



The Chartered Tax Adviser Examination

May 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 table information, you may assume that 2018/19 rates and allowances continue to apply for 2019/20 and future years. Candidates referring to actual or pending rates and allowances for 2019/20 and future years will not be penalised.

You work for David Bolmen, a partner in Bolmen Tax Consultancy, a firm of Chartered Tax Advisers. David has acted for Peter Hoting and his company, Arsane Ltd, for many years. Peter is the sole director and shareholder of Arsane Ltd, a company which sells garden machinery.

David has recently received a letter from Peter Hoting regarding the potential purchase of an investment property to supplement his future pension. Peter intends to use some surplus funds available within the company for this purpose.

David has agreed with Peter that he will prepare a report addressing the issues raised within his letter. David has asked you to prepare this report.

The following exhibits are provided to assist you:

- EXHIBIT A:** Letter from Peter Hoting to David Bolmen
- EXHIBIT B:** Balance Sheet of Arsane Ltd as at 30 April 2019
- EXHIBIT C:** Email from Andrew Lund dated 20 April 2019
- EXHIBIT D:** Pre-seen information

Requirement:

Draft a report to Peter Hoting advising on the issues addressed within his letter dated 1 May 2019.

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EXHIBIT A

Letter from Peter Hoting to David Bolmen

David Bolmen
Bolmen Tax Consultancy
15 Falun Road
Idre
AB1 2CD

Peter Hoting
25 Idre Street
Falun
EF3 GH4

1 May 2019

Dear David

I trust you are well.

I have recently been contemplating longer term planning for my retirement. The value of my existing registered pension fund is approximately £250,000. Whilst I have no immediate plans to retire, this amount and the annual contributions of £5,000 that my company is currently making seem unlikely to generate a large enough pension for me to live comfortably in retirement.

Arsane Ltd has built up a fairly significant cash balance which is currently generating only a very small amount of interest. I have therefore decided to use these funds to purchase an investment property which could generate rental income to supplement my pension when I retire. I have not yet found a suitable property but it will be a commercial property costing around £200,000. In addition I would estimate that the legal fees relating to the purchase will be in the region of £2,000.

I have printed out the company's balance sheet at 30 April 2019 (**EXHIBIT B**) from our accounts system for your information detailing the company's assets and liabilities. I think that the company will need to retain about £15,000 of cash for ongoing working capital purposes so the majority of the balance is surplus to current needs.

As there will be a shortfall in funds, I have been considering how to raise the balance. Apart from the possibility of the company borrowing to make up the shortfall there are two further potential sources to raise funds in the near future:

- 1) Andrew Lund, a local builder, has emailed me recently in relation to a possible purchase of part of the company's property. I have enclosed a copy of the email (**EXHIBIT C**) but I have not yet responded to it. If the company did sell this part of the property to Andrew I would estimate that the value of the remaining part would be in the region of £290,000.
- 2) Simon Bora, a long standing friend of mine, would like to repurchase the 25% shareholding which Arsane Ltd currently holds in his ceramics company, Bora Ltd. When Simon set up this company in 2010 he needed help with funding, which is why Arsane Ltd made this investment. As an investment this has not been that great with dividend income over the years being very modest. Simon would now like to buy back these shares and is willing to pay £30,000.

I only wish for the company to sell what is absolutely necessary so please explain which of these two options would be the preferred source of further funds from a tax perspective?

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Continuation

Assuming that all the required funds will be available within Arsane Ltd in the near future, it would seem simplest for the investment property to be purchased directly by the company. It would therefore be appreciated if you could explain the tax implications if the company does make a direct purchase. Before making any final decisions, however, I would also be grateful for your advice regarding the tax implications of any other possible ways that the company funds could be used to purchase the investment property.

I very much look forward to hearing from you regarding the above in the near future.

Yours sincerely

Peter Hoting

EXHIBIT B

Balance Sheet of Arsane Ltd as at 30 April 2019

	<u>Notes</u>	£	£
<u>Fixed Assets</u>			
Freehold property	1		72,100
Plant and Machinery	2		66,075
Investments	3		<u>20,000</u>
			158,175
<u>Current Assets</u>			
Stock		15,000	
Trade debtors		28,718	
Prepayments		2,506	
Cash at Bank		<u>190,102</u>	
			236,326
<u>Creditors: amounts falling due within one year</u>			
Trade creditors		(18,975)	
Corporation Tax	4	(19,832)	
Other taxes and social security		(18,763)	
Accruals		<u>(4,250)</u>	
			<u>(61,820)</u>
<u>Net Current Assets</u>			
			<u>332,681</u>
<u>Capital and reserves</u>			
Called up share capital			10,000
Profit and loss account			<u>322,681</u>
			<u>332,681</u>

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Notes

1) Freehold property comprises:

	£
<u>Cost</u>	
At 1 May 2018	75,000
Addition	20,000
At 30 April 2019	<u>95,000</u>
<u>Depreciation</u>	
At 1 May 2018	21,000
Charge for year	1,900
At 30 April 2019	<u>22,900</u>
Net book value at 30/04/2019	<u>72,100</u>

2) Plant and machinery comprises:

	£
<u>Cost</u>	
At 1 May 2018	115,675
Additions	15,500
Disposals	(10,000)
At 30 April 2019	<u>121,175</u>
<u>Depreciation</u>	
At 1 May 2018	48,900
Charge for year	10,875
Eliminated on disposal	(4,675)
At 30 April 2019	<u>55,100</u>
Net book value at 30/04/2019	<u>66,075</u>

3) Investments

	£
<u>Cost</u>	
At 1 May 2018	20,000
Addition	–
At 30 April 2019	<u>20,000</u>

The investments comprise a 25% shareholding in Bora Ltd.

4) Corporation Tax

Arsane Ltd's taxable total profits for the year ended 30 April 2019 are £104,379.

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EXHIBIT C

Email from Andrew Lund dated 20 April 2019

To: Peter Hoting
From: Andrew Lund
Date: 20/04/2019
Subject: Potential Purchase of Surplus Land

Hi Peter

I hope you are well.

As you know we are struggling with storing all our equipment at our current site and have been looking for a secure storage site for some time now. The corner of your yard that we looked at the other day looks ideal and I understand this is surplus to your company's requirements. I can confirm therefore that we are interested in buying this from you and think that the figure you mentioned of £30,000 would be acceptable.

I'd be grateful if you could just confirm that in principle you are in agreement with this and I'll get the ball rolling our end.

I look forward to hearing from you soon.

Kind regards

Andrew

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EXHIBIT D

Pre-seen information

Client Names

Peter Hoting and Arsane Ltd

Client Background

Peter was born on 18 February 1962.

He has never married and has no children.

He is UK resident and domiciled.

Peter owns the entire 10,000 issued ordinary shares of £1 each of Arsane Ltd and has done so since the company's incorporation.

Peter takes a salary of £11,850 and dividends of £60,000 per year from Arsane Ltd and plans to continue doing so.

Peter does not have any other income.

Arsane Ltd

Arsane Ltd is registered in England and was incorporated on 1 July 1995.

Peter Hoting is the sole director.

It is engaged in the sale of small garden machinery.

The company owns a freehold property, consisting of a warehouse, showroom and a large storage yard. This freehold property was bought in July 2005 at a cost of £75,000. The warehouse was extended in March 2019 at a cost of £20,000.

The company makes up its accounts to 30 April each year.

30 April 2018 Accounts

Profit and Loss Account

	£	£
Turnover		832,578
Cost of sales		(564,554)
		<hr/>
Gross profit		268,024
Administrative expenses		(154,893)
Interest receivable		1,015
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Profit before tax		114,146
Tax on profit		(19,399)
		<hr/>
Profit after tax		<u>94,747</u>

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Balance Sheet

	£	£
<u>Fixed Assets</u>		140,775
<u>Current Assets</u>		
Stock	14,000	
Debtors	35,724	
Cash at bank	168,580	
	<u> </u>	218,304
<u>Creditors</u>		
Amounts falling due within one year		(66,396)
		<u>292,683</u>
<u>Capital and reserves</u>		
Called up share capital		10,000
Profit and loss account		282,683
		<u>292,683</u>

Corporation Tax

The company's taxable total profits in recent years have been as follows:

<u>Year ended</u>	£
30 April 2016	105,878
30 April 2017	98,465
30 April 2018	102,100

VAT

Registered entity	Arsane Ltd
Registration number	000000001
Registration date	1 July 2001

All of Arsane Ltd's sales are standard-rated.

No option to tax has been made by Arsane Ltd.