

# **The Chartered Institute of Taxation**

**Advanced Technical**

**Taxation of Owner-Managed Businesses**

**May 2021**

**Suggested answers**

## ANSWER 1

### Dafydd – Income tax computation 2020/21

	Notes	£	£
Profit per accounts			19,000
Depreciation	1	36,000	
Less loader on finance lease		(5,400)	30,600
Lease costs for high emission car (£3,600 x 15%)	2		540
Goods for self (sales value)	3		100
Repairs on access road	4		-
Drainage and fencing repairs	5		6,500
Household costs (£3,750 x 75%)	6		2,812
Adjusted profit			<u>59,552</u>

- 1) Depreciation is disallowed and replaced by capital allowances (½). Depreciation is allowed as an expense for assets acquired under a finance lease (½).
- 2) The lease costs are restricted to 85% of the rental costs (½). The maintenance costs are not restricted (½) nor are the costs restricted for the employee's private use (½).
- 3) Goods for personal consumption are added back at sales value (½).
- 4) The repair of the road is allowable as an expense, following the decision in G Pratt & Sons v HMRC Commissioners [2011] UKFTT 416 (TC). (½)
- 5) The repairs are not allowable as they are considered capital in nature (they were reflected in the acquisition cost of the field) (½) following the decision in the Law Shipping Co. Ltd v CIR [1923] 12TC621.
- 6) There is no disallowance for the household costs for an employee (½), whereas the farmhouse costs are restricted for private use (½). (5)

### Plant and machinery allowances

Capital allowances		Main pool	Special rate pool	Private	Allowances
WDV b/f		4,000	7,000		
<b>Additions not qualifying for AIA</b>					
Tractor from brother	1	60,000			
Car for employee	2	12,000			
<b>Disposal</b>					
Tractor	3	<u>(51,000)</u>			
		25,000			
<b>Additions qualifying for AIA</b>					
Moveable panels	4	4,000			
Deposit on combine	5	12,000			
Cold water system	6	2,600			
Electrical installation on renovation	7	5,500			
Slurry store	8	3,000			
Wall and floor work	9	<u>14,000</u>			
		41,100			41,100
Solar panels	10	10,000		(75%)	2,500
WDA 18% x 18/12	11	(6,750)			6,750
6% x 18/12			(630)		630
Total plant and machinery allowances					<u>50,980</u>

Notes:

- 1) Asset not eligible for AIA as it has been acquired from a connected party. (1)
- 2) As a car, no AIA is available (½). The cost should include the VAT which is not recoverable (½) and as it is provided for an employee, there is no restriction for private use (½).
- 3) Disposal value includes the scrap proceeds (½) and the insurance proceeds (½).
- 4) As the panels are moveable (½) and it is intended that they will be moved (½), then plant and machinery allowances are available.
- 5) Annual Investment Allowance is only available on the deposit (½) for the combine harvester, as it is only to be brought into use in August 2021 (½).
- 6) The cold water system qualifies as integral features (½), whereas the drainage system does not qualify as it is considered part of the building (½).
- 7) The electrical installation on the renovated building qualifies for AIA as integral features (1).
- 8) A slurry store is specifically listed in List C s23, CAA 2001 and it is assumed to be plant on the basis that it has a function in the trade (1).
- 9) This work is allowable as incurred for the purposes of installing plant and equipment. (1). The related planning costs are also allowable (½).
- 10) The business proportion of the solar panels qualifies for AIA as integral features (½), although there is a restriction for private use (½).
- 11) Allowances are adjusted for the long accounting period (1).

**Structures & buildings allowance**

Total costs of renovation	45,000	
Less:		
Costs of land preparation (allowable)	-	(½)
Planning costs	1,500	(1)
Integral features	5,500	(7,000) (½)
	38,000	
Allowance available	3% x 3/12	285 (1)

Total allowances available: (50,980 + 285) = £51,265.

(15)

**MARKING GUIDE**

TOPIC	MARKS
Disallowance of depreciation	½
Depreciation allowed for finance lease	½
Goods for self at market value	½
Allowance of repair of road	½
Restriction of lease costs, not including maintenance and not restricted	1½
No allowance for repairs carried out due to condition on acquisition	½
Restriction for personal costs, but not employee costs	1
No AIA on connected party acquisition	1
No AIA on car, cost to include VAT, no restriction for employee	1½
Inclusion of scrap and insurance for disposal	1
Restriction of AIA to deposit on asset on HP	1
Allowance for moveable panels	1
Allowance of alteration costs, including planning	1½
Allowance for electrical installation	1
Allowance for cold water system, but not drainage	1
Allowance for slurry store	1
Allowance for solar panels as integral features, restricted	1
WDA extended	1
Calculation of allowance for SBA	3
<b>TOTAL</b>	<b>20</b>

## ANSWER 2

### Corporation tax computation Year ended 31 December 2020

	£	Note
Profits chargeable:		
<u>Income</u>		
Jones Farms LLP	69,000	1
<u>Deductions and reliefs</u>		
Trading losses	(52,330)	2
Non-trading loan relationship debits	<u>(100)</u>	
Profits chargeable to corporation tax	<u>16,570</u>	
Corporation tax at 19%	3,148	
Tax payable under s.464A CTA 2010	<u>13,000</u>	14
Corporation tax chargeable	<u>£16,148</u>	

#### Notes:

#### 1) Jones Farm LLP profit

As the accounting reference date of the LLP does not match that of the company, the share of the partnership profits for the years ended 31 March 2020 and 31 March 2021 are time-apportioned to the year ended 31 December 2020.

$$£108,000 \times 3/12 + £56,000 \times 9/12 = £69,000$$

#### 2) Trading profits adjustment

	£	Note
Profit/(loss) per accounts	99,150	
Add:		
Depreciation in cost of sales	12,000	3
Replace air conditioning system	2,700	4
Customer gifts	-	5
Customer entertainment and travel	4,350	6
Loan arrangement fees	-	7
Tax protection insurance	500	8
VAT interest	500	9
CT interest	100	9
Parking fine	30	10
Loss on sale of assets	5,200	11
Depreciation in overheads	10,500	3
Less:		
Accounting share of LLP profit	(134,500)	12
Capital allowances	<u>(52,860)</u>	13
Tax-adjusted trading profit/(loss)	<u>£(52,330)</u>	

- 3) Depreciation is a non-deductible capital cost within the profit and loss account.

Depreciation included in cost of goods produced is £14,000. However, £4,500 of this depreciation is included in closing stock and has therefore not been included as an “expense” of the year. Similarly, £2,500 of the depreciation included in the closing stock at 31 December 2019 has now been charged to the P&L through the cost of the goods sold in the period. As a result, the depreciation actually included in the P&L within cost of sales is:

$$£14,000 + £2,500 - £4,500 = £12,000$$

Depreciation within overheads is added back in full.

- 4) The air conditioning system is an integral feature. This is being replaced in full and is therefore capital expenditure, which qualifies for capital allowances.
- 5) Free samples given to customers are deductible, even if they are food or drink.
- 6) Client entertainment is not deductible as it is specifically disallowed by s.1298 CTA 2009. Travel costs which are incidental to the provision of entertainment are also disallowed – in this case, travel to the sporting event. Staff travel to business lunches is allowable, however, as this has an underlying business purpose.
- 7) Loan arrangement fees are deductible from trading profits as the loan has a trading purpose.
- 8) Tax protection insurance is not deductible as it potentially allows the company to reclaim fees incurred in negotiating additional tax liabilities resulting from careless or deliberate inaccuracies. It is not possible to apportion the premiums since it is impossible to identify a part that has been incurred wholly and exclusively for the purposes of the trade or profession. The cost remains disallowable even if the company makes no claim under the policy or only claims expenses that are allowable. This is because the premiums cover some risks where the related costs are not allowable for tax purposes.
- 9) No deduction is given for interest on late paid VAT under s.1303 CTA 2009. A deduction is given for CT interest, but it is a non-trading loan relationship debit, as it arises in the company's position as taxpayer and not as a trader.
- 10) A tax deduction is not given for fines and penalties paid by the company, on the basis that they are not wholly and exclusively incurred for trading purposes.
- 11) The loss on sale of assets is a non-deductible accounting adjustment.
- 12) The accounting share of the LLP's results must be adjusted out as it is an accounting entry. The company's share of the LLP's taxable profits is included at Note 1 above.

13) Capital allowances

Capital allowances	AIA @ 100% £	Main pool £	Allowances £
TWDV b/f	nil	18,000	
Additions:			
Steam stretching machine (used)	30,000		
Racking and shelving	3,550		
Cold store and installation work	14,000		
Air conditioning system	2,700		
Disposals:			
Steam stretching machine		<u>(3,500)</u>	
		14,500	
AIA @ 100%	(50,250)		50,250
WDA @ 18% x 14,500		<u>(2,610)</u>	<u>2,610</u>
			52,860
TWDV c/f	<u>nil</u>	<u>11,890</u>	

- 14) Dean has overdrawn his capital account in the partnership by £40,000 and therefore he has effectively "borrowed" £40,000 from the other (corporate) partner's capital account. This happened in the previous accounting period. As Dean is also a participator in the corporate partner, s.464A CTA 2010 applies to the indirect loan and the company should have paid an amount equal to 32.5% of the balance outstanding at 1 October 2020. As this loan remains outstanding no repayment of that tax can be claimed by the company.

## MARKING GUIDE

TOPIC	MARKS
Computation:	
Including LLP as separate trade	$\frac{1}{2}$
Deduction of trading losses	$\frac{1}{2}$
Deduction of NTLR debit	$\frac{1}{2}$
Calculation of CT payable at 19%	$\frac{1}{2}$
Inclusion of s.464A charge	$\frac{1}{2}$
Notes:	
LLP profits – explanation	1
LLP profits – calculation	$\frac{1}{2}$
Depreciation – explanation	1
Depreciation – calculation and add back	1
Air conditioning – explanation	$\frac{1}{2}$
Air conditioning – add back	$\frac{1}{2}$
Samples – explanation of no add back	$\frac{1}{2}$
Entertainment and travel – explanation	1
Entertainment and travel – add back	$\frac{1}{2}$
Loan arrangement fees – explanation of no add back	$\frac{1}{2}$
Fee protection insurance – explanation	1
Fee protection insurance – add back	$\frac{1}{2}$
VAT interest – explanation	$\frac{1}{2}$
VAT interest – add back	$\frac{1}{2}$
CT interest – explanation	$\frac{1}{2}$
CT interest – add back	$\frac{1}{2}$
Parking fine – explanation	$\frac{1}{2}$
Parking fine – add back	$\frac{1}{2}$
Loss on sale – explanation	$\frac{1}{2}$
Loss on sale – add back	$\frac{1}{2}$
LLP accounting entries – explanation	$\frac{1}{2}$
LLP accounting entries – add back	$\frac{1}{2}$
Capital allowances – additions from question	$\frac{1}{2}$
Capital allowances – addition of air conditioning system	$\frac{1}{2}$
Capital allowances – disposal proceeds	$\frac{1}{2}$
Capital allowances – AIA	$\frac{1}{2}$
Capital allowances – WDA	$\frac{1}{2}$
Overdrawn capital account – explanation	$1\frac{1}{2}$
<b>TOTAL</b>	<b>20</b>

### ANSWER 3

#### Company own share buy-back

##### Income Treatment

The default position (1/2 mark) on a buy-back is that any monies received in excess of the original subscription price (1/2 mark) will be taxed as a dividend. (1/2 mark)

In addition the difference between the acquisition cost and subscription value of the shares will result in either a capital gain or loss or Nil. (1/2 mark)

##### Capital Treatment

Where all of the following qualifying conditions are met then the above income treatment will be overridden, and the monies received will be automatically treated as a capital disposal (1/2 mark).

The qualifying conditions are:

- 1) The buy-back must be shown to be for the benefit of the trade and not undertaken for tax avoidance purposes (1/2 mark)
- 2) The shareholder must be resident in the UK and have held the shares for at least five years (relaxed in certain circumstances) (1/2 mark)
- 3) The buy-back must result in a "substantial reduction" in the individual's shareholding. That is the shareholding after the buy-back must be equal to or less than 75% of the pre-buy-back holding (1/2 mark)
- 4) The individual must not be "connected" to the company following the buy-back. This requires that they must hold no more than 30% of the share capital and be entitled to no more than 30% of the assets on a winding up (1/2 mark)

The shares of a husband and wife are considered together when applying the above tests.

There are provisions that will allow the company to seek advance clearance from HMRC that the capital treatment will apply. This is not a pre-requisite for the relief but it is usually advisable to seek this clearance. (1 mark)

#### Lesley and Afan Khan

The buy-back of a small number of shares will not meet the substantial reduction or continued connection tests (1/2 mark). Although Afan in isolation would meet these tests he will still fail as a married couples holdings are considered together. Furthermore it may also be difficult to meet the "benefit to trade" test (1 mark).

As such any buy-back will be treated as an income distribution. As both are top rate tax payers then the rate payable on the consideration in excess of par value will be 38.1% (1/2 mark)

In addition a capital loss will be realised as follows:

			Lesley £	Afan £
Buy back consideration	10 x £18,000	180,000		
Subject to income tax		(179,990)		
Subject to capital gains tax (original subscription price)	(1/2 mark)		10	10
Base cost	10 x £4,500		(45,000) (1/2 mark)	(45,000) (1/2 mark)
Capital loss			(44,990)	(44,990)



### Paula Andrews

The buy-back of Paula's shares satisfies all of the tests for capital treatment (1 mark). As such any gain will be subject to capital gains tax.

She also meets all of the qualifying conditions for Business Asset Disposal Relief (1/2 mark).

The tax arising would be as follows:

		£
Buy back consideration	28 x £18,000	504,000
Base cost 28 x £5,000	(1 mark)	(140,000)
Net gain		364,000
Annual allowance		(12,300)
		351,700
Tax payable at 10%		35,170

### Gareth Phillips

If all of Gareth's shares are bought back at the same time then this would satisfy the numerical tests but it may be difficult to argue that this met the trading benefit test. (1/2 mark) HMRC may accept that the wholesale withdrawal of a non-participating shareholder could meet this test (1/2 mark) but this would need to be confirmed by submitting a clearance application. If this were the case then the capital gains tax liability would be as follows:

		£
Buy back consideration	8 x £18,000	144,000
Base cost	8 x £1	(8)
Net gain		143,992
Annual allowance		(12,300)
		131,692
Tax payable at 10% (1/2 mark)	£24,000	2,400.00
Tax payable at 20% (1/2 mark)	£107,692	21,548.
Total tax payable		23,948

Gareth may prefer not to have capital treatment on the buy back. In which case he would need to deliberately breach one of the capital treatment tests. This could be achieved by staging the buy-back over a number of years. This would also allow the sums received to fall within his basic rate tax band. (1 mark).

If the company were to buy-back 1 share per annum then the annual income tax charge would be as follows:

		£
Buy back consideration	1 x £18,000	18,000
Subscription price		(1)
Taxable distribution		17,999
Tax payable:		
£2,000 x 0% (1/2 mark)		
£15,999 x 7.5% (1/2 mark)		1,200

The total tax payable over eight years would be just £9,600.

## MARKING GUIDE

TOPIC	MARKS
Default position is dividend	1/2
Excess of subscription price	1/2
Taxed as a dividend	1/2
Capital gain/loss on subscription value	1/2
Automatic capital treatment where all tests are met	1/2
Benefit of trade	1/2
Residence in UK	1/2
Substantial reduction	1/2
Connection test	1/2
Possibility of advance clearance	1/2
Small number of share fail the numeric tests	1/2
Dean fails as spouse shares are combined and fails benefit to trade test	1
Taxed at dividend rate	1/2
Subscription cost is the deemed sale proceeds	1/2
Base cost for Lesley is Probate value	1/2
Afan will take on Lesley's base cost on gift	1/2
Paula will meet all of the capital tests	1
Qualifies for BADR	1/2
Base cost is market value at date of grant	1
No obvious trade benefits to Gareth buy back	1/2
May argue trade benefit on wholesale exit of non-participating share holder Mark will be given if candidate demonstrates a case for a counter argument	1/2
No BADR therefore taxed at 20%	1/2
Propose benefit of deliberately avoiding capital treatment	1
Dividend allowance	1/2
Balance at 7.5%	1/2
PHS	½
<b>TOTAL</b>	<b>15</b>

## ANSWER 4

### Rollover relief

In the absence of any relief then the following capital gains will arise on the disposal of the property by the company (1):

	The Old Foundry	11 Marston St
	£	£
Proceeds	1,100,000	650,000
Cost	(370,000)	(410,000)
Capital gain	730,000	240,000

The above gains may be deferred by utilising “rollover relief”. This is available where a company disposes of qualifying trading assets and reinvests the proceeds into a qualifying replacement asset.

For these purposes qualifying assets will be the properties used in B.C. Ltd’s trade.

Full rollover is available only where the whole of the sale proceeds are reinvested (1/2). Any sale proceeds not reinvested will be chargeable immediately (1/2).

Replacement assets must be acquired in the period 12 month prior and 36 months after the date of the gain (1/2).

It is possible to make a provisional claim (1/2). This will avoid the need to pay tax on gains provided there is a serious intention to reinvest the proceeds within the rollover period.

The gain rolled over reduces the base cost of the replacement asset (1/2), resulting in an increased capital gain on any future disposal. (1/2)

In order to qualify for relief the replacement asset must be brought into use immediately (1/2). HMRC will allow a short delay provided there are commercial reasons and the property is not used for any non-trading activity (1/2).

Where the replacement asset is a “depreciating asset” then the relief operates rather differently. A depreciating asset is one with a useful life of less than 60 years (1/2). This would include the lease premium on Dire Avenue.

Reinvestment into a depreciating asset does not reduce the base cost of the replacement asset but rather the gain is simply “frozen” (1/2). This gain will become taxable on the earlier of (1):

- 1) The sale of the asset
- 2) Cessation of trading
- 3) On the tenth anniversary of the acquisition of the replacement asset

This is less flexible than a full rollover relief claim although there are provisions to allow a frozen gain to be fully rolled over in the event a non-depreciating asset is acquired before one of the above three events arises(1/2).

### Mixed Use

The capacity to rollover a gain is restricted where the old asset or the replacement asset has mixed business and non business use (1/2). This is relevant for The Old Foundry and Marston Street. It is necessary to apportion the gain based on the ratio of trading and non-trading use as follows:

	The Old Foundry		TOTAL
	Trading*	Non-trading	
	£	£	£
Proceeds	990,000	110,000	1,100,000
Gain	657,000	73,000	730,000

\*Apportioned based on trading use through period of ownership (1).

	11 Marston Street		TOTAL
	Trading*	Non-trading	
	£	£	£
Proceeds	390,000	260,000	650,000
Gain	144,000	96,000	240,000

\*Apportioned based on floor area (1).

The non-trading proportions will be fully taxable. The trading elements will be eligible for rollover relief. (1/2)

#### Summary

Property	reinvestment required	gain rolled over / frozen
Old Foundry	£990,000	£657,000
11 Marston St	<u>£ 390,000</u>	<u>£144,000</u>
Total	£1,380,000	£801,000

#### Maximising the claim

It is open to the company to elect what replacement asset is used to rollover the above gains. (1/2)

Dean Row:

As 80% of this property will be used in the trade then the purchase cost must be apportioned (1):

Trading 80%	Non-trading 20%	TOTAL
£	£	£
1,300,000	325,000	1,625,000

Parson Road

As this will initially be used for non-trading purposes then it will not qualify for rollover relief (1).

Dire Avenue

Cost £65,000

As a depreciating asset any gain frozen against this purchase will become chargeable on the earliest of the three dates outlined above unless a non-depreciating asset is acquired in the interim.

Summary	£
Reinvestment in Dean Row	1,300,000
Reinvestment in Dire Avenue	<u>65,000</u>
Total	1,365,000

To roll over £801,000 of gains a reinvestment of £1,380,000 was required so there is a shortfall in reinvestment of £15,000 meaning only £786,000 of gains can be rolled over / frozen. The remaining £15,000 of gain is added to the taxable elements of the gains calculated above.

The taxpayer has free choice over which assets they allocate the gains. Since any allocation to Dire Avenue would result in a crystallisation of the gain in 10 year maximum it is advised all of the £786,000 gain is rolled over into Dean Row.

## MARKING GUIDE

TOPIC	MARKS
Summarise capital gains that will arise	1
Full rollover requires reinvestment of all proceeds	1/2
Sale proceeds not reinvested will be taxable	1/2
Reinvestment period	1/2
Possible provisional claim	1/2
Rolled over gain reduces base cost	1/2
Increased capital gain on subsequent sale	1/2
Must be brought into use immediately/short delay possible if no non-trading purposes	1/2
Define depreciating asset	1/2
Gain is "frozen" does not reduce base cost	1/2
Summarise circumstances where gain becomes chargeable	1
Gain may be rolled over during period of hold over	1/2
Rollover restricted where mixed use	1/2
Apportioned based on period of use	1
Apportioned based on floor area	1
Non-trading immediately chargeable	1/2
Discretion to allocate reinvestment against gains	1/2
Apportionment of cost between trade and non-trade	1
Initial non trading use removes the possibility of rollover	1
Calculation of remaining unallocated	1/2
Calculation of remaining gain	1/2
Calculation of remaining base costs	1
PHS	1/2
<b>TOTAL</b>	<b>15</b>

## **ANSWER 5**

### **Discovery Assessments**

HMRC can make a discovery assessment if they discover that:

- An amount which ought to have been assessed has not;
- An assessment has become insufficient; or
- Relief given has become excessive.

Circumstances where a discovery assessment can be made include an incorrect or incomplete return. The assessment is to be in an amount necessary to make good the loss of tax.

There are restrictions on the ability of HMRC to make discovery assessments. There can be no discovery assessment unless:

- The loss is brought about carelessly or deliberately or
- The HMRC officer could not have been reasonably expected, on the basis of the information available at the material time, to be aware of facts giving rise to the loss. The material time is the latest date for a notice to enquire or the date a closure notice is issued.

Where the taxpayer has not adequately disclosed information within the tax return, its supporting documents or in writing to HMRC, the officer could not be expected to realise the return was incomplete. In this case, HMRC can issue a discovery assessment to recover the tax lost.

If sufficient information was disclosed to make the officer aware of the situation giving rise to a loss of tax, once the enquiry notice period is over there can be no discovery and any additional tax cannot be collected.

In this case, Jack has provided HMRC with the information in his return which means that it could be argued that he provided sufficient information for any officer to be able to realise that there might be an error in the return. However, HMRC may wish to argue that he has been careless by virtue of not having taken advice where the deductibility was not clear cut. This is the same argument as would be used in relation to the penalties above. If they wish to argue he has been careless it would not matter if the disclosure on his tax return was sufficient as discovery assessments can always be issued where there is careless or deliberate behavior.

The time limit for a discovery assessment depends on the reason for the incomplete disclosure:

- The general rule limits a discovery assessment to 4 years from end of tax year to which the assessment relates.
- If the incomplete disclosure results from careless behaviour this time limit is extended to 6 years.
- The time limit can be further extended to 20 years where deliberate behaviour leads to an incomplete disclosure.

In this case, if it can be argued that there is no discovery then only the year of the enquiry would be capable of being assessed. If it is a careless offence, then HMRC would be able to issue discovery assessments for up to 6 years.

### **Penalties for Inaccurate Returns**

Penalties apply where there is an inaccuracy which leads to understatement of tax, overstatement of a loss or a claim to repayment. Penalties can also be charged if HMRC issues an inadequate assessment and the taxpayer fails to take reasonable steps to notify HMRC within 30 days. In this case, there is clearly an inaccuracy in the return which has resulted in a loss of tax so HMRC could charge a penalty.

The penalty charged is a percentage of the potential lost revenue ("PLR") i.e. the extra tax due. There may be a number of errors in the return which lead to PLR, and each is considered separately.

The level of the penalty depends on the nature of the error. Penalties can arise for a number of reasons:

- Failure to take reasonable care;
- Deliberate action; and
- Deliberate and concealed action.

The level of penalty depends on which course of action has been taken by the taxpayer, together with the method of disclosure of the inaccuracy, whether prompted or unprompted. Additional penalties can be levied in certain circumstances, for example where there is overseas income.

<b>Behaviour</b>	<b>Maximum</b>	<b>Minimum (unprompted)</b>	<b>Minimum (prompted)</b>
Deliberate and concealed	100	30	50
Deliberate	70	20	35
Careless	30	0	15

No penalty is charged where the inaccuracy arises despite taking reasonable care.

The actual penalty charged between the minimum and maximum depends on cooperation and helping HMRC with identifying and quantifying the disclosure.

A penalty for failure to take reasonable care may be suspended for two years, by agreement with the taxpayer to certain conditions being met. If the conditions are met throughout, the penalty will be cancelled. Suspension does not apply for deliberate behaviour.

In this case, it is likely that HMRC would consider that both of the errors have arisen due to the careless behavior of Jack. It seems that an argument that he had taken reasonable care would be successful but it does not appear to be a deliberate offence. However, Jack may be able to provide additional information that shows he did take reasonable care. HMRC might counter this argument by saying that he should have sought advice if he felt that there were deductions he was unclear about.

If HMRC argue that the error gives rise to a penalty, then it will be a prompted offence as it arose out of the enquiry. It may be worth asking for the penalty to be suspended as it would seem likely that acceptable conditions could be set, such as getting professional help in preparing his return in future.



## MARKING GUIDE

TOPIC	MARKS
<b>Discovery</b>	
Assessment where: amount not assessed; assessment insufficient; relief excessive	1
No assessment unless: careless or deliberate/HMRC not aware	1
Sufficient information disclosed - no discovery.	0.5
Time limits: General 4 years; Careless 6 years; Deliberate 20 years	1.5
May be possibility of arguing that had made sufficient disclosure but HMRC likely to argue carelessness	1
If no carelessness then only enquiry year can be amended, otherwise 6 years if careless	0.5
<b>Penalties</b>	
Penalty where: understatement of tax/overstatement of loss or repayment	0.5
Likely to be a penalty charged here as understatement of tax	0.5
Penalty is % of PLR	0.5
Different errors different PLR calculations.	0.5
Nature of inaccuracy: Careless; Deliberate; Deliberate and concealed.	1.5
Also prompted/unprompted.	0.5
No penalty where reasonable care.	0.5
Actual penalty mitigated on behavior	1
Suspended where failure to take reasonable care. Conditions met, penalty cancelled	1
Likely that HMRC will argue that penalty arises due to carelessness for Jack but may be reasonable care argument	1
Suggest that ask for suspension as likely that acceptable conditions could be set	1
PHS	1
<b>TOTAL</b>	<b>15</b>

## ANSWER 6

### Requirement 1

		£
Lease cost	£410 x 12	4,920
Class 1A NIC	Note 1	2,877
Fuel		5,050
Other costs		<u>1,050</u>
		13,897
Less: CT deduction	Note 2	<u>(2,518)</u>
Cost to the company		<u>£11,379</u>

#### Note 1

The applicable taxable benefit percentage is 33%, plus the additional 4% diesel supplement.

Car benefit - 37% x £31,850 = £11,784

Fuel benefit – 37% x £24,500 = £9,065

Total taxable benefits = £20,849

Class 1A NIC on the above at 13.8% = £2,877

#### Note 2

		£
Lease cost	= 19% x (£410 - £50) x 12 x 85%	698
Maintenance element	= 19% x £50 x 12	114
All other costs	= 19% x (£2,877 + £5,050 + £1,050)	<u>1,706</u>
		<u>£2,518</u>

The CT deduction on the leased car element of the leasing payment is restricted by 15%, due to the Co2 emissions exceeding 130g/km.

#### Tutorial Note:

An alternative calculation would be;

Total cost to Company (as above)

Less high emission car restriction

£(410 - 50) = £360 x 12 x 15%

Total deducted for CT

£13,249 x 19% = £2,518 CT deduction

£
13,897
(648)
<u>13,249</u>

### Requirement 2

Costs to company of proposed new arrangement:

		£
Business mileage	= 10,000 x 45p + 15,000 x 25p	8,250
Less: CT deduction	£8,250 x 19%	<u>(1,568)</u>
Cost to company		<u>£6,682</u>
Remaining cost to company of salary and NIC	£11,379 - £6,682	4,697
Grossed-up for CT deduction	£4,697 / 0.81	<u>5,799</u>
Employer's NIC	= 13.8 / 113.8 x £5,799	703
Salary payable	= 100 / 113.8 x £5,799	<u>£5,096</u>
CT deduction	£5,799 x 19%	<u>£1,102</u>
Cost to company	£5,096 + £703 - £1,102 + £6,682	<u>£11,379</u>

If the company paid a salary of £5,096 and business mileage claims of £8,250, this would effectively cost £11,379, the same as the cost of the current arrangement.

### Requirement 3

The travel costs paid to the employee will be a deductible expense for the company when calculating its profit subject to corporation tax.

The travel expenses incurred in travelling between the Cardiff and the Swansea offices would be treated as travel incurred in carrying out the duties of the employment, because this is travel which is “on the job” i.e. between two workplaces in connection with a single employment.

These expenses would therefore be able to be reimbursed free of any income tax or NIC implications, provided the payments are within HMRC’s approved mileage rate. There is nothing to report in this case.

However, as Swansea is a permanent workplace (being one which is attended regularly, on a permanent basis), the reimbursement of the cost of travelling directly between Swansea and the manager’s home would not be exempt from income tax, as this would be “ordinary commuting” i.e. from home to a permanent place of work.

If these costs are reimbursed, the company will need to include these as earnings for the purposes of PAYE and Class 1 National Insurance.

### MARKING GUIDE

TOPIC	MARKS
<b>Part 1 – Calculation of cost to company</b>	
Annual lease cost	½
Base benefit percentage	½
Diesel supplement	½
Car Benefit	1
Fuel Benefit	1
Class 1A NIC	½
Other costs to company (fuel, other)	1
CT deduction – Lease subject to restriction	1
CT deduction – Maintenance element	½
CT deduction – All other costs	½
<b>Part 2 – Additional salary</b>	
Business mileage cost to company	1
Business mileage CT deduction	½
Remaining cost to company available	½
Grossing up for CT deduction	1
Salary payable	1
Employer’s NIC payable	1
<b>Part 3 – Travel expenses</b>	
Between workplaces exempt/Temporary Workplace rules	1
No reporting obligations	½
Home to work is ordinary commuting	1
Reimbursed ordinary commuting – PAYE/Class 1	½
<b>TOTAL</b>	<b>15</b>