Application and Professional Skills

Chartered Institute of Taxation

Excellence in Taxation

Taxation of Owner-Managed Businesses

1	1	4	3	1	(Ensure this number matches your candidate number on your desk label and on your candidate attendance form)

REA	Centre Code

0	9	0	5	2	0	1	9	Date of Examination

☐ Tick box if you have answered in accordance with Scots Law

☐ Tick box if you have answered in accordance with Northern Ireland Law

Instructions

Your script will be scanned electronically. Failure to comply with these instructions may lead to your paper not being marked. You must:

(a) Write on the answer pages using BLACK or BLUE ballpoint pen only.

(b) Write on one side of the page.

(c) Not write in the margin areas indicated.

(d) If you have used additional pages, please add your candidate number and the question title to these pages.

(e) Do not put blank pages into the envelope at the end of the exam.

Please do all of the above before the end of the examination.

Question Title	Your Candidate No.
Taxation of Owner-Managed Businesses	11431

TO: PETER HOTING

REPORT INTO THE AQUISITION OF INVESTMENT PROPERTY AND THE SALE OF CURRENT INVESTMENTS.

As requested I have looked at your potential purchase of a freehold property and sale of investments, with regards to your planning for your retirement.

This report will cover the following:

- Sale of part of the company's property against the sale of shares in Bora Ltd.
- Current pension provisions and the potential to increase pension at retirement.
- Purchase of investment company and how this should be funded.

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Executive Summary.

if you wanted to sell an asset you

I recommend that the shares in Bora Ltd are sold to Simon Bora, which will give the company a corporation tax liability of £1900.

The company should make a pension contribution into your pension scheme of £145,000, which will be a corporation tax deduction for the company at no extra tax cost to you individually.

I do not recommed an investment property is purchased by the company as this could affect its trading status and subsequent reliefs.

Excess money in the company can be left until needed and a further pension contribution in the following year of £40,000 can be made.

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Potential sale of surplus land.

As ~~you~~ the company will only be selling part of the land, for the purposes of capital gains this is a part disposal.

Therefore in calculating the gain, which is proceeds less cost, only part of the original cost of the building is used.

We follow the formula cost x A/A+B, where A is the proceeds you have received and B is the value of the asset retained.

Companies also get indexation allowance up until December 2017 to account for inflation.

I calculate the potential gain on the sale of the yard to be £17,951.

Corporation tax will be due on the gain at 19%, of £3410.69.

TO: ~~DAVID B)~~

Appendix 1

Sale 30,000.

less cost.

30,000 / (30+300+290,000)	X 75,000	(cost)
	33525	(indexation)
	20,000	(extention

75,000 X (278.1−192.20) / 192.20 (0.447)

(12049)

17951.

Potential sale of Bora Ltd.

The cost of the shares in Bora Ltd was £20,000 so if they were to be sold for £30,000, the company would make a £10,000 gain.

The gain will be taxed at 19% in the company so corporation tax of £1900 would be due.

The sale of the shares would mean no further dividend income would be paid, but as it is currently minimal this would not cause a drop in income.

The value of shares could rise in the future, which could increase the value, however could also affect the trading status of the company.

Selling part of the property may hinder future prospective buyers.

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I reccommend that if the company was to sell either asset then it should be the shares in Bora Ltd, because there will be less corporation tax for the company to pay, so company will end up with more money.

Also it may affect the future selling price of the property.

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Current pension provisions

Currently your retirement fund is worth only £250,000.

The lifetime allowance of a pension fund for 2018/2019 is currently £1,030,000, so there is plenty of scope to increase the pension pot.

Due to the level of your income, as you are not personally contributing to your pension scheme, the company can make payments of £40,000 a year, without any charges.

As the pension scheme has been going for many years, not only is the £40,000 available for the current year, there is also relief brought forward from the previous three years.

As only £5,000 has been paid in for the previous years, there is £105,000 brought forward that

Therefore the company could pay up to £145,000 into your pension fund.

The company will receive a corporation tax deduction on this payment in the period it is paid, receiving relief at 19%

It is not a benefit in kind and therefore there will be not tax to pay for you.

Futhermore, from the age of 55 an individual can take 25% of their person fund tax free and invest the rest into an annuity.

If you start to draw down on your pension, contributions are restricted to £4000.

This does mean however, that the company can pay into your pension fund over the next few years and as you have already turned 55, the pension fund is available to you as soon as you wish to use it.

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The company currently has enough funds to make the pension contribution.

As there is quite alot of excess cash in the company, using the funds to pay into your pension fund is a good way to maintain the trading status of the company.

I recommend therefore using the company's surplus cash to pay into a pension fund is the best way of increasing your pension, because theres no additional cost to you, and the company will receive a deduction.

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~~[illegible]~~ Purchase of commercial property.

The immediate tax consequences if the company buys the property is that stamp duty land tax will need to be paid on the property within 30 days of purchase.

Stamp duty ~~is~~ will be payable at 2% on the purchase price over £150,000 so £1000.

~~[illegible]~~

If you are planning on buying a brand new commercial property, VAT will be applied at 20%.

As the company will not be making taxable supplies it will not be able to claim back the VAT, unless it opts to tax the building.

Opting to tax the building turns the building its self into a taxable supply, so any VAT incurred on the purchase or work can be reclaimed.

It does mean however that any rent charged

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are also subject to VAT.

Once the building has been purchased the rents received will be subject to corporation tax on an accruals basis at 19%.

The purchase of the investment company is likely to affect the trading status of the company.

When HMRC look at a company to determine the status of the company, they look at the 20%/80% rule.

HMRC will look at
① Assets on the balance sheet. The value of the ~~trading~~ investment company makes up more than 20% of the value of the assets.

② How the income of the company is derived.
If rental income is high, again it will affect what percentage of the profits are trade and what are investment.

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(3) Work carried out. As it is an investment ~~com~~, property it is likely that very little work will be carried out compared to the rest of the trade.

When the time comes to sell the shares in the company your gains, (Proceeds less cost) will be taxed at 20% unless you make a claim for entrepeneurs relief.

To make a claim for entrepeneurs relief on the sale of shares they must be ~~in~~ material disposal, in an unquoted trading company, that you are an employee, that you have held for a year.

If the company is not classified as a trading Co, entrepeneurs relief will not be given.

The investment property if purchased for £200,000 would make up more than 20% of the assets in the company.

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As it is the company that has purchase the property, it is the company that will retain the profits.

As mentioned earlier, the company pays tax on these profits at 19%.

You will then need to extract the profits from the company.

how you do this will lead to a further tax charge.

If you choose to extract the funds whilst the company is still trading there are various options.

① Via Salary/bonus - this will be subject to class 1 NIC on any amounts over £8424 for you as an individual at the company will have to pay a further 13.8% employers NIC. You will also be liable to tax at 20%/40%. (co will receive deductions for NIC/salary).

② Dividend. No NIC, but further tax charge at 32.5%/38.1%.

③ Pension payments into pension. You could top your pension up from the profits the investment property makes.

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If you liquidate the company on retirement and then receive the income, distribution will be treated as a capital gain.

As the company will not have its trading status the gain will be subject to 20% tax rate, than 10% if entrepreneurs relief could be claimed.

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Furthermore, currently the shares you hold make up part of your estate for inheritance tax purposes.

As they are shares in an unquoted trading company Business property relief means that 100% of the value is not subject to inheritance tax, which is payable at 40% over £325,000.

For inheritance purposes we look at a 50% scenario, so if more than 50% of the business relates to land & buildings or other investments then the Business property relief would not apply.

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An alternative to the company purchasing the property itself is to make a loan to you to purchase the property.

As ~~you~~ you are the only shareholder in the company, Arsone Ltd it a close company.

This means there are special rules regarding the loan to a shareholder.

If the company makes a loan to you of over £15000, as you hold a material interest in the company (ie you hold more than 5%) the company will have to pay a penalty tax.

The penalty tax is 32.5% on any amount outstanding on the payment date 9 months & 1 day after the accounting period ie 1 feb ~~2022~~ 2021. (if the loan was made in current accounting period).

To cover the stamp duty you would have to pay and the legal fees, you would need to borrow £203,000 approximately.

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The company would have to pay £65,975 to HMRC by 1 Feb 2021.

When the loan is repaid or written off the company will receive the tax back, although this will be 9 months and 1 day after the accounting period, so cash flow could be an issue.

You would be assessed at 20% or 40% on whatever rents you received. If below £150,000 this would be on a cash basis.

If purchased whilst you are still receiving dividends from the company, ~~you~~ and you are receiving rents, could affect your personal allowance.

The loan would be a benefit in kind on you, and you would have to pay 20% on the benefit value and the company would have Class 1A NIC to pay at 13.8%.

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The company could pay you a dividend in which you could pay for the property yourself.

However, the dividend would be subject to tax at 32.5% and 38.1%.

Therefore you would need a dividend of £310274 to enable you to purchase the property.

Additional salary would also prove costly as you would have to pay 12% and 2% on the income and tax up to 45%. And you would lose your personal allowance.

The company would have to pay 13.8% employers NIC on any bonus.

If the loan was written off rather than repaid, this would be subject to tax and NIC as you are an employee.

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You need to consider what return you would be making on the investment of the commercial property and how much rental income you expect yourself or the company to receive

A generous yield of 10% would mean rents are received of £20,000, ~~[illegible]~~ so the tax costs may not make this the most financially viable option.

~~Recommendation~~

I do not recommend that buying the investment property is the best way of supplementing your income, ~~[illegible]~~ from a tax perspective, as there is a tax charge when the company receives the rents and again when ~~the~~ you extract the profits from the company.

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SD, VAT, NIC, IHT, IT, CGT, CT

VAT ⇒ not making taxable supplies for the building - renting out - opt to tax.

Stamp duty on purchase price

0-150,000 = 0%

150000 - 200000 = 2%

PURCHASE OF INVESTMENT BUILDING

Assets of company 20%/80%

HMRC will look @ BS ⇒ 20/80% assets.

Income ⇒ how much rental income will be received?

CT on profits @ 19%.

Then extract the cash.

would company still be trading co?

⇒ effect BPR for IHT.

CGT ⇒ ER - condition must be trading.

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30,000.

(12049) £17951

$$\frac{30,000}{(30,000+290,000)} \times 75,000 + \frac{2784-192.20}{192.20}$$

=

75000 x 0.447 = 33525

108525

\+ 20,000

128525.

Gain on sale of property = £17951.

Trading assets reduced.

Sale of shares ⇒ gain £10,000.

Sell shares back to Simon bore - some ~~new~~ money less gain.

downside - no further div income (however has been modest.

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Purchase investment co.

⇒ money to director – close co S455 penalty tax.

need £200,000 + 1000 SD + 2000 = £203,000.

penalty tax 9m 1day ⇒ £65975.

loan benefit ⇒ 203,000 x 2.5% = £5075 x 40% =

2030

fund itself ⇒

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SD, VAT, NIC, IHT, IT, CGT, CT

Pension – fund can go up to 1.03 million.

income threshold under 115000 ∴ £40K allowance each yr.

Co only paying £5000.

∴ 3 yrs   35000 x 3 = £105000

plus 40K   £ 40,000

£ 145,000 co can make.

Cash in co	~~332,681~~ 190,102
less pension	(145,000)
	~~187681~~.
plus	30,000
	217681.
	(200,000)
	17681

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