

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

Event **NA**

Exam Mode **OPEN LAPTOP**

Answer-to-Question-_1_

| | £ | | |
|-----------------------|---------|--|--|
| Trading profits (W1) | 100,738 | | |
| Gain on sale | 1,000 | | |
| Taxable total profits | 101,738 | | |
| | | | |

CT:

$$£101,738 \times 19\% \times 11/12 = £17,545$$

$$£101,738 \times 25\% \times 1/12 = £2,120$$

Trading profits (W1):

| | Notes | £ | |
|-------------------------------------|-------|---------|--|
| Profit | | 199,200 | |
| Add back: | | | |
| Depreciation | 1 | 9,000 | |
| Loss on disposal | 2 | 1,500 | |
| Premium | 3 | 5,767 | |
| Replacement of water heating system | 6 | 3,000 | |
| Fees for late filing penalty | 8 | 1,420 | |
| Property valuation fee | 9 | 1,200 | |
| Fee for creating SAYE | 10 | 2,500 | |
| Provision for pension contributions | 11 | 100 | |
| Less: | | | |
| Gain on sale of asset | 12 | (1,000) | |
| Dividends | 13 | (500) | |

| | | | |
|-------------------------------------|----|-----------|--|
| CAs (W2) | | (17,600) | |
| SBAs | 15 | (200) | |
| Enhanced R&D relief (79,730 x 130%) | 18 | (103,649) | |
| Adjusted trading profits | | 100,738 | |

Notes:

- 1) Depreciation is a capital expense and so is not allowed as a revenue deduction. Relief is provided instead via capital allowances.
- 2) Losses on disposal are not allowable as relief is provided via capital allowances.
- 3) When the premium is paid, an element of the premium is capital. The capital element is added back (W1).
- 4) Removal costs are allowable provided they do not relate to a relocation for the purposes of expanding the business.
- 5) Improvements in assets to keep up with existing technology are allowable as revenue deductions. The replacement of double glazed windows is therefore allowable.
- 6) As the whole of the water heating system has been replaced, the cost is capital and so not allowed.
- 7) The re-tiling of the kitchen is a genuine repair and there is no element of enhancement so it is an allowable revenue deduction.
- 8) Fees for disputing penalties, regardless of whether they are successful or not, are not allowable as HMRC do not allow costs which could potentially lead to a loss of revenue which they are owed in the form of a penalty.

9) Property valuation fees are capital and so are not allowed as a revenue expense.

10) The set up costs for SAYE schemes are not allowable, only the running costs are allowed.

11) Provisions are allowable provided there is an obligation to pay the expense at the year end which would usually be allowable, there is a reasonable expectation payment will be made within 12 months of the year end, and the amount due can be reasonably estimated. The rates, insurance and sundry accruals are therefore allowed.

The provision of staff bonuses are allowed as they are paid within nine months of the year end.

Pension contributions are only allowed in the accounting period in which they are paid. The difference in balances at 30 April 2022 and 2023 is therefore added back.

12) Gains on sales of assets are deducted and taxed as non-trading income.

13) Dividends received by companies are exempt income.

14) The water heating system is an integral feature but qualifies for AIA.

15) The extension of the car park is not eligible for P&M CAs. Instead, the SBA is claimed on 3% of the cost, and pro-rated for the first year it was brought into use $(8,000 \times 3\% \times 10/12) = \text{£}200$.

16) The van does not qualify for the FYA super-deduction because it is not new

17) Where a company incurs P&M which would qualify for general pool CAs in the period 1 April 2021 to 31 March 2023, the company gets a FYA of 130% of the cost.

18) Where a company incurs qualifying R&D expenditure, there is an enhanced rate of relief of 130% of the cost (in addition to the usual 100% relief). Only expenditure directly included in the R&D project qualifies for relief. The total qualifying expenditure of the company in the year ended 30 April 2023 is $\text{£}79,730$ (W3).

19) As the accounting period straddles 1 April 2023, the CT rate has to be apportioned for the 11 months it relates to 31 March 2023 at 19%, and one month at 25%.

Capital element of premium (W1):

$$6,000 - (2\% \times 6,000 \times (9 - 1)) = \text{£}5,060$$

$$\text{£}5,040/9 \times 5/12 = \text{£}233$$

$$\text{Add back } 6,000 - 233 = 5,767$$

Capital allowances:

| | FYA (£) | AIA (£) | | |
|----------------------------|---------|----------|--|--------|
| Additions: | | | | |
| Water heating system (N14) | | 3,000 | | |
| Van (N16) | | 8,750 | | |
| Furniture | 4,500 | | | |
| FYA 130% | (5,850) | | | 5,850 |
| AIA 100% | | (11,750) | | 11,750 |
| Total | | | | 17,600 |

Qualifying R&D expenditure:

| | | £ | |
|----------------|------------------------|--------|--|
| Staff costs | (74,950 + 7,800) x 90% | 74,205 | |
| Sub-contracted | 8,500 x 65% | 5,525 | |

| | | | |
|-------|--|--------|--|
| Total | | 79,730 | |
|-------|--|--------|--|

Overheads are not qualifying costs, only consumables are specifically qualifying.

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

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

Answer-to-Question-_2_

Income tax before employee costs:

| | £ | | |
|------------------------------|---------|--|--|
| Profits | 120,000 | | |
| Less: PA | (2,470) | | |
| Basic rate: 37,700 x 20% | 7,540 | | |
| Higher rate: 79,830 x 40% | 31,932 | | |
| Total | 39,472 | | |

Income tax after employee costs:

| | £ | | |
|------------------------------|----------|--|--|
| Profits (W1) | 98,957 | | |
| Less: PA | (12,570) | | |
| Basic rate: 37,700 x 20% | 7,540 | | |
| Higher rate: 48,687 x 40% | 19,475 | | |
| Total | 27,015 | | |

Net cost to Remi

| | £ | | |
|-------------------------|----------|--|--|
| Total employee costs | 19,800 | | |
| Payroll software | 120 | | |
| Less: income tax saving | (12,457) | | |
| Net cost | 7,463 | | |

Profits after employee costs (W1):

| | £ | | |
|--|----------|--|--|
| Profit | 120,000 | | |
| Less: | | | |
| Salary | (16,400) | | |
| Class 1 secondary NICs (W2) | (1,099) | | |
| Benefits | (3,400) | | |
| Class 1A NICs on taxable benefits (W3) | (144) | | |
| Taxable profits | 98,957 | | |

NICs on salary (W2):

$$(16,400 - 9,100) \times 15.05\% = 1,099$$

Class 1A NICs:

$$(80 \times 12) \times 15.05\% = \text{£}144$$

2)

Salary:

Remi will need to notify HMRC when he employs Heidi in order to get access to the online payroll service.

PAYE reporting takes places via Real Time Information (RTI).

Remi will be required to deduct income tax and Class primary 1

NICs each month via PAYE and submit this to HMRC. The deductions are taken into account when Heidi is paid, but the amounts will be paid to HMRC on 22 of each tax month. Remi will also be responsible for deducting Class 1 secondary NICs.

The submissions are made to HMRC by Full Payment Submissions (FPS). The FPS will need to include the details of Heidi's pay and the PAYE deducted.

The first FPS will also need to include Heidi's address and passport number.

To calculate the correct amount of income tax deducted each month, Remi will need to operate Heidi's PAYE code, which will be generated by HMRC based on the information submitted by Remi.

Remi needs to provide Heidi with a P60 by 31 May following each tax year, detailing her gross income and tax deducted.

Benefits:

As Heidi is also receiving taxable benefits, Remi will need to report the value of the benefit on form P11D each year. The P11D must be provided to Heidi, and submitted to HMRC by, 6 July following each tax year.

Remi needs to pay Class 1A NICs on the value of any taxable benefits. The Class 1A needs to be reported on form P11D(b), which must be submitted to HMRC by 22 July following the tax year. Payment of Class 1A NICs is due by the same date where made electronically (19 July otherwise).

The medical insurance will need to be reported on form P11D.

Alternatively, Remi can register to collect the tax and NICs on the benefits via payroll. In this case, no forms P11D or P11D(b) will need submitting. Remi will need to inform Heidi each year of her taxable benefits and the tax deducted.

The mobile phone is an exempt benefit and so had no reporting requirements for Heidi. The laptop is also exempt as private use is insignificant.

The contribution to Heidi's pension scheme is an exempt benefit, Remi must apply PAYE after the contribution has been deducted from her salary.

The approved mileage rate is £0.45 per mile for the first 10,000 business miles. Remi will therefore have to apply PAYE and Class 1 NICs to the excess of £0.15 per mile. This will be reported and paid to HMRC in the same way as Heidi's earnings.

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

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

Answer-to-Question-_3_

1)

For a company to qualify for an EMI scheme, it must be a small trading company.

For EMI purposes, trading means the companies non-trading activities are not-substantial. Substantial means not more than 20% of various factors including time spent, turnover and balance sheet assets.

Star Trading Ltd will be a trading company as it operates a retail store. It is therefore necessary to consider the impact the sale of the premises will have on the company's balance sheet and turnover.

The premises is currently being used by the company, so will be a trading asset.

Option one:

Under option one, a trading asset in the balance sheet will be replaced for cash. Surplus cash can affect a company's trading status if it is not being held for trading purposes.

However, as the proceeds from the sale will be retained for working capital, the additional cash in the balance sheet will not affect the company's trading status.

Star Trading Ltd will not be receiving any additional income under this option, so turnover will not be affected.

If John proceeds with the sale of the property, this is unlikely to affect the company's trading status for EMI purposes.

Option two

Under option 2, as the premises will be rented out to a third

party, it will no longer be used for trading purposes. Therefore, Star Trading Ltd will now hold a non-trading asset in its balance sheet.

Assuming the remainder of the company's assets are all held for trading purposes, the balance sheet will now be made up of 20% non-trading assets.

In addition, the rent received will be non-trading income, so this will affect the company's turnover.

On the basis 20% of the company's balance sheet assets, and 30% of its turnover, is now non-trading, this option will affect the eligibility for EMI purposes.

However, the limits are only just over the 20% threshold, and Star Trading Ltd is a trading company. Therefore, this method presents a risk of a disqualifying event for EMI purposes, but the disqualifying event is not certain.

Option 3:

The development of the property into flats will affect the trading status of the balance sheet as the company will now hold an investment property.

However, as the premises only makes up 20% of the balance sheet assets, and there has been no impact to the turnover, it is unlikely the development of the properties will affect the company's trading status.

However, when the flats are sold for a substantial amount, this gain will make up a significant amount of the company's non-trading income for the year of sale.

Therefore, the year the flats are sold might affect the trading status for EMI purposes, and result in a disqualifying event.

2)

Where EMI options are exercised within 10 years of grant, there is only an income tax charge if the shares are exercised at a discount.

If the share options are exercised in June 2023, this will be within 90 days of the disqualifying event. Therefore, the income tax advantages of the scheme will be preserved.

As the shares were granted to Bill at a discount, there will be an income tax charge arising on the difference between the lower of the market value of the shares at grant and exercise, and the amount Bill paid for the shares.

Therefore, the income tax charge will be £8,499 ($£85 \times 100$) - ($£0.01 \times 100$)

There will be no CGT charge until Bill sells the shares. When the shares are sold, a chargeable gain will arise on the difference between the consideration received and the market value at exercise.

If the shares are exercised in June 2026, this will be three years after the disqualifying event. Bill will be subject to income tax on the increase in the value of the shares between the disqualifying event and exercise $£5,500$ (140×100) - (85×100).

The CGT arising on the disposal of John's shares will be calculated in the same way as if they were exercised in June 2023.

3)

As there are trading arrangements in place for John to pass the company onto Bill, their shares will be RCAs.

The company will receive a CT deduction at the exercise of the shares equal to the difference between the market value at exercise and the amount Bill paid for the shares.

The amount charged to income tax at exercise will be subject to PAYE at Bill's marginal rate and the company will have to pay Class 1 NICs on this amount at 15.05%. This will have to be paid to HMRC by 22 June (if paid electronically) and reported on the company's full payment submission for the month.

The company will receive a CT deduction for the Class 1 NICs paid.

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

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

Answer-to-Question- _4_

1)

| | AIA (£) | General pool (£) | Special rate pool (£) | Private use Lakeside (£) | Private use EV (£) | CAs (£) |
|-------------------------|----------|------------------|-----------------------|--------------------------|--------------------|---------|
| Tax wdv b/f | | 17,000 | 23,000 | 23,000 | | |
| Additions: | | | | | | |
| Heating system | | | 34,000 | | | |
| Wood panelling | 17,000 | | | | | |
| Pictures | 4,000 | | | | | |
| Car | | | 18,000 | | | |
| Electrical and plumbing | 6,700 | | | | | |
| Lift deposit | 5,000 | | | | | |
| Electric car | | | | | 5,800 | |
| Disposals: | | | | | | |
| | | (15,000) | | | | |
| AIA 100% | (32,700) | | | | | 32,700 |

| | | | | | | |
|---------|--|-------|----------|---------|-----|--------|
| WDA 27% | | (540) | | (4,658) | 940 | 6,138 |
| WDA 9% | | | (41,000) | | | 41,000 |
| | | | | | | |
| | | | | | | |
| | | | | | | |

SBAs:

$$(\pounds63,000 + 4,500) \times 3\% \times 2/12 = \pounds338$$

SBAs are available from when the building is first brought into use.

Notes:

1) Accounting periods for sole traders can exceed 12 months. As Megan is not trading through a company only one CA's computation is prepared. The WDA on the general and special rate pools are adjusted to 27% and 9% respectively.

2) The heating system has an element of private use so is added to its own pool. The system is an integral feature so the AIA is claimed on this asset in priority.

3) Decorative assets are only eligible for CAs where they are used for the benefit for the trade. The assets will be eligible in the hotel as they are for the customers. The pictures in the offices are not eligible.

4) The car is added to the special rate pool as CO₂ exceeds 50 g/km. There's no private use adjustment for employees as they will be taxed on the car as a benefit.

6) The electrical and plumbing costs are integral features. The

remainder of the costs aren't eligible for P&M CAs. SBAs can be claimed on the construction and demolition costs but not on the legal fees.

7) Lifts are integral features. As the balance is paid after the year end, CAs will be claimed in the next accounting period. The deposit is accounted for when it is paid.

8) CAs are incurred when the obligation to pay becomes unconditional which is usually the date of delivery. This does not apply if there are more than four months between payment and delivery. The deposit on the electric car is deducted when it's paid. The first balance will be allowable assuming it was paid when the car was delivered. The remaining four years will not be allowable in the y/e 31 March 2023. The FYA is not available because the car isn't new. The AIA isn't available for cars.

2)

Sale of Moorside:

The SBA is a 3% per annum straight line deduction on the allowable cost. When Megan sells the property, the SBAs in the year of sale will be apportioned for the months in the accounting period which it relates to.

The SBAs claimed up to the date of sale will be added to the consideration received when calculating the chargeable gain.

Purchase of Woodside:

Megan will not be able to claim SBAs on the purchase price as it was built prior to October 2018.

Megan can only claim CAs on the fixtures of Woodside if the fixed value requirement and the pooling requirement are met.

Megan and the seller can make an election under s.198 CAA 2001 to fix a disposal value to the fixtures in the building. Megan can then claim CAs on this value when the building is purchased.

The election must be submitted to the Tribunal within two years of completion.

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

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

Answer-to-Question-_5_

1)

When a business is incorporated, the assets are deemed to be disposed of at their market value.

The chargeable assets of James' business consists of land and buildings and goodwill. The transfer of the plant and machinery would give rise to a loss and therefore, there is no gain arising on the transfer of the P&M.

Motor vehicles and stock are not chargeable assets so there will be no CGT implications of their transfer at incorporation.

The CGT arising on the transfer of the chargeable assets will be the difference between their market value at the date of transfer, and their original cost.

The chargeable gains arising at incorporation, before any reliefs, will be £645,000 (W1).

This gain will be subject to CGT on James.

Incorporation relief (IR) is available to defer the chargeable gains arising at incorporation. The gain reduces the individual's base cost of their shares in the company.

For IR to apply, either the whole or part of consideration must be received in the form of shares, and all of the sole trade's assets (except for cash) must be transferred to the company. IR is automatic at incorporation.

If James transfers all of his assets to the company, IR will be available. If all of the consideration is received in shares, there will be no gain chargeable in 2023/24.

However, if James does receive some consideration in cash, IR will be reduced in proportion to the element of cash received, and this element of the gain will remain chargeable.

If James receives some consideration in cash, the gain on L&B not

covered by IR will qualify for business asset disposal relief (BADR). This is because he is making a material disposal of his sole trade, of which he has operated for more than two years.

The gain arising on incorporation is within James' lifetime allowance of £1 million.

Therefore, any gain arising on the disposal of the L&B will be charged at 10%, even though James is a higher rate taxpayer.

BADR is not available on the disposal of goodwill to a connected company where the individual holds at least a 5% shareholding. Therefore, the gain on the goodwill will not qualify for BADR and will be subject to CGT at 20%.

The amount of IR will need to be apportioned between the gain on the L&B and the goodwill.

Alternatively, if James does not wish to transfer all of the assets to the company, and for example, keep the L&B personally, the disposal will not qualify for IR, but James can make a claim for gift relief.

Gift relief will defer the gain arising at incorporation, and the gain reduces the base cost of the company's assets.

A joint claim for gift relief will have to be made by James and the company within four years of the end of the gift.

Gains arising on incorporation (W1):

| | £ | | |
|---------------------|-----------|--|--|
| Land and buildings: | | | |
| Proceeds | 500,000 | | |
| Less: cost | (300,000) | | |
| Gain | 200,000 | | |
| | | | |

| | | | |
|-------------|---------|--|--|
| Goodwill | | | |
| Proceeds | 465,000 | | |
| Less: cost | nil | | |
| | | | |
| Total gains | 645,000 | | |
| | | | |

2)

a)

James:

| | | | |
|-------------------------------|---------|--|--|
| | £ | | |
| Sole trade profits | 115,000 | | |
| Less: PA | nil | | |
| Basic rate: £37,700 x 20% | 7,540 | | |
| Higher rate: £77,300 x 40% | 30,920 | | |
| | | | |
| Interest | | | |
| £500 x 0% | | | |
| £1,500 x 40% | 600 | | |
| | | | |
| Dividends | | | |
| £2,000 x 0% | | | |
| £13,000 x 33.75% | 4,389 | | |
| | | | |
| Total | 43,449 | | |

Betty:

| | | | |
|-------------------|--------|--|--|
| | £ | | |
| Employment income | 25,000 | | |

| | | | |
|------------------------------|----------|--|--|
| Less: PA | (12,570) | | |
| Basic rate: £12,430 x 20% | 2,486 | | |
| Total | 2,486 | | |

b)

Company distributable profits:

| | | | |
|--------------------------|----------|--|--|
| | £ | | |
| Profits | 115,000 | | |
| CT £115,000 x 25% | (28,750) | | |
| Distributable profits | 86,250 | | |
| | | | |
| Dividends each | 43,125 | | |
| | | | |

James:

| | | | |
|-----------------------------------|----------|--|--|
| | £ | | |
| Interest | 2,000 | | |
| £500 x 0% | 0 | | |
| £2,000 x 20% | 400 | | |
| | | | |
| Dividends | 58,125 | | |
| Less: PA | (12,570) | | |
| | 45,555 | | |
| £2,000 x 0% | 0 | | |
| Basic rate: £33,200 x 8.75% | 2,905 | | |
| Higher rate 7,855 x 33.75% | 2,651 | | |
| | | | |
| Total | 5,956 | | |

Betty:

| | £ | | |
|-------------------------------|----------|--|--|
| Employment income | 25,000 | | |
| Less: PA | (12,570) | | |
| Basic rate: £12,430 x 20% | 2,486 | | |
| | | | |
| Dividends: £43,125 | | | |
| £2,000 x 0% | 0 | | |
| Basic rate: 33,214 x 8.75% | 2,906 | | |
| 7,911 x 33.75% | 2,670 | | |
| Total | 8,062 | | |
| | | | |

Difference in tax liabilities:

$$45,935 - 14,018 = \text{£}31,917$$

 -----ANSWER-5-ABOVE-----

-----ANSWER-6-BELOW-----

Answer-to-Question-_6_

1)

Furniture shop:

Up to and including the 2022/23 tax year, sole traders were assessed on their taxable profits falling in their basis period.

The tax year a basis period relates to is the tax year in which the accounting period ends in.

As Gustav ceased the furniture shop in September 2022, he ceased trading in the 2022/23 tax year. The closing year rules will therefore apply for 2022/23.

Under the closing year rules, for the final year of trade the trader is taxed on profits arising in the period starting immediately after the end of the previous accounting period, up to the date of cessation.

In 2022/23, Gustav will therefore be taxed on the profits arising in the period 1 May 2021 to 30 September 2022.

As the business commenced prior to 1997/98, Gustav will have notional overlap profits which he can deduct from his final year of trade. The profits will be those that arose in the 1997/98 tax year prior to 5 April 1997.

As this business ceased trading in 2022/23, there will be no basis period in 2023/24 or 2024/25.

Art gallery:

In 2022/23, the basis period will be determined under the current year basis rules. Therefore, Gustav will be taxed on the profits arising in the period 1 May 2021 to 30 April 2022.

From 2024/25 onwards, basis periods have been abolished, with 2023/24 being the transition year.

From 2024/25 onwards, where a sole trader does not have a 31 March or 5 April year end, they will be assessed on the profits arising in the tax year, rather than those falling in the basis period.

For 2023/24, the basis period starts immediately after the prior one ends, and ends on 5 April 2024.

In 2023/24, Gustav will be taxed on his profits arising in the period 1 May 2022 to 30 April 2023, as well as profits up to 5 April 2024.

The first 12 months of trade will be the standard part of the basis period, with the remaining 11 months making up the transitional period. The transitional profits will be spread over five years and 20% of the profits will be taxed in each tax year.

Gustav can deduct any overlap relief from when he commenced trading from his transitional profits.

Gustav can elect to have more of the transitional profits taxed in an earlier year if he wishes.

From 2024/25 onwards, Gustav's profits will be taxed to the extent they fall in the tax year (being the profits arising in the period 6 April 2024 to 5 April 2025). Gustav will therefore have to apportion his profits going forwards into a one month period, and a subsequent 11 months so that they fall within the tax year.

2)

| | £ | | |
|--------------------------------|--------|--|--|
| Profit | 39,800 | | |
| Add back: | | | |
| Depreciation | 16,800 | | |
| Statutory redundancy above cap | 7,100 | | |

| | | | |
|---------------------------------------|---------|--|--|
| Removal of fixed partitions (capital) | 6,000 | | |
| Accountancy and legal advice | 1,500 | | |
| Loss on disposal of fixed assets | 4,900 | | |
| Less: CAs (W1) | (1,800) | | |
| Tax adjusted profit | 74,300 | | |
| | | | |

Notes:

- The cost of goods taken for own use are added to taxable turnover. As the £4,000 has already been included in the cost of sales, no adjustment is required.

NICs:

Class 2:

$$£3.15 \times 52 = £164$$

Class 4:

| | | | |
|----------------------------|---------|--|--|
| | £ | | |
| Furniture shop | 121,300 | | |
| Gallery | 27,000 | | |
| £11,908 x 0% | 0 | | |
| (50,270 - 11,908) x 10.25% | 3932 | | |
| 98,030 x 3.25% | 3,186 | | |
| | | | |

Capital allowances (W1):

| | | General pool (£) | Special rate pool (£) | CAs (£) |
|---------------------|--|------------------|-----------------------|---------|
| Tax wdv b/f | | 7,000 | 4,800 | |
| Disposals: | | | | |
| Fittings | | nil | | |
| Van | | (10,000) | | |
| Balancing allowance | | | (4,800) | 4,800 |
| Balancing charge | | 3,000 | | (3,000) |
| Total | | | | 1,800 |
| | | | | |
| | | | | |