



# The Chartered Tax Adviser Examination

November 2019

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## Application and Professional Skills

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### Human Capital Taxes

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TIME ALLOWED – 3 ¼ HOURS

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- The first 15 minutes is designated as reading time. During this time you may read your question paper and legislation, annotate your question paper and use your calculator. You are not permitted to start writing your answer. The Presiding Officer will inform you when you can start writing.
- In order to secure a pass in this paper, you will be required to demonstrate competence in each of three skills.

You will be assessed across your answer as a whole for Structure. A pass or fail grade will be awarded.

You will be assessed for competence in a number of broad topics for the following skills:

- Identification and Application
- Relevant Advice and Substantiated Conclusions

For each topic for each of these two skills, a grade will be awarded. The grades for those topics will be weighted and averaged to produce a final grade for each skill of 0, 1, 2, 3 or 4. A grade of 3 or 4 is required to demonstrate competence.

- Write on one side of the paper only. Do not write in the margins.
- All workings should be shown and made to the nearest month and pound unless the question specifies otherwise.
- Candidates who answer any law elements in this paper in accordance with Scots law or Northern Ireland law should tick the appropriate box on the cover sheet.
- Scots Law candidates may provide answers referring to Land and Buildings Transaction Tax rather than Stamp Duty Land Tax.
- Unless otherwise indicated by the provision of additional information, you may assume that 2018/19 legislation (including rates and allowances) continues to apply for 2019/20 and future years. Candidates answering by reference to more recently enacted legislation or tax cases will not be penalised.

You are Anna Smith, a tax manager in a firm of Chartered Tax Advisers. You have received an email (**EXHIBIT A**) from William Edwards, the Chief Executive Officer of your client, ASU Ltd.

He wants to introduce an incentive scheme for senior staff to help encourage growth in the company for a possible sale. In this regard he has taken advice from an HR consultant (**EXHIBIT B**) and would like your advice in relation to the suggestions made.

The following exhibits are provided to assist you:

**EXHIBIT A:** Email from William Edwards

**EXHIBIT B:** Letter from HR consultant

**EXHIBIT C:** Pre-seen information

**Requirement:**

**Prepare a draft report to William Edwards, which advises on which of the reward schemes they should consider implementing.**

#### **EXHIBIT A**

##### Email from William Edwards

From: William Edwards  
To: Tax Manager  
Date: 01 November 2019  
Subject: Proposals for a new reward scheme

Dear Anna

I hope you are well.

As you know, ASU Ltd has been growing over the last four years and we want to double the size of the business over the next three years. At this point, Petra and I consider that we will be in a good position to sell the company. We have already had some interest from a couple of sources and feel this is a realistic goal.

To achieve this aim we are recruiting heavily and want to expand our senior management team by adding a Head of Sales and a Head of Marketing. It is important that these are high calibre individuals with a proven track record. Recruitment has started and we are aiming to have both in role by 1 March 2020.

We also want to make sure our existing heads of department (Frances and Harry) and their team leaders (around 15 individuals) remain engaged and motivated: we are very keen to avoid disruption through staff turnover at the leadership level in the run up to a sale.

We think this can be achieved by introducing a reward scheme that focuses the team on company growth ready for sale and also discourages them from leaving the company. We have discussed this with an HR consultant who has provided two suggestions. One is based around share options and the other around cash awards. I have attached his letter. Petra and I have agreed that if there is any share value dilution as a result of the implementation of either scheme then this will only impact my holding.

Please can I have your thoughts on his suggestions and also your recommendations as to which we implement.

Many thanks

William

Continued

Continuation

**EXHIBIT B**

Letter from HR consultant

William Edwards  
ASU Ltd  
Horley  
Surrey

Timothy Yarrow  
HR Solutions Ltd  
Guildford  
Surrey

25 October 2019

Dear William

Long Term Incentive Awards for senior staff

Thank you for giving me the opportunity to meet with you recently.

From our conversation I understand that you are interested in implementing a new rewards scheme that will both incentivise and retain your key senior employees over a period of three years culminating with the sale of the company. You are not certain whether you want a share based or a cash based scheme.

You want there to be incentives within the scheme to encourage participants to stay to the end of the three years. Additionally you are keen that the scheme will help encourage your senior employees to stay focused on growing the business.

The appendices to this letter contain two suggestions for you to consider. I would be happy to discuss these with you further and would be delighted to work with you through the implementation process once you have made your decision. Whilst I've obviously got a working knowledge of tax issues relating to HR matters, I'm not a tax specialist, so I would recommend that you discuss the suggestions with your tax adviser.

Yours sincerely

Timothy Yarrow  
CEO HR Solutions Ltd

Appendix A: Enterprise Management Incentive Scheme

This is a share option scheme under which you grant your employees options to buy shares in your company in the future at a price set today.

As this is an HMRC approved tax advantaged scheme, employees can benefit from any increase in the value of the shares over the intervening period Income Tax and NIC free. When they sell the shares they will benefit from a low 10% Capital Gains Tax rate!

You can build in conditions to keep your employees with you and focused on your goal of growing the business with an aim to sell in three years' time.

As you won't want to reward employees who leave and buying back shares isn't an easy or cheap process, we recommend that the plan is set up as an "exit only" scheme where individuals will only be able to exercise their options in the event of a company sale. Additionally, we recommend that individuals are only allowed to exercise their options if they are still employed by the company at the date of exercise.

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Continuation

For your employees there is a built-in incentive for them to work towards company growth as the more the shares are worth the more valuable their option becomes and the greater amount of cash they will be able to realise when they sell the shares.

Appendix B: Flexible Cash Award Scheme

Under this scheme you grant your employees the right to receive cash awards in the future.

Individuals will only be eligible to receive the cash award if they are still employed by ASU Ltd on the date they are due to receive the cash award. We recommend that the plan contains pay-out dates across the three years that the scheme will be designed to cover.

To build in a feature to encourage your employees to work towards company growth we recommend that the cash value of awards to be paid under the scheme is linked to growth in the value of the company over the financial year. We can discuss further how this will be achieved as the scheme is implemented if this is of interest.

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**EXHIBIT C**

Pre-seen information

Client Name

ASU Ltd

Client Background

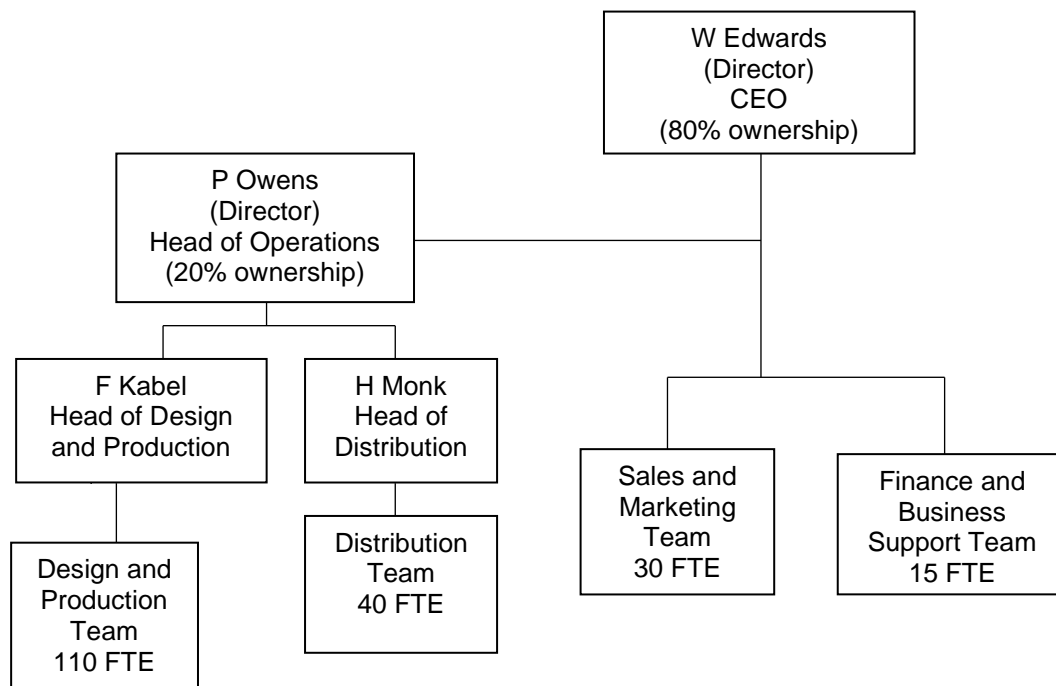
ASU Ltd is a software development company, which was incorporated on 1 June 2010.

It has two directors, William Edwards and Petra Owens.

There are 1,000 ordinary shares of £1 each in issue. 80% of the shares are held by William Edwards with the remaining 20% held by Petra Owens. These were issued on incorporation.

There is no separate shareholders' agreement.

Organisation Chart



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Client Pension arrangements

William Edwards and Petra Owens each have a personal pension plan that they contribute to individually. They have opted out of auto-enrolment.

ASU Ltd did not operate a company pension scheme prior to 2015. From 1 April 2015 the minimum level of contributions for each relevant employee have been made to NEST.

Key Individuals

William Edwards:	CEO (Director and 80% shareholder) UK Resident and Domiciled Works full-time for ASU Ltd Salary from ASU Ltd – £200,000 per annum P11D items: Company car and medical insurance
Petra Owens:	Head of Operations (Director and 20% shareholder) UK Resident and Domiciled Works full-time for ASU Ltd Salary from ASU Ltd – £160,000 per annum P11D items: Company car and medical insurance
Frances Kabel:	Head of Design UK Resident and Domiciled Works full-time for ASU Ltd Salary from ASU Ltd – £140,000 per annum
Harry Monk:	Head of Distribution UK Resident and Domiciled Flexible working arrangement – three day week for ASU Ltd Salary from ASU Ltd – £50,000 per annum

VAT

Registered entity:	ASU Ltd
Registration number:	26154826
Registration date:	10 January 2011

No option to tax has been made on the company's property.

Corporation Tax – Taxable Total Profit for ASU Ltd

<u>Year ended</u>	£
31 March 2019	680,211
31 March 2018	675,599
31 March 2017	501,023

Continued

Continuation

Summary accounts for ASU Ltd for the year ended 31 March 2019

Income statement for the year ended 31 March 2019

	£	£
Sales		3,500,000
Cost of sales		<u>(1,400,000)</u>
Gross profit		2,100,000
Other income:		
Bank interest	10,500	
Property income	100,000	
	<u>          </u>	110,500
Expenditure:		
Director's remuneration	603,140	
Employment costs	909,000	
Other administration costs	34,550	
	<u>          </u>	<u>(1,546,690)</u>
Net profit		<u>£663,810</u>

Director's remuneration and employment costs include all Class 1 secondary National Insurance contributions and company pension contributions.

Property income refers to rental receipts from the letting of excess office space in the ASU Ltd premises.

Balance sheet at 31 March 2019

	£
Freehold property	2,200,000
Plant and machinery	900,000
Debtors/inventory	550,000
Bank: current account	280,000
deposit account	1,100,000
Less: creditors	<u>(170,000)</u>
	<u>£4,860,000</u>
Capital and reserves:	£
Share capital	1,000
Profit and loss	<u>4,859,000</u>
	<u>£4,860,000</u>