THE CHARTERED INSTITUTE OF TAXATION

ADVANCED TECHNICAL

Taxation of Owner-Managed Businesses

May 2021

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.
- Except as set out below or indicated by additional information in the question, you may assume that 2020/21 legislation (including rates and allowances) continues to apply for 2021/22 and future years.

  1) You MUST assume that the UK remains within the European Union.

  2) You MUST ignore all temporary Covid related legislation including furlough, grants, loans and the reductions in VAT and SDLT rates.

  Except in relation to points 1) and 2) above, candidates answering by reference to more recently enacted legislation or tax cases will not be penalised.
- You must type your answer in the space on the screen as indicated by the Exam4 guidance.

1. Dafydd is a sheep and cattle farmer in North Wales. He has previously prepared accounts to 30 September each year but in 2020, he decided to extend his year end to 31 March and therefore prepared accounts for the 18-month period to 31 March 2021.

The draft profit for the period was £19,000 after deducting the following expenses:

1) Depreciation of £36,000. This includes £5,400 in respect of a loader, acquired under a finance lease.

2) Leasing costs of £4,800 for a car, with CO_2 emissions of 185 g/km used 50% by an employee for private purposes. The costs are broken down as £3,600 for rental and £1,200 for maintenance.

3) Repairs of £14,000 on the access road to the farm.

4) Drainage and fence repairs of £6,500 in respect of a field which was purchased at a low cost due to its condition. The works were required to bring the land into a useable condition.

5) Household costs of £4,000 for a farm cottage occupied by a farm employee and of £3,750 for the farmhouse occupied by Dafydd, which is used 25% for business purposes.

In addition, a lamb was butchered for Dafydd's use which cost £70 and could have been sold for £100.

The main pool balance brought forward at 1 October 2019 was £4,000 and the special rate pool balance brought forward was £7,000. The following equipment transactions took place during the period:

1) Lightweight panels costing £4,000 were bought, which will be used to partition a barn during lambing in March, but then removed for the rest of the year.

2) A new car for an employee's use at a cost of £10,000 plus VAT of £2,000. The employee's business use is 60%. The CO_2 emissions of the car are 105 g/km.

3) Solar panels were installed on the farmhouse at a cost of £10,000. They will generate power for the farmhouse.

4) A tractor was written off in an accident in February 2021. The tractor was sold for scrap proceeds of £6,000 in March 2021. Insurance proceeds of £45,000 were received in June 2021. Dafydd purchased a replacement tractor from his brother at its £60,000 market value in March 2021. His brother had purchased the tractor for £80,000 when new.

5) On 24 March 2021, Dafydd paid a deposit of £12,000 as part of a hire purchase agreement for a combine harvester, which has a total cost of £75,000 and which will be delivered in early summer ready to be used for harvesting in August 2021. The balance is repayable over 48 months from April 2021.

Continued

1. Continuation

The following work was carried out on buildings during the period:

1) An outbuilding was improved in August 2020 as follows:

   (a) Provision of a drainage system at a cost of £3,750.

   (b) Provision of a cold water system £2,600.

2) Between 1 September 2020 and 31 December 2020, a disused barn was renovated at a cost of £45,000. The cost included:

   (a) £4,000 for the preparation of the land.

   (b) £1,500 for planning costs.

   (c) £5,500 for a new electrical installation.

3) In October 2020 a new slurry store was built at a cost of £3,000.

4) In November and December 2020, the walls and floor of a barn were altered to allow the installation of a grain dryer in May 2021. The cost of the work was £14,000, including planning costs of £1,500.

Requirement:

Calculate with explanations:

1) The adjusted profit for the period ended 31 March 2021. (5)

2) The capital allowances available for the period ended 31 March 2021. (15)

Total (20)

2. Castle Foods Ltd specialises in the manufacture and sale of handmade cheeses from its small factory in Lincolnshire. The company is owned and managed by Dean Jones and his wife. Jones Farms LLP, which operates a dairy farm providing milk to the company and to other customers, is a partnership between Castle Foods Ltd and Dean Jones. The mixed partnership rules do not apply to this LLP.

Dean's partnership capital account has been overdrawn by £40,000 since 1 January 2019. This is expected to continue to be the case for the foreseeable future.

Dean has provided the company's draft profit and loss account for the year ended 31 December 2020.

	Notes	£	£
Turnover			245,000
Cost of sales			
Opening stock		34,000	
Purchases and direct costs of production	1	162,500	
Closing stock		(65,000)	
			(131,500)
Gross Profit			113,500
Other income:			
Share of profit of Jones Farms LLP	2		134,500
Overheads:			
Staff costs		68,000	
Premises costs		30,000	
Premises repairs	3	5,650	
Office costs		3,000	
Bank charges		500	
Advertising and marketing	4	4,000	
Travel and entertainment	5	6,500	
Legal and professional fees	6	8,000	
Interest payable	7	4,050	
Loss on sale of assets		5,200	
Depreciation		10,500	
Sundry expenses	8	3,450	
			(148,850)
Net Profit/(Loss)			£99,150

Continued

2. Continuation

Notes

1) Cost of Sales

The direct costs of production include £14,000 for the depreciation of plant and machinery used for cheese production. The closing stock has been valued on the basis of the total cost of production per unit and depreciation of £4,500 is included in this figure. The corresponding figure for the opening stock balance is £2,500. This accounting treatment is in accordance with UK accounting standards.

2) Share of profit of Jones Farms LLP

The share of profit of the LLP of £134,500 represents the company's interest in the LLP's accounting profits. The company's share of the LLP's tax adjusted profits was £108,000 for the year ended 31 March 2020 and £56,000 for the year ended 31 March 2021. No further adjustments need to be made for Corporation Tax purposes. The company does not, and has never, drawn its profit share from the partnership.

3) Premises repairs

	£
Replace office kitchen	2,050
Paint exterior of building	600
Replace entire air conditioning system in office	2,700
General repairs	300
Total	£5,650

4) Advertising and marketing

	£
Online advertising costs	2,250
Local media advertising costs	1,000
Free samples of cheese given away to customers	750
Total	£4,000

5) Travel and entertainment

	£
Corporate hospitality at Six Nations rugby, Paris	3,000
Travel with client to Paris for the above	750
Business lunches with clients in local area	600
Staff travel to above business lunches	100
Business travel and subsistence	2,050
Total	£6,500

6) Legal and professional fees

Legal and professional fees include £1,000 in relation to the negotiation of a business loan for the purchase of new machinery during the year and £500 in respect of tax fee protection insurance, which allows the company to reclaim the costs of any accountancy fees incurred in defending an HMRC enquiry into a careless or deliberate inaccuracy.

Continued

2. Continuation

7) Interest payable

Interest payable includes £100 in relation to Corporation Tax paid late for the year ended 31 December 2019 and £500 in relation to the late payment of VAT for the quarter ended 31 November 2020.

8) Sundry expenses

	£
Parking fine incurred by Dean Jones	30
Customer bad debt written off	1,000
Sundry office administration costs	2,420
Total	£3,450

9) Fixed assets

During the year ended 31 December 2020, the company acquired and disposed of the following assets:

Date	Description	Cost	Disposal proceeds
		£	£
28 January 2020	Steam stretching machine (used)	30,000	
6 February 2020	Old steam stretching machine	(25,000)	3,500
17 October 2020	Racking and shelving	3,550	
30 November 2020	Cold store and installation work	14,000	
Total		£22,550	£3,500

At 31 December 2019, the tax written down balance on the main pool was £18,000 and £nil on the special rate pool.

Requirement:

Prepare the Corporation Tax computation for Castle Foods Ltd for the year ended 31 December 2020, together with brief explanatory notes where appropriate. (20)

3. DePac Ltd is a company whose principal trade is the manufacture and distribution of food packaging materials.

The share ownership is as follows:

	£1 Ordinary shares
Lesley Khan	80
Afan Khan (husband of Lesley)	20
Paula Andrews	28
Gareth Ripley	8
Total Share Capital	136

Lesley inherited her shares from her father in June 2004 when they were valued at £4,500 per share. She is currently a director of the company.

Afan received his shares as a gift from Lesley in February 2006, a year after they married. The market value in February 2006 was £6,000 per share. He has never been an employee or officer of the company.

Paula subscribed £2,000 per share for her shares in January 2007 under an Enterprise Management Incentive option. The market value of the shares when the option was granted in 2005 was £5,000 per share. She is currently a director of the company.

Gareth is a founder shareholder and subscribed par value for his shares in May 1988. He retired as a director and employee of the company in 2014.

All of the shareholders are resident in the UK and, with the exception of Gareth, all are top rate tax payers. Gareth's only income is a pension of £26,000 per annum.

A Board meeting of the company was held in April 2021 and it was clear that there were irreconcilable strategic differences between Lesley and Paula. Matters have deteriorated since then and the directors have decided that the company will buy-back Paula's shares at an open market value of £18,000 per share. Gareth has also indicated that he would be happy to dispose of his shares at this price although he is flexible about how and when this is achieved. Lesley and Afan would also like to realise some value and would consider a buy-back of 10 shares each at this price.

The company has distributable reserves of £2.1 million and it satisfies the Business Asset Disposal Relief trading status requirements in TCGA 1992. The company's lawyers have already provided advice regarding the company law requirements and implications of a buy-back.

Requirement:

Advise on the tax implications for the directors of the proposed share buy-backs.
(15)

4. BC Ltd is a trading company. It made the following disposals during the accounting period ended 31 December 2020:

	Date sold	Original cost	Proceeds
		£	£
“The Old Foundry”	June 2020	370,000	1,100,000
11 Marston Street	March 2020	410,000	650,000

The history of the above assets is as follows:

“The Old Foundry” was purchased in June 2000 and let to third parties until June 2002. It was subsequently occupied by BC Ltd as one of its production facilities.

11 Marston Street was purchased in March 2011. BC Ltd has always used the ground floor (approximately 60% of the total) as a showroom. The top floor was let as a residential flat.

The directors plan to make the following acquisitions during the accounting period to 31 December 2021:

	Cost
	£
4 Dean Row	1,625,000
Parson Road	800,000
Dire Avenue	65,000

Dean Row will be a replacement production facility. There will be a two-month delay before this can be occupied by BC Ltd to allow for fit out. Approximately 20% of this facility will be surplus to requirements and will be let to third parties.

Parson Road is a storage facility but it is not required immediately. It is likely that it will be let to third parties for two years prior to occupation by BC Ltd.

The expenditure on Dire Avenue is a premium for a 55-year lease. The property will be used by the company as a retail outlet.

Requirement:

Explain the chargeable gains arising on the disposals and how any gains can be mitigated. Ignore Indexation. (15)

5. Jack is a sole trader who has been in business for a number of years.

Jack had completed his 2018/19 tax return himself but then HMRC opened up an enquiry into the return which focused entirely on his sole trade. HMRC stated that certain expenses were not deductible. Jack's view is that these items were deductible although it appears that whilst there is an argument for a deduction being allowed, it is not clear-cut. Jack has always sent in an analysis of the figures shown in his tax return.

The HMRC officer has indicated he will issue a closure notice and also assessments for earlier years under the discovery provisions. He has also raised the issue of penalties with Jack, who is concerned about the potential quantum of these.

Requirement:

Explain:

1) **The circumstances in which HMRC can make a discovery assessment and the time limits which apply.** (6)

2) **The penalty provisions applicable to inaccurate returns and how these might be applied in this case.** (9)

Total (15)

6. Cendrillon Ltd is an unquoted trading company and its sole shareholder and director is James MacDonald.

James has been interviewing a new senior operations manager and is looking to offer either a company car or a cash alternative as part of his remuneration package.

Details of the potential company car are as follows:

List price	£31,850
CO_2 emissions	153g/km
Cost of lease (per month)	£410
Estimated business mileage (p/a)	25,000
Estimated personal mileage (p/a)	6,000
Estimated fuel cost (p/a)	£5,050
Fuel type	Diesel (non-RDE2)
Insurance and road tax	£1,050

The lease contract includes all maintenance required on the vehicle. The cost of this is £50 per month and this is included within the £410 per month above. Fuel for both private and business journeys would be paid by the company.

Instead of the company car, James is willing to pay the new operations manager a car allowance as additional salary. He would then submit mileage expense claims at the HMRC-approved mileage rates for any business miles travelled.

James would like to ensure that both options incur the same total cost to the company once all payments and tax deductions are taken into account.

The new operations manager would work primarily at the main office location in Cardiff, but would also be required to spend time each week at the company's office in Swansea in the performance of his duties. If the company reimburses the costs of travel between the Cardiff and the Swansea offices, James would like to know how the company should treat this for tax purposes, and whether this would be different if the manager travels directly to and from Swansea from his home.

Requirement:

1) Calculate the annual cost to the company of providing the company car. (7)

2) Calculate the maximum additional salary the company could pay without increasing the annual cost to the company calculated above. (5)

3) Explain how the reimbursement of the travel costs should be treated by the company. (3)

Total (15)

You are NOT required to consider VAT.