Jack. This will therefore fall under the taxation rules of ITEPA 2003 s.401. As the value of the car is less than £30,000, this will not be taxable on Jack and no class 1A NICs will be payable on gifting the car to Jack. Additonally, no PAYE will need to be applied to the payment.

PAYE & NIC Reporting

As discussed above, PAYE will need to be applied to the bonus and ex gratia payments paid to Jack as part of the termination package. This will be made of income tax and class 1 primary and secondary NICs. The amount treated as earnings must be reported on a FPS on or before the termination payments are made to Jack, being 31 July 2024.

As the gift of the car falls under the £30,000 exemption for ITEPA s.401, no amounts need to be reported by the company in repsect of the car, and no PAYE or NIC needs to be paid in repsect of the car.

As the termination payments are made to Jack after his employment ends and the P45 is issued, Jack will receive 1/12th of the tax bands and his personal allowance.

PAYE to be Witheld

	£	£	
Amount taxed as earnings		55,000	
Income tax covered by PA	(12,570 x 1/12)x0% = 1,048	nil	
IT @ BR	(37,700 x 1/12)x20%	628	

IT @ HR	(125,140 x 1/12) - (37,700 x 1/12) x 40%	2,915	
IT @ AR	(55,000 - (125,140 x 1/12))x45%	20,057	

Part 2)

The company will be able to receive a tax deduction for the cost of the bonus paid to Jack of £10,000. This will be deductible in the period in which the bonus accrues provided it is paid within nine months of the end of the AP.

As the company is not ceasing to trade, the amount of the ex gratia payment will not be restricted so the company can receive a full deduction for the payment of £45,000.

Additionally, the company will also be able to deduct the class 1 secondary NICs payable.

--------------ANSWER-4-ABOVE---------------

--------------ANSWER-5-BELOW---------------

Answer-to-Question-_5_

In order for the company to be able to be able to purchase its own shares from Dorothy, the following conditions have to be met:

- there must be requisite power in the articles of association of the company to allow for the company to purchase its own shares.
- there must be sufficient distributable reserves within the company to be able to purchase them.
- the shares must be fully paid for at the date of acquiring the shares.

Income Distrubution

For Dorothea, the purchase of her shares will result in an income distribution in the tax year that each of her shares are disposed of, unless the conditions for capital treatment apply.

If the sale of her shares is classed as an income distribution, she will be classed as receiving a dividend based on the difference of the sales proceeds received and her original subscription price in the shares. Additionally, she is treated as making a capital disposal on the difference between the subscription price and the cost paid for her shares, but because she was the original subscriber of the shares no capital loss or gain will arise for her.

This will result in an extremely large dividend which she will pay income tax on at her marginal rate of tax.

Capital Distribution

For the purchase of her own shares to be treated as a capital distribution, the following conditions must be met:

- The company must be an unquoted trading company, and this condition is met here as the company is not listed on a recongnised stock market and the company is a trading company as it provides architectural services (a minimum of 50% trading activity is required for this purpose so we will assume that this

is the case here).

- The vendor must be UK resident and must have held the shares for at least five years. This condition is clearly met.

- The purchase of own shares must be for the benefit of the trade and one of the mian purposes of the purchase must not be the avoidance of tax. This condition would seem to be met as Dorothy wishes to retire, but the children wish to continue running the company wihtout any external shareholder being involved. They also cannot afford to purchase the shares themselves.

HMRC guidance gives an example of when the purchase of own shares would be for the benefit of the trade, and gives the example of an unwilling shareholder who wishes to sell their shares without having to sell them to a third party that would not be suitable for the rest of the shareholders. It also goes on to explain that an unwilling shareholder would include a director who is a majority shareholder who wishes to retire and make way for new management. This seems to be the case for the purchase of Dorothea's shares, and it could therefore be argued that the capital treatment applies.

More detail is given on this below.

- The vendor must make a substantial reduction of their shareholding in the company by at least 25%. Two tests are considered for this, being the share in nominal value of the shares and the share in distributable profits of the company. Sharesholdings of associates must also be included, but this only includes spouses and children under the age of 18, so her children's holdings would not be considered here.

- The vendor must not be connected with the company after the purchase of own shares, meaning that they must not own more than 30% of the ordinary shares, voting rights, or loan capital of the company after the purchase.

Advance clearance can be applied for to get confirmation that the capital treatment applies.

Immediate Sale

For the immediate sale, Dorothea would not be connected to the company after the sale of these shares, as she would only have a 28.6% holding in the shares.

Shareholding before sale = 50%

Shareholding After Sale = 20/70 = 28.57%

% Reduction = (50 - 28.57)/50 = 42.86%

She therefore has at least a 25% reduction in her shareholding.

However, given that she would still maintain some shares and does not dispose of all of her shares, HMRC would likely argue that this could not be for the benefit of the trade. Therefore the income treatment would likley apply.

Final Disposals

It is likely that only her final disposal would qualify for capital treatment. A capital gain would arise on the difference between the sales proceeds and the cost of her shares.

She would qualify for BADR if she stays as a director until the final sale of her shares because:

- she would have been a director for at least two years before disposal.
- the company would have been her persona; trading company for at least two years prior to disposal.

Therefore a gain at 10% would arise, but if she retires before then BADR would not apply to her final gain of the final 10 shares.

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--------------ANSWER-5-ABOVE---------------
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--------------ANSWER-6-BELOW---------------

Answer-to-Question-_6_

Part 1)

As the company has received advanced assurance that its activities constitute qualifying R&D activities, it will be able to claim an enhanced deduction for any qualifying costs that it incurs during the period. The notes below provide an explanation of the qualifying costs.

For accounting period beginning after 1 April 2024, the enhanced deduction is 86% of the qualifying expenditure, giving a total enhanced deduction of 186%.

Qualifying R&D Costs - YE 31 March 2024

		Qualifying Cost	Enhanced Deduction
	Workings (£)	£	£
Karen's staff costs (N1)		nil	nil
Ramanpreet's staff costs (N1	(125,000+11,500+10,000) x 80%	117,200	100,792
Daniel's staff costs (N1)	(140,000+13,500+16,000) x 80%	135,600	116,616
Software (N2)	14,000 x 100%	14,000	12,040
Utilities/COnsumables (N3)	(1,000 + 1,250 + 2,500) x 80%	4,750	4,085
Connected subcontracted costs (N4)	43,000 x 100%	43,000	36,980
Total		314,550	270,513

N1 - staff costs are a qualifying category of R&D expenditure, and this includes salaries, employer's NIC and employer's pension contributions. The benefits in kind are not a qualifying cost for R&D purposes.

Staff costs only qualify to the extent that they directly or indirectly relate to the R&D activities and helping to overcome the technical uncertainties of the project. As Karen is simply involved in the sales and strategy of the company, no proportion of her costs will qualify for relief.

As Ramanpreet and Daniel are directly involved in the R&D activities, 80% of their qualfiying staff costs will qualify. The remaining 20% of the time spent on sales activities does not qualify.

N2 - software is another qualifying category of R&D costs, provided that the software is used in overcoming the technical uncertainties of the R&D projects. The general applications will therefore not qualify, but the license for the engine modelling application will qualify at 100% of its cost, provided that it is wholly used for R&D purposes.

N3 - consumable items are another category of qualifying cost, which include water, gas and electricity. 80% of these costs will therefore qualify for tax relief as 80% of the building is used for R&D purposes. This is an acceptable method of apportioning these costs.

The rent and rates, insurance and cleaning costs, however, will not qualify for relief.

N4 - R&D activities that are subcontracted to a connected third party qualify at 100% of the lower of the amount paid to the third party or the costs incurred by the connected third party. As Raan Ltd incurs £43,000 on the activities contracted to them, this will be the qualifying amount as it is lower than the £50,000 paid to them from Miracle Ltd.

PArt 2)

The total enhanced deduction of £270,513 is deducted from taxable

trade profits as per below.

Non-trading income will need to be deducted when calculating the trade loss but will be included in the TTP of the company.

Trade Profit/Loss for the YE 31 March 2024

		£	
Loss before tax		(478,000)	
Less:			
NT income		(80,000)	
R&D Enhanced Deduction	Part 1 of Q	(270,513)	
Trade Loss		(828,513)	

The company will therefore have a trade loss of £828,513 for the YE 31 March 2024.

£80,000 of this will be used as a current year trade loss relief against the non-trade income, which will reduce the trade loss to £748,513.

There are no other taxable profits in the other accounting periods to use carry the loss back against, so the only other loss relief available would be to carry the trade loss forward. As the company expects to generate substantial taxable profits going forward, this could result in a tax saving at 25% if taxable profits exceed £250,000. If taxable profits are between £50,000 and £250,000 then a marginal tax saving of 26.5% would result, and for profits of less than £50,000 a tax saving at 19%. These corporation tax savings however would only arise 9 months and 1 day after the end of the accounting period in which the taxable profits arise, so this would delay the benefit of the R&D claim, and would also rely on the profits actually arising.

Alternatively, the company could claim an R&D tax credit for the YE 31 March 2024 at a rate of 10% of the surrenderable loss for the period, being the lower of:

- the unrelieved trade loss for the period (£748,513)
- 186% of the qualifying R&D expenditure (186% x £314,550 = £585,063

Therefore, a tax credit of £58,506 could be claimed (10% x £585,063), which would be paid by HMRC one they have processed the CT600 and the claim documentation. The remaining trade loss of £163,450 would be carried forward and used against total profits arising in the company as discussed above.

It may be favourable for the company to claim the tax credit for cash flow purposes and to fund the R&D project development work, but if cash flow is not an issue then a greated tax benefit would result if the company carried forward all of the tax loss.

There is a cap on the R&D tax credit but this will not apply to the company as they are developing intellectual property.