

The Chartered Institute of Taxation

Advanced Technical

Taxation of Owner-Managed Businesses

May 2022

Suggested solutions

ANSWER 1

Part 1

Plant and machinery allowances

	AIA £	FYA 130% £	Main Pool £	SRP £	Cas £
Brought forward			109,278	23,000	
Additions:					
Sign		5,000			
Kitchen		5,500			
Office furniture		3,000			
Carpet tiles		2,000			
Heating system		55,000			
EV charging points (1)		4,800			
Other main pool expenditure		25,000			
Removal of machinery (2)	2,000				
Installation of machinery (2)	3,000				
New steel rolling machine (5)		120,000			
Deposit for forming machine (6)		35,000			
Disposals:					
s.198 election values (7)			(1)	(1)	
Steel rolling machine (8)			(80,000)		
	5,000	255,300	29,277	22,999	
AIA 100%	(5,000)				5,000
FYA 130% (10)		(331,890)			331,890
18% WDA			(5,270)		5,270
6% WDA				(1,380)	1,380
Carried forward			24,007	21,619	
Maximum PMAs					<u>£343,540</u>

Notes

- 1) Electrical vehicle charging points qualify for 100% first year allowances (s.45EA CAA 2001) but the 130% super deduction FYA gives more capital allowances so will be claimed here.
- 2) Costs of removal and installation of assets, which are capital in nature, are treated as qualifying expenditure on the qualifying assets but will not qualify for the 130% FYA (which is only available in respect of expenditure on new/unused assets) so the AIA will be claimed instead.
- 3) Decoration of the offices is a revenue cost.
- 4) The suspended ceiling is not plant and machinery expenditure, in line with case law in *Hampton v Fortes Autogrill Ltd.*
- 5) Subsidised expenditure cannot qualify for capital allowances, as it is met by another party.
- 6) As the company will be entitled to the benefit of the contract when the machinery is completed, the deposit paid can qualify for allowances under s.67 CAA 2001. The balance may not be claimed until the unconditional obligation to pay it arises on delivery.
- 7) The amounts agreed in the s.198 election must be removed from the relevant pools.
- 8) The amount removed from the pool is restricted to the cost of £80,000.

- 9) The maximum annual investment allowance is $9/12 \times £1,000,000 + 3/12 \times £200,000 = £800,000$

Note:

The announcement at the Autumn Budget 2021 that the £1m AIA limit will be extended to 31 March 2023 came after the legislative cut-off date for 2022 exams of 31 July 2021. Candidates will not be penalised for applying the actual correct legislation. On this occasion a student would gain the same marks if they assume the change in the AIA limit applies at 1 January 2022 or at 1 April 2023.

Structures and buildings allowance

Qualifying expenditure:	£
Structural expenditure	650,000
Suspended ceiling (1)	<u>2,500</u>
	652,500
3% SBA	19,575
Apportioned from 30 Nov to 31 March (4m) (2)	<u>£6,525</u>

Notes

- 1) This forms part of the structure of the building and was constructed prior to occupation.
- 2) The SBA is only available from the date the property comes into use.
- 3) Land, planning costs and legal fees are not qualifying costs for SBA purposes.

Maximum capital allowances for the year ended 31 March 2022 = £350,065

Part 2

	£	Note
Proceeds	920,000	
Disposal costs	(3,000)	
Acquisition cost	(835,000)	1
Legal fees on acquisition	(2,500)	
Enhancement expenditure	<u>(150,000)</u>	1
Gain / (loss)	(70,500)	
Restriction under s.41 TCGA 1992	<u>70,500</u>	2
Chargeable gain	<u><u>-</u></u>	

Notes:

- 1) The allowable costs include fixtures, which are part of the property in law.
- 2) The loss is restricted by the amount of the capital allowances retained by the company in relation to the fixtures above. £85,000 has been spent on qualifying fixtures. As a £1 fixtures election has been signed for each of the capital allowances pools, the amount of allowances retained is £84,998. However, the restriction under s.41 is limited to the amount of the loss itself – a gain cannot arise as a result.

MARKING GUIDE

TOPIC	MARKS
Part 1 – Capital allowances	
Sign	$\frac{1}{2}$
Kitchen	$\frac{1}{2}$
Furniture	$\frac{1}{2}$
Carpet tiles	$\frac{1}{2}$
Decoration	$\frac{1}{2}$
Suspended ceiling	$\frac{1}{2}$
Heating system	$\frac{1}{2}$
EV charging points	1
Removal and installation	1
New steel rolling machine	1
Deposit payment	$1\frac{1}{2}$
s.198 election values	$\frac{1}{2}$
Disposal proceeds	1
Maximum annual investment allowance	$\frac{1}{2}$
Calculation of PMAs	2
3% SBA and apportionment	2
Ceiling	1
Land and other non-qualifying costs	1
Part 2 – Chargeable gain	
Deduction of costs and enhancement	2
Comment on fixtures	$\frac{1}{2}$
s.41 restriction	$1\frac{1}{2}$
TOTAL	20

ANSWER 2

Part 1

Esther – Taxable profits

2020/21 and 2021/22

Adjustment to profit

	Notes	£	£
Profit per the draft accounts			135,000
Add:			
Raw material taken for own use	1	175	
Profit on dress taken for self	2	1,133	
Disallowable premium	3	22,267	
Hire purchase repayments	4	5,400	
Van expenses (50%)	5	2,100	
Car expenses (25%)	5	600	
Legal costs for tenancy	6	2,000	
Loan to friend	7	4,500	
General bad debt provision	8	5,700	
Depreciation	9	14,000	57,875
Less:			
Deposits	10	3,500	
Hire purchase interest	11	675	
Capital allowances	12	39,660	
			<u>(43,835)</u>
Assessable profit			<u><u>149,040</u></u>

Notes:

- 1) The fabric taken for Esther's own use is disallowed. As this is raw material rather than finished stock, it is valued at cost.
- 2) Where trading stock is taken for personal use, the retail price of the stock should be included. S 172B ITTOIA 2005.

	£
Fabric cost	200
Profit margin (85/15 x 200)	1,133
Retail value	<u>1,333</u>
Less already included	<u>(200)</u>
Adjustment required	<u>£1,133</u>

- 3) Disallowable premium:

	£
Lease premium paid	25,000
Less: 2% x 25,000 x (10 – 1)	<u>(4,500)</u>
Property income taxed on landlord	<u>20,500</u>

Allowable for Esther over term of lease, 10 years, at £2,050 per annum.

Relief for period 1 January 2021 to 30 April 2022 (16 months) = £2,050 * 16/12 = £2,733

Add back should therefore be £25,000 - £2,733 = £22,267

- 4) Hire purchase repayments are disallowed as capital.
- 5) The private costs for the van and car expenses are disallowed.
- 6) The legal costs for the new lease are capital and therefore disallowed.
- 7) The loan to Esther's friend is not for a business purposes, therefore disallowed. The loan to the employee is allowable as the write off will have been taxable on the employee as remuneration.
- 8) The provision of 5% against general debtors is not allowable as it is a general provision. The provision against the debt due from Quefit Ltd is allowable as it is relates to a specific balance.
- 9) Depreciation is disallowed as capital allowances are claimed instead.
- 10) Under the accruals basis, deposits should be included when the work is completed.
- 11) Hire purchase interest on car:

		£
Repayments	60 x 900	54,000
Cost		45,000
Interest		<u>9,000</u>
Interest for period	6 x 9,000/60	<u>900</u>
Allowable (75%)		<u>675</u>

12) Capital allowances:

	AIA £	Main pool £	Car £	PU £	Allowances £
Additions:					
Equipment	26,000				26,000
Gift from mother (at value)		4,000			
Van	15,000			50%	7,500
Software	2,500				2,500
Car			45,000		
WDA					
18% x 16/12		(960)			960
6% x 16/12			(3,600)	25%	2,700
WDV c/f		<u>3,040</u>	<u>41,400</u>		
Allowances					<u>39,660</u>

Taxable income

Assessable:	Notes	2020/21 £	2021/22 £
Period ended 5 April 2021 3/16 x 149,040	1	27,945	
6 April 2021 – 5 April 2022 12/16 x 149,040 Employment income (9 x 12,000)	2		111,780
		<u>108,000</u>	
		135,945	111,780
Personal allowance (restricted)	3	-	(6,680)
Taxable income		<u>£135,945</u>	<u>£105,100</u>

Notes:

- 1) First year of trading: actual from date of commencement to 5 April 2021.
- 2) Second year of trading: no accounting period ending in the tax year, therefore basis of assessment is 6 April 2021 – 5 April 2022.
- 3) As taxable income exceeds £100,000 the personal allowance is restricted.

Part 2

National Insurance contributions

As an employee, Esther was liable for Class 1 National Insurance primary contributions on her salary each month.

When she commenced self-employment on 1 January 2021, she became liable to Class 2 National Insurance contributions. When however, she reached state retirement age on 1 March 2022, the liability to pay Class 2 National Insurance contributions ceased.

There is an annual maximum for the total contributions payable, which may apply in 2020/21. The overpayment will be calculated automatically by HMRC and Esther will receive a refund if appropriate. As she only had one employment, it is unlikely that she has overpaid Class 1 National Insurance, but she may have overpaid Class 4.

2021/22

6 April 2021 – 1 March 2022
47 weeks at £3.05 pw £143.35

She is also liable to pay Class 4 National Insurance contributions from 1 January 2021 until 6 April 2022: the beginning of the tax year after she reaches state retirement age.

2021/22

(50,270 – 9,568) x 9%	3,663
(111,780 – 50,270) x 2%	<u>1,230</u>
	<u>£4,893</u>

MARKING GUIDE

TOPIC	MARKS
Part 1 – Taxable income	
Adjustment to profit (including explanations):	
Adjustments re goods for self	1
Adjustments re premium	2
Adjustment for hire purchase repayments	½
Adjustments for private use of van and car	½
Adjustment for legal cost	½
Adjustments re debts	2
Adjustment for depreciation	½
Adjustments for hire purchase	1
Adjustments re deposits	½
Capital allowances:	
Pre-trading cost	½
Gift from mother	½
Private use van	½
Software	½
WDA on main pool extended period	1
WDA on car – rate and private use	1
Inclusion in adjusted profit	½
Allocation to tax years:	
Basis periods including explanations	1½
Personal allowance restriction	½
SUB TOTAL	15
Part 2 – Explanation and calculation of National Insurance	
Class 1 on salary	½
Class 2 liability until retirement	1
Class 4 liability until tax year following retirement	1½
Explanation of annual maximum	2
SUB TOTAL	5
TOTAL	20

ANSWER 3

Part 1

Staff costs

Staff costs of those directly involved in the technological development of the project will qualify for enhanced relief. All the staff members appear to be directly contributing to the technological development and so all should qualify. However, the qualifying costs are restricted by time not spent on qualifying activities.

Time spent meeting with customers and viewing the company's technology is not time spent resolving the technological uncertainties of the project, so will not qualify.

Time spent on the corporate financing of the projects will also not qualify, as this is not related to the technological development, nor is it a qualifying indirect activity.

As a result, Fred's costs will be restricted to 45%

Training which is directly related to the technological developments on the project can be included as qualifying time. However, general administration work will not qualify for enhanced relief, as it does not address technological issues. For the other four staff members, their time will therefore be restricted to 90%.

The staff costs which qualify for relief are restricted to salary, employer's NICs and employer's pension costs. Benefits in kind do not qualify for relief.

Name	Salary	Employer's NIC	Company pension contributions	Total	Qualifying %	Qualifying cost
	£	£	£	£		£
Fred	100,000	12,000	20,000	132,000	45	59,400
McMurray						
Ruth Thomson	50,000	5,000	1,000	56,000	90	50,400
Ken Anderson	40,000	4,000	-	44,000	90	39,600
Mary Jones	23,000	2,000	-	25,000	90	22,500
Tim Conway	23,000	2,000	-	25,000	90	<u>22,500</u>
Total						<u>£194,400</u>

Software

Software costs which are directly related to the technological developments on the project (such as the development and modelling software) are eligible for relief.

As financial and personnel support of the R&D work is a "qualifying direct activity", the software costs associated with that activity i.e. the payroll software allocation to the R&D department can qualify for enhanced relief.

Total qualifying software costs - £11,000

Property and other business costs

Rent and rates, and telephone, are not costs which fall within any of the qualifying heads of expenditure.

Heat, light and power is specifically a qualifying cost within the R&D legislation.

Total qualifying property and other business costs - £3,500

Subcontractor costs

As the payment to Luxo is to a connected company (as the company is controlled by an associate of James), the qualifying payment is the lower of (1) the payment to the other company and (2) the amount of expenditure incurred by the connected company on the project.

The company's qualifying expenditure on the project is the salary of £40,000 paid to James's son, and as this is less than the amount charged, the amount claimed is £40,000 being the lower of the two amounts.

In the case of the payment to the third party company, it does not matter that the company is not a UK-based company. Relief is available for 65% of the amount paid.

Total qualifying sub-contractor payments - £40,000 + (£25,000 x 65%) = £56,250

The enhanced tax deduction available for the year ended 31 December 2021 is therefore:

	£
Staff costs	194,400
Software	11,000
Property and other business costs	3,500
Subcontractor costs	<u>56,250</u>
	265,150
Enhanced tax deduction (130%)	<u>£344,695</u>

Part 2

The enhanced tax deduction of £344,695 will be treated as an additional tax deduction and will therefore reduce the taxable profits of the year ended 31 December 2021 to nil and will generate a loss of £119,695.

This will save the company corporation tax of £42,750, which would otherwise have been payable in relation to the year ended 31 December 2021.

As the company is now in a loss-making position as a result of the R&D claim, it can surrender the lower of:

- Its unrelieved trading loss (£119,695); or
- 230% of its qualifying expenditure (£609,845)

for a payable tax credit of 14.5% - equal to £17,355.

However, if the losses of £119,695 are carried back to the year ended 31 December 2020, they would save tax at 19%, and generate a repayment of £22,742 (plus interest).

As such, the maximum benefit of the R&D claim is £42,750 + £22,742 = £65,492 (plus interest).

MARKING GUIDE

TOPIC	MARKS
Part 1 – Enhanced deduction	
Staff costs:	
Qualifying activities	3
Qualifying costs	1½
Software	1
Property and other business costs	1
Subcontractor costs:	
Connected company	2
Unconnected company	1
Calculation of enhanced deduction	½
Part 2 – Tax relief	
Adjusted December 2021 position	1
Potential CT saved	½
Potential loss surrender	2
Loss carry back	1
Maximum benefit	½
TOTAL	15

ANSWER 4

Discount for sales staff

The discount offered to the sales staff is a taxable benefit arising by reason of their employment. The issue however is how the value of the benefit should be calculated? The value is its 'cash equivalent', the 'cost to the employer', of providing the benefit. This would not be the sales price as the employer would be adding a mark-up to the cost of the goods. The lost profit is not a 'cost' for these purposes. Provided the partnership can show that the mark-up on their stock is at least equal to the discount offered to staff the value of the benefit would be £nil and a form P11D will not be required. If not, the difference will need to be reported on form P11D. This will then be liable to employer's NIC at the rate of 13.8%.

Provision of free accommodation

The provision of the free holiday in the property owned by the senior partner is a benefit. There are special rules for calculating the value of the benefit, the cash equivalent, on the provision of living accommodation.

The cost of providing the accommodation is the amount paid by a person involved in providing the accommodation. This includes the senior partner, who is deemed connected with the employer, the partnership. As the cost of providing the accommodation is greater than £75,000, the cash equivalent is the annual value of the property, which is its rateable value, plus the excess of the cost over £75,000 multiplied by the official rate of interest. This amount is then reduced proportionately for the period of occupation i.e., two weeks.

In addition to the above the employee is also taxable on the amount of any expenses paid such as heating.

Leaving gift of holiday on retirement

The reimbursement of the cost of the holiday would be employment income for Sally to the extent of the VAT inclusive price paid. Once the tax liability on the holiday is calculated. if the partnership wishes to pay the tax on the benefit they will need to make a grossed up payment through their payroll to compensate Sally for the tax liability. This will need to go through payroll in the normal way, and the grossed up amount will be subject to PAYE and employees' NICs.

Van benefit and vehicle allowance

The car allowance up to 1 January 2022 would be taxable as earnings in the normal way through PAYE. The provision of a company van from that date will give rise to a benefit. The annual van benefit is normally based on a fixed amount of £3,500 per annum, time apportioned for the year first provided.

Where the benefit is provided through 'optional remuneration arrangements' in which the employee gives up the right to an amount of earnings in return for a benefit as in this case the taxable benefit is based on the greater of:

- The cash equivalent of the benefit of the van, and
- The amount of pay foregone with respect to the provision of the van, the vehicle allowance.

A comparison will therefore need to be made to ensure that the correct amount is included for the benefit purposes and on the P11D. A liability to Class 1A NIC will also arise.

Car Benefit

The provision of the car for private use results in a benefit based on the list price of the car. When calculating the value of the car, the cost of any accessories added later, is included subject to a minimum limit of £100. As the roof rack cost £75 an additional benefit does not arise.

Replacement accessories can also be added to the list price for benefit purposes if they are superior to the original as would appear to be the case with the alloy wheels. The £240 will therefore be added to the list price of the car when calculating the benefit.

Payments for private use of a car can be deducted from the car benefit calculated but only if they are for private use and the agreement is in place when the car is first provided. This is not the case here and the £50 payments will have no effect on the calculation.

MARKING GUIDE

TOPIC	MARKS
Discount for sales staff:	
Cash equivalent/Cost to employer	1
Mark-up issue	1
P11D/Class 1A	1
Living accommodation:	
Senior partner accommodation	$\frac{1}{2}$
Calculation of benefit	$1\frac{1}{2}$
Other expenses	$\frac{1}{2}$
Holiday to Portugal:	
Employment income	1
Application of PAYE	1
Grossing – up	1
Vehicle Allowance/Van Benefit:	
Van benefit	1
Optional Remuneration Arrangements	$1\frac{1}{2}$
Calculation of benefit	1
Car Benefit:	
Accessory less than £100	1
Number plate not superior	1
Private use payments non-allowable	1
TOTAL	15

ANSWER 5

General Comments

Where shares are gifted to a connected person or sold at undervalue the disposal is deemed to take place at market value for CGT purposes. It is however possible to claim gift relief under s165 TCGA 1992 provided the gifted shares are in an unquoted trading company. A joint election must be made within five years and 10 months of the end of the tax year of the gift.

If relief is claimed no immediate gain will arise and instead the recipient has a reduced base cost for a future disposal. A personal company is one in which more than 5% of the shares are held. A trading company is one whose activities do not include, to a substantial extent, non-trading activities. HMRC apply a 20% test for defining "substantial" to turnover, profits, assets or management time and the whole position is considered "in the round".

The value of the investment property, a non-trading asset, is just over 20% of net assets. If however goodwill, the freehold property and the development land were included at their market value then the 20% threshold would not be exceeded. In addition, as rental income and rental profits are less than 20% the company will qualify as a trading company.

Where the company holds non-business chargeable assets, the gift relief is restricted to the gain multiplied by the ratio of chargeable business assets to total chargeable assets. Chargeable assets are those which would give rise to a chargeable gain or allowable loss on disposal. The company's chargeable assets are the properties and goodwill. The value of business assets will not include the investment property. A proportion of the gain will therefore be liable to Capital Gains Tax.

The taxable part of the gain will qualify for Business Asset Disposal Relief (BADR) as the shares are in a trading company and Aaron has been a director owning at least 5% of the shares for over two years. The restricted gain less the annual CGT exemption would be taxed at 10% provided a claim is made and the lifetime BADR limit of £1m has not been exceeded.

Gift to Daughter.

Crystal, Aaron's daughter, is a connected person and the market value rule will apply giving rise to a gain of £299,980. Crystal's base cost of the shares would be £300,000 and Aaron could choose to pay 10% on the full gain. Alternatively, a claim for gift relief could be made, in which case Crystal's base cost would be reduced.

Gift to Step-Son

Edward is also a connected person and the market value rule will also apply. As however Edward is paying for the shares the gift relief will be restricted by the proceeds received.

Aaron will be liable to CGT on £149,990, the excess of market value over cost, subject to a claim for gift relief. As Edward will be paying £75,000 for the shares which exceeds Aarons base cost by £74,990 the maximum gift relief claim is £75,000 subject to the restriction for non-business assets outlined above.

In addition to the CGT implications, when shares are transferred to an employee at a discount the difference is treated as taxable income if the shares are received "from the employment" or the shares are employment-related securities ("ERS").

The legislation on ERS is widely drawn and catches almost all shares received by employees. However, there is an exception if the transfer is made to an individual due to a family or personal relationship and therefore no charge will arise under this legislation.

Gift to Francois

The CGT position will be similar to the transfer to Crystal apart from the £10 nominal value paid, and gift relief can be claimed subject to the non-business asset restriction.

If Francois moves to France he could become non-UK resident. When the recipient of a gift becomes non-resident within six tax years the deferred gain becomes taxable on them at the date of emigration. If the CGT is not paid within 12 months HMRC can seek recovery from Aaron. These rules would not apply if Francois moves to France on a full-time contract of employment but returns to the UK within three years.

Francois will be liable to income tax on the discount of £149,990 on the shares he receives, as these have been acquired "from his employment". As the shares are not readily convertible assets because there is no opportunity to immediately sell them this amount will be taxed via his self-assessment tax return and not via PAYE.

MARKING GUIDE

TOPIC	MARKS
General Comments:	
Gift/Sale at undervalue deemed market value	1
Outline Gift Relief including time limit	1
Joint Election	½
Definition Trading Company	1½
Restriction Non-Business Assets	1
Base Cost for Crystal	½
Business Asset Disposal relief	1½
Gift to Crystal:	
General comments	1
Gift to Edward:	
General Comments	1
No employment charge	1
Gift to Francois:	
Non-resident issue	1
Potential Claim on Aaron	1
Exception for full time employment	1
Earnings charge	1
Method of taxing charge/RCA's	1
TOTAL	15

ANSWER 6

Part 1

Profit allocation:

	Total	Raqeeb	Roman	Mason	Philip
Salary	105,000	0	50,000	5,000	50,000
Return on capital	40,000	40,000			
PSR	(555,000)		(222,000)	(111,000)	(222,000)
	(410,000)	40,000	(172,000)	(106,000)	(172,000)
Notional profit reallocation (note)		(40,000)	15,289	9,422	15,289
Allocated profits/(losses)	(410,000)	0	(156,711)	(96,578)	(156,711)

Note:

As Raqeeb is initially allocated a profit despite the partnership being loss making, this notional profit is re-allocated between the other partners in proportion to their existing loss allocation (s.850B ITTOIA 2005).

Part 2

Options for loss relief:

Each partner can decide on their own loss relief (s.850 ITTOIA 2005). The options available are:

- Set against other income in the current or prior year under s.64 ITA 2007 ("sideways loss relief"). If this claim is made, or could have been made had there been other income, an extended carry back against trading profits of the previous two years before the prior year can be made on a last in, first out basis.
- To the extent that relief has been claimed for any particular tax year under s.64 ITA 2007, a claim can be made to extend the relief for offset against gains under s.71 ITA 2007 and s.261(b) TCGA 1992.
- Carry forward against future profits from the partnership under s.83 ITA 2007.
- Opening year relief under s.72 ITA 2007 allows carry back against the previous 3 years on a first in, first out basis. ("early years loss relief").

Roman

If Roman carries back the losses to 20/21, he will waste his personal allowance and will save some tax at basic rate and some at higher rate. A carry back to 19/20 would use the remaining losses, saving some tax at higher rate, some at basic rate and wasting some of the personal allowance.

If Roman carries his losses forward, he will save tax at the additional rate on £90,000 of the losses and the higher rate on the remaining losses but with the additional benefit of preserving his personal allowance.

If cash flow is not an issue, Roman should carry the losses forward.

Mason

As Mason works in the partnership one day per month (less than 10 hours per week), he will be classed as a non-active partner. The loss reliefs available to a non-active partner are restricted. For early years loss relief, the relief is limited to the capital contribution made which for Mason was £nil. As Mason has been a partner for over 12 years however this restriction is not relevant. For sideways loss relief the restriction is a maximum offset of £25,000 per tax year against other income. The £25,000 restriction does not apply to offset against profits from the same trade.

Mason has £84,000 of non-partnership income each year and in the year 2020/21 had a share of partnership profits of £10,000. Under s.64, therefore he can carry back a total of £35,000. He can also relieve £25,000 in the current year. This would save tax at higher rate. He can also carry back against the trading profits of £16,000 in 2019/20 and £14,000 in 2018/19, saving higher rate tax.

In 2022/23, Mason is predicted to have profits of £100,000. His total income will, therefore, be £184,000 and it will be beneficial to carry the losses forward as this will result in some tax being saved at additional rate and will also prevent Mason's personal allowance being abated in 2022/23.

If Mason has no cash flow issues, he will benefit from carrying losses forward.

Philip

Philip is a new partner. He works full time in the business. In previous tax years he has had income from employment of £120,000 per annum and in the tax year 2021/22, he had chargeable gains of £54,000. His expected profits in 2022/23 are £240,000.

Any losses offset against income from employment or capital gains under s.64, s.71 or s.72 will be restricted to the greater of £50,000 and 25% of the adjusted total income (ATI) for that tax year (s.24 ITA 2007).

As 25% of ATI in the years prior to 2021/22 is £30,000, the £50,000 restriction will apply.

If Philip made a claim under s.72, he could relieve £50,000 in 18/19, £50,000 in 2019/20 and £50,000 in 2020/21. The remaining £6,711 could either be offset against gains in 2021/22 or carried forward to 2022/23.

The option to relieve £50,000 per annum would save tax at higher rate in each of these tax years but would also result in Philip having his personal allowance reinstated in each of these years (saving tax at 60% on this portion). This option is also attractive from a cash flow perspective as a repayment can be claimed.

Offsetting against gains under s.71 would save a maximum 10%/20% tax and so this is not recommended.

If the losses were carried forward to 2022/23, they would save tax at additional/higher rate and would also result in the annual allowance being preserved. This will not result in as high tax savings as s.72 and it should also be noted that the future profits are not guaranteed.

MARKING GUIDE

TOPIC	MARKS
Part 1:	
Allocation of salaries	1
Allocation of return on capital	½
PSR	1
Notional profit reallocation -identification and explanation	1
Notional profit calculations	1
Totals	½
Part 2:	
Each partner can choose own loss relief	½
Identification of options – ½ mark per option	2
Roman:	
CB discussion	½
C/fwd discussion	½
Recommendation	½
Mason:	
- Non active partner	½
- Restriction	½
- CY/CB discussion	½
- C/fwd discussion	½
- Recommendation	½
Phillip:	
- Restriction	1
- s.72 discussion	1
- s.71 discussion	½
- C/fwd discussion	½
- Recommendation	½
TOTAL	15