



The Chartered Tax Adviser Examination

November 2019

Application and Professional Skills

Taxation of Owner-Managed Businesses

TIME ALLOWED – 3 ¼ HOURS

- 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 a tax senior in a firm of Chartered Tax Advisers reporting to the tax partner, Jack Almond. Jack has recently received a letter (**EXHIBIT A**) from one of his clients, Peter Walnut, who is an electrician trading through a limited company, Walnut Electrics Ltd.

Peter has been in discussions with his friend, Phil Peanut, who is a local builder, on how it may be mutually beneficial for them to work together. He has asked Jack to advise him on how this could best be achieved and the potential tax implications.

Jack has spoken to Peter and agreed that a report will be prepared advising on how the new business might be structured and considering matters relating to the engagement of workers. Jack will then meet with Peter to discuss the report and agree how to proceed. Jack has asked you to prepare a draft report for him to review. Jack has said that at this stage detailed computations are not required.

The following exhibits are provided to assist you:

EXHIBIT A: Letter from Peter Walnut to Jack Almond

EXHIBIT B: Email from Peter Walnut containing information about Phil Peanut's business

EXHIBIT C: Proposed arrangements with workers

EXHIBIT D: Pre-seen information

Requirement:

Prepare a draft report to Peter Walnut, for review by Jack Almond, which advises on the structuring of the new business and the arrangements with workers.

EXHIBIT A

Letter from Peter Walnut to Jack Almond

Jack Almond
Almond Chartered Tax Advisers
1 Tree Street
Nutville
NU1 3UN

Peter Walnut
12 Wheat Lane
Nutville
NU3 5EN

29 October 2019

Dear Jack

As you know, I am always looking for ways to grow and expand my business and in this regard I have recently been in discussion with a friend of mine, Phil Peanut, who is a local builder.

Phil has often used the services of my company to carry out the electrical work on any properties that he may be refurbishing and this has always worked well. We both now feel that there is a gap in the local market for a property maintenance business and feel that by combining our skills we could tap into that market. We need to consider how such a business could be structured.

We have already had discussions with the managing director of a local company, Nutville Properties Ltd, for whom Phil and I have done some work in the past. He is keen to offer us the maintenance contracts for all of the properties that the company owns. There are around 30 properties, mostly residential but some commercial. It is hoped that this can commence by 1 January 2020. Nutville Properties Ltd have told me that they do not mind how the business is structured between Phil and me and they will contract with whatever vehicle we chose to establish.

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If we do contract with Nutville Properties Ltd we would have to provide a 24-hour call-out service for their tenants with workers available to respond to reports by tenants within agreed timescales. We would receive a fixed fee plus a variable payment based on the number of call-outs in the month. Specialist work would also be undertaken with costs agreed in advance.

We would probably require two small vans initially for the workers to use and some other equipment for this new business. We could use our existing vans and other assets but we would like to keep this new venture separate from our existing businesses. The initial set-up costs, which we estimate to be in the region of £20,000, are to be funded by the two of us, although no agreement has yet been made as to how this will be done. We intend to store any stock/equipment at my current premises and this will operate as the administrative centre for the work.

This contract with Nutville Properties Ltd would be a significant first step for us as we both currently work independently. I have asked Phil if he can let me have some basic information about his business which might be useful to have and I will email this to you once I receive it (**EXHIBIT B**).

We hope that the opportunity the maintenance service will provide will allow the business to expand very quickly and reach similar agreements with other property owning businesses in the area. I do however expect that my company will continue to do electrical work independently as well as for the new business. We would like your advice on the best structure for the new property maintenance business. In this regard we would be keen to involve our wives and children in the new business (our intention is to create a business to pass on to our children rather than something to sell).

As I am an electrician and Phil is a general builder we will need to bring in a number of other workers with specialist skills from time to time to help carry out the maintenance work, such as plumbers, plasterers and carpenters, as well as needing a number of general labourers to help with the call-out service. I am familiar with the Construction Industry Scheme so do not need advice on how this operates. Clearly, it will aid administration and save National Insurance costs if we don't need to have any employees, but at the same time we don't want to get into trouble with HMRC. Perhaps you could have a look at the enclosed proposed arrangements with the workers (**EXHIBIT C**)?

I look forward to hearing from you and thank you in advance for your help.

Kind regards

Yours sincerely

Peter Walnut

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EXHIBIT B

Email from Peter Walnut containing information about Phil Peanut's business

From: peter.walnut@walnutelectrics.co.uk
To: jack.almond@almondtax.co.uk
Date: 1 November 2019
Subject: Phil Peanut's business

Jack

I mentioned I would let you have some details about Phil and his current business. I have not obtained a huge amount of detail for the moment but have included things which I think might be relevant.

Phil is a general builder who works for local individuals and businesses as a sole trader, having started trading in 2000. He makes up accounts to 30 June each year. He tells me that his latest accounts to 30 June 2019 show turnover of £62,420 and net profit of £32,140. Due to this, he is not VAT registered. He rents a small industrial unit, has a second hand van that he purchased about 12 months ago for £4,000 and some small items of building equipment (valued at about £7,500) as well as some stock (valued at about £1,500). He has a bank loan taken out two years ago which is repayable over five years.

Phil is undecided as to what he will do with his existing business if this venture is successful and may consider bringing it in its entirety into the new property maintenance business.

Phil is married with one son (Paul) who works in a local shop but who is quite keen to learn new skills. Phil's wife (Patricia) works in the local chemist, earning £15,000 per annum.

Phil and Patricia have no other sources of income.

Regards

Peter

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EXHIBIT C

Proposed arrangements with workers

We will need a mixture of general workers to deal with the routine call-out service and specialist workers for any one off assignments or specialist jobs which may arise.

General workers

- 1) We will need to be able to deal with the call-outs on a 24 hour basis within specified time-limits and so we would need a pool of workers to be available on a rota basis to cover all times. We would therefore need suitable contracts with such workers and to negotiate an hourly rate of pay.
- 2) At this stage there is no certainty that the maintenance contract with Nutville Properties Ltd will be a success and so we would initially prefer short term flexible contracts with the workers. If it is helpful the contract will state that the relationship is not one of employment.
- 3) As they tend to be cheaper, we will only engage with individual sole traders.
- 4) Workers will need to give us priority over any other work they were doing as we must meet the terms of our contract with Nutville Properties Ltd within the time constraints and in return, we hope to offer them regular work.
- 5) We could provide tools and materials to the workers in order to carry out the work. Alternatively, they could use their own tools and charge us (at cost) for any materials they may use.
- 6) They could have access to our business vehicles to attend the call-outs if they require. As the business grows we may even provide them with uniforms displaying our business name.
- 7) Payment would be based on an agreed hourly rate but we will not provide any holiday pay, sick pay or similar benefits unless absolutely necessary.
- 8) Payment would be made subject to the satisfactory completion of the work.

Specialist workers

- 1) As we expect to have less regular needs for specialists and it may be more difficult to obtain the right skills, we may need to use larger businesses rather than just sole traders.
- 2) Given the more limited extent of the work to be offered, it may not always be possible to agree that we will be given priority over other clients of the specialist. Similarly, due to the lower frequency of work, we would not expect to provide tools or materials, although we could offer this if necessary.
- 3) Work will need to be quoted in advance and the price agreed.
- 4) Payment would be made subject to the satisfactory completion of the work and we will require a suitable guarantee.

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EXHIBIT D

Pre-seen information

Client Names

Peter and Wendy Walnut and Walnut Electrics Ltd

Peter and Wendy Walnut

Peter Walnut, born 20 June 1969, is a qualified electrician. He is married to Wendy, born 13 July 1971. Their only income is from salaries and dividends from Walnut Electrics Ltd.

They have two children, David, aged 22, who currently works for a local building supplies company on a salary of £12,500 per annum, and Susan, aged 20, in her final year at university studying business management with no sources of income.

Walnut Electrics Ltd

The company provides electricians' services to unconnected third parties.

Peter owns 75 of the 100 issued shares and Wendy owns the remaining 25 shares.

Peter and Wendy are both directors and are the only employees of the company. Each receives an annual salary of £8,000.

The company pays annual dividends of £30,000.

The company was registered for VAT on 1 July 2010 with registration number: 123456781. It has not made an option to tax in respect of the freehold property.

The company prepares its accounts to 30 June each year and draft accounts for the year ended 30 June 2019 show the following:

Balance Sheet as at 30 June 2019

	<u>Notes</u>	£	£
Fixed Assets:			
Freehold property	1	90,000	
Plant and machinery	2	<u>10,050</u>	
			100,050
Current Assets:			
Cash at Bank		22,515	
Stock	3	2,020	
Debtors		<u>4,595</u>	
			29,130
Creditors	4		<u>(40,100)</u>
Net Assets			<u>£89,080</u>
Represented By:			
Share Capital			100
Profit & Loss b/fwd			74,900
Profit for the year	5		<u>14,080</u>
Net Assets			<u>£89,080</u>

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Continuation

Notes

- 1) The property is a small industrial unit that was purchased at a cost of £90,000 on 1 October 2017 but is now valued at £120,000.
- 2) Plant and machinery, which includes a small van, has a market value of £8,000. The tax written down value of the main rate pool as at 30 June 2019 is £4,000.
- 3) Stock represents various electrical parts at cost.
- 4) Creditors include a loan from Peter of £20,000.
- 5) Profit for the year is after provision for Corporation Tax and annual dividends.