THE CHARTERED INSTITUTE OF TAXATION

ADVANCED TECHNICAL

Taxation of Owner-Managed Businesses

November 2022

TIME ALLOWED

3 HOURS 30 MINUTES

- 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 indicate this where relevant.
- 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 in the question, you may assume that 2021/22 legislation (including rates and allowances) continues to apply for 2022/23 and future years. Candidates answering by reference to more recently enacted legislation or tax cases will not be penalised.
- Additional marks may be awarded for presentation.
- You must type your answer in the space on the screen as indicated by the Exam4 guidance.

1. Birch Tree Holidays Ltd operates a caravan park on a 50 acre site. The site currently includes a field for tents, three acres of grass pitches for 15 touring caravans, toilet facilities and a derelict barn.

The grass pitches and the access road to the site have deteriorated, so the company is planning to carry out work on the existing facilities and also upgrade the site to provide a shop, bar and an area to house animals.

The schedule of work to be carried out is as follows:

<u>Work on existing facilities</u>

1) The grass pitches for touring caravans will be replaced by hardcore pitches.

2) The access road to the site will be resurfaced.

3) Five touring caravans will be bought. Four caravans will be let to holiday makers. The fifth caravan will be fixed in place and used by a warden who will be employed to manage the site. The warden will be required to be available on call at all times.

<u>Upgrade and development work</u>

1) Expenditure will be incurred on preliminary costs and professional fees for the overall site development.

2) A shop will be built to sell food and other items to holiday makers. Costs will include:

   (a) Advertising signs.
   (b) A suspended ceiling to cover the air conditioning and electrical systems.
   (c) Partition walls. Although the partitions will all be moveable, it is expected that approximately half will be kept permanently in the same place.

3) The derelict barn will be converted into a bar and restaurant. Costs will include:

   (a) Decorative items, such as paintings and sculptures.
   (b) Tiling in toilet areas.
   (c) A sloping tiled floor in the cold store.

4) Animals such as rabbits, llamas and sheep will be bought and a number of small buildings built to house them as an attraction for children.

Requirement:

Explain, with reference to case law, any relief available on the above costs as either repairs or plant and machinery allowances. You are NOT required to discuss structures and buildings allowances. (10)

2. Mike Stifle is a director and 50% shareholder of a small safety training company, Safety Ltd.

Mike is considering a potential acquisition of Besail Ltd.

Besail Ltd undertakes several activities:

1) Yacht timeshare – Besail Ltd assists with the acquisition of yachts for timeshare. Each yacht has six timeshare owners with Besail Ltd using a booking system to allocate time on the yacht to each client. It receives a commission for the acquisition and an annual management fee for cleaning, maintenance and mooring of the yachts at a luxury yacht club.

2) Training – all clients need first aid and fire safety training to sail independently.

3) Social events – Besail Ltd organises events for clients including a summer party and an annual ski trip. The summer party is paid for entirely by Besail Ltd, with clients attending free of charge. Clients pay to attend the ski trip, but Besail Ltd obtains a significant group discount which it does not pass on to the clients.

These activities are a single trade for Corporation Tax purposes.

Besail Ltd is loss making. Mike believes that the company can return to profitability within two years of acquisition by:

1) Changing its focus from luxury yachts to more affordable ones, with more timeshare clients per yacht, moorings in a cheaper area and less spending on social functions.

2) Outsourcing the training aspects of the business.

A review of the historical accounts and Company Tax Returns of Besail Ltd show that:

1) Besail Ltd has made significant losses for each of the previous 10 years.

2) All costs in relation to social functions have been expensed and no adjustment has been made in any Company Tax Return in respect of them.

3) The largest asset held by Besail Ltd is the bespoke booking system. This was developed by a friend of the owner of Besail Ltd. Besail Ltd did not pay for the development of the booking system but instead gave the developer a free timeshare for a year. The owner of Besail Ltd believed the booking system to be worth £100,000. He wanted this to be shown in the accounts of Besail Ltd and so debited intangible fixed assets with £100,000. He was unsure of what to credit and so credited the director's loan account with the same amount.

4) The accounts contain a note regarding a contingent liability. Legal action has been taken against Besail Ltd following the death of a client on a yacht. Besail Ltd's solicitor has stated that he expects the case against Besail Ltd to be unsuccessful, but the liability could be more than £1million if it was successful. Besail Ltd does not have insurance to cover this.

The other shareholder in Safety Ltd does not want to be involved in the acquisition of Besail Ltd and so Mike intends to purchase 100% of the shares in Besail Ltd in his own name for £250,000. He will consider an alternative method of acquiring the business if there is an advantage to this.

Mike only has £50,000 cash available for the acquisition and so will borrow £100,000 from Safety Ltd and £100,000 from a bank. Safety Ltd will not charge any interest but the bank will charge 7% per annum interest. Safety Ltd will also lend £50,000 directly to Besail Ltd after the acquisition has taken place. Interest will be charged on this loan at 0.5%.

Requirement:

1) Explain the Corporation Tax issues that could arise if the acquisition were to go ahead and, where relevant, identify any potential alternative acquisition structures which could limit the impact of these. (14)

2) Explain the tax issues that arise for Mike, Besail Ltd and Safety Ltd from the proposed loans from Safety Ltd and the bank. (6)

You should ignore VAT and Stamp Duty.

Total (20)

3. On 1 February 2010, Ross and Abby commenced a trading partnership, preparing accounts to 31 January each year. It was agreed that profits would be shared between Ross and Abby in the ratio 3:1 respectively. Overlap profits arose on the commencement of the trade of £30,000 and £10,000 for Ross and Abby respectively.

From 1 February 2018, it was agreed profits would be shared between Ross and Abby in the ratio 3:2 respectively, after a salary to Abby of £24,000 per annum.

On 1 June 2021 Ross retired from the partnership and was replaced by Yousef. It was agreed that profits would be shared equally between Abby and Yousef, after prior salaries of £21,000 and £15,000 per annum to Abby and Yousef respectively.

It was also decided that the accounting date of the partnership would be changed to 31 May. Accordingly, a set of accounts were prepared for the period from 1 February 2021 to 31 May 2022. Tax-adjusted partnership profit figures were:

	£
Year ended 31 January 2021	150,000
Period ended 31 May 2022	240,000

The partnership owns its own trading premises which cost £100,000 on 1 February 2017. These were revalued in the accounts on 31 January 2018 at £150,000. When Ross retired, it was agreed that Ross would dispose of his interest in the property to Abby and Yousef based on its market value of £300,000. Abby and Yousef have agreed to continue to include the property at £300,000 in the partnership accounts. Capital profits are shared in line with the profit sharing ratio.

Ross made no other capital disposals in 2021/22 and this is the only business he has ever been involved in.

Requirement:

1) Calculate, with explanations, the taxable profits for Ross, Abby and Yousef for 2021/22 and 2022/23, detailing any overlap relief carried forward. (13)

2) Calculate, with explanations, the Capital Gains Tax liability for Ross for 2021/22 and the base cost of the property carried forward for Abby and Yousef. (7)

Total (20)

4. Alex Walsh (who identifies as non-binary and uses the pronoun "they") has run their sole trader business of graphic design for many years, using the trading name Plaza Creations.

Alex has provided the following draft profit and loss account for the year ended 31 March 2022.

	Notes	£	£
Turnover			294,530
Cost of sales			(74,500)
Gross Profit			220,030
Other income:			
Interest received	1		1,700
Overheads:			
Staff costs	2	75,000	
Premises costs		25,000	
Office costs		8,000	
Bank charges		750	
Advertising and marketing		2,000	
Bad debts	3	500	
Travel and subsistence		2,500	
Interest payable	4	1,000	
Depreciation		5,550	
Sundry expenses	5	3,500	
			(123,800)
Net Profit/(Loss)			£97,930

Notes

1) Interest received

Interest of £150 relating to March 2022, and included in the accounts, was received on 15 April 2022. In the prior year, interest of £100 which was included in the accounts to 31 March 2021 was received on 15 April 2021.

2) Staff costs

The March payroll was processed on 31 March 2022 and included pension payments for the month of £600, comprising employee contributions of £350 and employer contributions of £250.The pension payments were paid to the pension provider on 4 April 2022.

3) Bad debts

During the period a specific bad debt of £3,500 was written off, and a previous bad debt of £2,000 recovered.

The business also has a general bad debt provision which was £3,000 at 31 March 2022 (2021: £4,000).

4) Interest payable

The interest payable relates to mortgage interest payable on the business premises.

5) Sundry expenses

	£
Subscriptions	1,250
Staff entertainment	500
Charitable donation - British Heart Foundation	720
Administrative expenses	1,030
Total	£3,500

6) Fixed assets

At 1 April 2021 the tax written down balance on the main pool was £20,000.

During the year ended 31 March 2022, the business acquired the following assets:

Date	Description	Cost £
16 June 2021	New van (CO_2 emissions: 149 g/km)	30,000
10 November 2021	New computer equipment	12,500
Total		£42,500

In the year to 31 March 2021, the business made a tax adjusted loss of £10,000. Alex was able to offset £5,000 of that loss against their investment income in 2020/21, leaving losses of £5,000 to be carried forward.

Alex also had employment income in 2021/22 from work as a part-time consultant. Their income was £18,000 for the year. PAYE of £1,086 and Class 1 NIC of £1,011 was deducted from this salary.

Requirement:

Calculate, with explanations for any trading profit adjustments, the Income Tax and National Insurance payable by Alex for 2021/22. (20)

5. Barput Ltd was incorporated on 1 April 2020. The company supplies specialist milk and coffee to cafés and restaurants.

The two directors and equal shareholders of Barput Ltd are Peter and Bharat. Neither Peter nor Bharat had previously been involved in the administration of a company and did not take professional advice when incorporating Barput Ltd.

Initial funding for the company was provided by a loan of £50,000 from Peter, which was deposited in an interest-bearing bank account in Barput Ltd's name on 1 May 2020. The company commenced trading on 1 June 2020, with its first set of accounts drawn up to 31 December 2020.

The company did not prepare draft accounts for the period ended 31 December 2020 until January 2022. These accounts show a pre-tax profit of £165,000 and a Corporation Tax charge of £16,750.

The following information has also been provided:

1) The directors didn't realise the company had to register with HMRC for Corporation Tax. No notice to file a Company Tax Return has yet been issued and no Corporation Tax paid.

2) The directors have taken monthly salaries of £2,000 each since June 2020. They registered for PAYE and accessed the PAYE Online Service in June 2020. A monthly payroll was processed from June 2020 using HMRC software. However, as the directors did not understand the operation of the software, no online returns were submitted to HMRC and no PAYE or National Insurance contributions were paid.

3) The company provided a car to each director from 1 June 2020. The cars both have CO_2 emissions of 190g/km and are used privately. The directors pay for all fuel.

4) A loan agreement was drawn up by a solicitor for the £50,000 initial loan from Peter. The agreement provides for interest to be paid to Peter at 10% per annum and repayment by way of quarterly instalments of interest and capital over 10 years. The first instalment was paid on 1 June 2020.

Requirement:

Explain the tax compliance issues for Barput Ltd from the above information. Calculations are NOT required. (15)

6. Umber Printing Ltd is a print and design company, owned by Joyce Carlson. Turnover for the year ended 30 June 2022 was £12.5 million (year ended 30 June 2021: £11.75 million) and the company's gross assets as at 30 June 2022 were £7 million (at 30 June 2021: £6.25 million). The company had 45 full-time employees in both years.

As part of the development of a new colouring process, the company has engaged with a company, Small World Ltd, to provide the services of their employee Scott Forbes. Scott is a specialist colour technician, who also owns all of the shares in Small World Ltd. Small World Ltd will invoice Umber Printing Ltd £12,500 per quarter for the provision of Scott's services for a period of 12 months, starting in May 2023. Scott will work as part of the company's R&D department and will perform the work given to him under the control and supervision of Joyce. He will however provide his own laptop and other computer equipment. He will spend 20 hours per week working for Umber Printing Ltd and the remainder of his week working for Small World's other clients. He will perform the work personally and will not be able to send a substitute in his place. He will not be entitled to any company benefits.

Umber Printing Ltd wants to appoint a non-executive director, who will attend the company's monthly board meetings. The board have identified a suitable candidate for the role, Cliff Edwards. The company will pay Cliff an agreed amount of £12,000 per annum for attending the board meetings. They will also reimburse any travel and accommodation expenses incurred by Cliff in attending the board meetings, which are expected to be £2,000 per annum. In addition, Cliff will provide the company with consultancy services as required, for which he will be paid £30,000 per annum. Cliff will provide these services as a self-employed consultant.

Requirement:

Explain the PAYE and National Insurance implications for Umber Printing Ltd of the arrangements with:

1) Small World Ltd. (9)

2) Cliff Edwards. (6)

Total (15)