THE CHARTERED INSTITUTE OF TAXATION

APPLICATION AND PROFESSIONAL SKILLS

Taxation of Owner-Managed Businesses

May 2021

TIME ALLOWED

3 HOURS 30 MINUTES

- In order to secure a pass in this exam, 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.

- 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.

You work for Christina Powley, the founder of Powley Taxation, a firm of Chartered Tax Advisers.

Christina has recently received a letter from Adrian Charl a new client. Adrian owns Charl Communications, which installs telephone systems and operates on a sole trader basis.

Adrian currently lives abroad in Morova but wants to return to the UK in the near future. He requires advice regarding the expansion of his business once he has returned and how this should be funded. Christina has spoken with Adrian and agreed that she will draft a report to him advising on the issues contained in his letter (**EXHIBIT A**).

It was agreed that for the purposes of drafting the report that the following assumptions will be used:

1) Adrian Charl resumes UK tax residence on 1 August 2021; and

2) Any illustrative figures used to compare options are based upon a full year's tax adjusted trading profits of £100,000 and eventual sale proceeds for the business of £500,000.

The following exhibits are provided to assist you:

EXHIBIT A: Letter from Adrian Charl to Christina Powley

EXHIBIT B: Schedule of business and other significant disposable assets owned by Adrian Charl

EXHIBIT C: Capital allowances Information

EXHIBIT D: Pre-seen information

Requirement:

Prepare a draft report, for review by Christina, advising Adrian on the issues contained in his letter.

Continued

EXHIBIT A

Letter from Adrian Charl to Christina Powley

Christina Powley
1 New Street
Newton
England
AB1 2CD

Adrian Charl
2 Old Viam
Oldtone
Morova

15 April 2021

Dear Christina

Return to UK and Reinvigoration of Charl Communications

As you will know, I lost interest in Charl Communications when I divorced from Mary in 2017. I needed a complete change of scenery and therefore decided to move to the country of Morova on 1 November 2017 where Mary and I used to take regular holidays. My former accountants confirmed that HMRC agreed that I became non-UK resident on 1 November 2017 having always been UK resident to that point. If relevant, they also confirmed that there is no double tax treaty between the UK and Morova and that Morova does not charge Capital Gains Tax on any asset disposals.

Thankfully, I did decide to keep Charl Communications, albeit very much on a 'backburner' basis. The business has been ticking along making useful, albeit unexciting, profits of around £20,000 per year. I haven't returned to the UK much since leaving but I do have regular on-line meetings with my manager, Bill Davies, who's been managing the business on a day-to-day basis.

After spending November 2017 in rented accommodation, I bought a small house in Morova, where I currently live, using part of my divorce settlement from Mary.

Due to a mistake, one of the larger clients of Charl Communication has recently been threatening legal action. This situation is resolving quickly but has worried me into thinking that perhaps a more direct hands-on approach is now required. There are also growth opportunities appearing in the near future which could see the business profits quickly rise to approximately £100,000 per year.

To fully exploit these opportunities, I will need to return to the UK where I will remain at least until the business is sold in a few years. I will therefore return on 1 August 2021 and from that date will start living in my UK house. Mary and I bought this property in 2010 and it passed to me absolutely as part of our divorce settlement. The expansion of the business will start shortly after I return to the UK.

The planned business expansion will require the purchase of equipment costing £25,000. We also need better premises to service more prestigious clients. I have therefore located some ideal premises which I intend to purchase for £200,000. If it is of interest to you, my solicitors have confirmed that these premises were built in 2010; no VAT will be payable when they are bought; and the vendor will only agree to allocating a disposal value of £1 to fixtures. If possible, I would like to personally own these premises. I do not, however, wish to take on any borrowings so I will need to sell something to provide the necessary funding. I do not wish to sell my UK home. Please provide some guidance from a tax perspective as to which other asset(s) I should sell for this purpose.

Continued

Continuation

In view of the recent threat of legal action I also need advice on how my personal risk exposure could be reduced going forwards, together with any associated tax implications or tax benefits from changing the structure of the business. However, the business is developed, I will remain its sole owner so I do not want to consider partnerships as an option. I do not require any detailed legal advice from yourselves regarding this as, once any final decisions are taken, I will fully consult with my solicitors.

I will run the business for a further five years after which I will be looking to sell it, hopefully for around £500,000, when I retire. I will work for the business on a full-time basis until then.

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

Yours sincerely

Kind regards

Adrian Charl

Continued

Continuation

EXHIBIT B

Schedule of business and other significant disposable assets owned by Adrian Charl

Charl Communications

	Market Value
	£
Goodwill	50,000
Equipment	58,000
Vans	45,000
Manager's car	12,000
Stock	25,000
Debtors	32,000
Bank & cash in hand	38,000
Creditors	(10,000)
	250,000

The equipment includes a specialist item which cost £20,000 in May 2016 but has a current value of £35,000. None of the other equipment has a cost or market value of more than £6,000.

Other significant disposable assets

Shareholding

10,000 shares in Morodby Communications Inc, a Morovan company registered on the Morovan stock exchange. These were acquired from Mary as part of Adrian's divorce settlement in May 2017 when the shares had a market value of £50,000. Mary had originally bought the shares for £25,000. These shares generate approximately £19,000 of dividends each year and are currently valued at £250,000.

Morovan house

This house was bought on 1 December 2017 for £150,000 when Adrian began using it as his main residence and is currently valued at £250,000.

Continued

Continuation

EXHIBIT C

Capital allowances information

The tax written down values for Charl Communications at 31 March 2021 were as follows:

	£
Main pool	nil
Special rate pool	25,382

The asset in the special rate pool is a car used by Bill Davies which was originally bought for £30,000 and has a net book value as at 31 March 2021 of £18,000.

Continued

Continuation

EXHIBIT D

Pre-seen information

Client name

Adrian Charl

Client Background

Born 18 February 1964.

UK domiciled but currently resident in the country of Morova.

Married Mary on 1 July 2010. Separated from Mary on 1 November 2016 with divorce from her completed on 1 May 2017.

Adrian has no children and is single.

Charl Communications

The business was started by Adrian and Mary in partnership on 1 April 2012 and advises upon and installs telephone systems within the UK.

Mary left the business on 1 November 2016 and since then it has been run on a sole trader basis by Adrian Charl.

Accounts are made up to 31 March each year.

The business currently operates from rented premises.

For several years the day-to-day operations of the business have been dealt with by a manager, Bill Davies, who oversees a small team of technical and administrative employees and reports to Adrian on a periodic basis.

Tax Information

Adrian Charl has not used any of his lifetime limit for business asset disposal relief purposes.

VAT

Registered entity	Adrian Charl
Registration number	111000000
Effective registration date	1 May 2013

All of Charl Communications' supplies are standard rated.

Continued

Continuation

Most recent accounts of Charl Communications

Profit and loss account for the year ended 31 March 2021

	£	£
Sales		255,170
Opening Stock	22,000	
Purchases	115,600	
Less: Closing stock	(20,000)	
		(117,600)
Gross Profit		137,570
Expenditure		
Wages	74,500	
Rent & rates	12,800	
Utilities	3,450	
Repairs & renewals	6,160	
Telephone	1,280	
Print & stationery	580	
Advertising	1,650	
Accountancy	2,000	
Vehicle	4,800	
Depreciation	9,600	
		(116,820)
Net Profit for Year		20,750

Balance Sheet as at 31 March 2021

	£	£
Fixed Assets		
Equipment		69,000
Vehicles		66,000
Current Assets		
Stock	20,000	
Debtors	32,000	
Bank & cash in hand	38,000	
	90,000	
Current Liabilities	(10,000)	
Net Current Assets		80,000
		215,000
Capital Account		215,000