THE CHARTERED INSTITUTE OF TAXATION

ADVANCED TECHNICAL

Taxation of Owner-Managed Businesses

May 2024

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 2023/24 legislation (including rates and allowances) continues to apply for 2024/25 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. Stefan has been trading for many years as a sole trader, preparing accounts to 30 April. He runs an outdoor activity centre.

His draft profit and loss account for the year ended 30 April 2024 is as follows:

	Notes	£
Sales	1)	625,700
Cost of sales		(215,300)
Gross profit		410,400
Other income	2)	17,200
		427,600
Expenses		
Wage costs	3)	(240,900)
Motor expenses	4)	(17,800)
Premises costs	5)	(42,400)
Other costs	6)	(17,200)
Depreciation		(19,000)
Net profit		90,300

Notes

1) A group of Stefan's friends had a sailing course with an instructor and were not charged. The cost of providing the course was £200. Customers would normally be charged £600.

2) Stefan receives rental income from Alex, who operates a café that occupies 15% of Stefan's site. The rent includes all premises and utilities costs.

3) Wage costs include the following accruals:

	Notes	£
Bonuses for the year ended 30 April 2024	(a)	6,000
April 2024 employer pension contribution	(b)	675
Wage for Stefan's son	(c)	10,000

(a) The bonuses will be paid at the end of May 2024.

(b) The pension contribution will be paid on 10 May 2024.

(c) Stefan's son is a qualified climbing instructor and is paid at the same rate as other instructors. He is saving for a trip and has asked Stefan to wait and pay his salary to him when he leaves in March 2025.

4) Motor expenses are as follows:

	Notes	£
Car leasing	(a)	7,800
Car running costs	(b)	3,400
Van running costs	(c)	6,600
		17,800

(a) The lease is of Stefan's car, which has CO_2 emissions of 110 g/km and is used 60% for business purposes. The annual payments are split as follows:

	£
Lease	6,000
Maintenance	1,800
	7,800

(b) Car running costs also relate to Stefan's car.

(c) The van is used to take equipment to different sites for activities. It is taken home each night by one of the employees. Stefan estimates this makes up 10% of the use of the van.

5) Premises costs are as follows:

	Notes	£
Rent and rates	(a)	32,500
Heat, light and water	(b)	9,900
		42,400

(a) Rent and rates relate to the whole site.

(b) 25% of the electricity and water charges relate to the café.

6) Stefan took a training course in paragliding, which cost £2,400. Stefan will begin offering paragliding courses when he has finished his training.

During the period, Stefan bought some second-hand sailing equipment from a company that had ceased trading. The cost of the equipment was £34,000. There were no other acquisitions or disposals during the year. The written down values on the general and special rate pools at 1 May 2023 were £15,000 and £6,500.

Stefan's tax-adjusted trading profits for the year ended 30 April 2023 were £65,000.

Stefan has overlap profits brought forward of £6,000 and has no other taxable income or outgoings.

Stefan reached state retirement age on 1 January 2024. He is contemplating retiring in September 2026.

Requirement:

1) Calculate, with explanations Stefan's assessable trading profit for 2023/24 and any adjustments carried forward. (12)

2) Explain how the tax year basis will apply to Stefan from 2024/25 onwards. (5)

3) Explain the National Insurance contributions payable by Stefan for 2023/24. (3)

Total (20)

2. Sally (aged 42) is a sole trader and has always prepared accounts to 31 March. She owns a chain of four retail stores across Cornwall, selling women's clothing. She previously also owned one store in Devon. On 30 September 2023, Sally closed the Devon store and sold it to her sister for £150,000, who will rent it to a hairdresser. The store cost Sally £85,000 in December 2010 and was valued at £275,000 in September 2023.

Sally wants to open another store in Cornwall. She will initially buy a property on a 55-year lease at an initial capital cost of £175,000, and will then look for a replacement freehold property to buy in four to five years for around £250,000.

Sally's tax adjusted profits for the year ended 31 March 2024 were £85,000. Her only other income for 2023/24 was £5,000 of dividends. She made payments of £360 per month to her pension scheme and £40 per month of gift aid donations. Her only capital gain during 2023/24 was on the Devon store and she had no capital losses brought forward. In January 2024, Sally made the first payment on account toward her 2023/24 tax liability of £13,000.

Sally estimates that her taxable profit for the year ended 31 March 2025 will be lower than for 2023/24 as she expects to buy equipment for the new store.

Requirement:

1) **Explain Sally's chargeable gain on her disposal of the Devon store and any reliefs which may be available, taking into account her future plans.** (8)

2) **Calculate Sally's Income Tax and National Insurance payments due on 31 July 2024 and 31 January 2025 and explain any claims she can make.** (7)

Total (15)

3. Harble Ltd was incorporated on 1 March 2020 and produced dog treats from a factory in Wales until 31 December 2023. The company had always drawn up its accounts to 30 September each year.

On 15 April 2020, Harble Ltd purchased an unused factory from a developer for £228,800 (including £100,000 for the land) and started to use it on 1 May 2020.

The developer's original costs were as follows:

	£
Construction costs	82,000
Land purchase	40,000
Planning permission	2,000
Design fees	3,000

The company acquired the following assets qualifying for capital allowances since incorporation:

Purchase date	Description	Notes	Original Cost
			£
22 April 2020	Plant and machinery	1)	456,000
11 October 2020	Computer equipment	2)	74,000
18 January 2021	Car – CO_2 emissions 190g/km		30,973
8 August 2021	Car – CO_2 emissions 30g/km		63,057
10 April 2022	Plant and machinery	3)	18,000
6 January 2023	Computer equipment		3,000
18 January 2023	Electric car		28,500
18 January 2023	Electric charging points		2,800

Notes

1) The annual investment allowance was claimed in respect of this plant and machinery in the year ended 30 September 2020.

2) The annual investment allowance was claimed in respect of this computer equipment in the year ended 30 September 2021.

3) A super deduction of £23,400 was claimed in respect of this plant in the year ended 30 September 2022.

On 30 June 2023, Harble Ltd made the following disposals:

Original purchase date	Asset	Proceeds
		£
18 January 2021	Car – CO_2 emissions 190g/km	10,800
10 April 2022	Plant and machinery	15,000

On 31 December 2023, Harble Ltd ceased trading and sold the trade and all assets of the business to a third-party purchaser. The assets sold which had qualified for capital allowances were as follows:

Original purchase date	Description	Proceeds
		£
22 April 2020	Plant and machinery	300,000
11 October 2020	Computer equipment	22,000
8 August 2021	Car – CO_2 emissions 30g/km	19,000
6 January 2023	Computer equipment	2,200
18 January 2023	Electric car	22,000
18 January 2023	Electric charging points	2,500

Harble Ltd's factory was sold for £412,000 including £130,000 for the land.

Requirement:

Calculate, with explanations, the maximum capital allowances available to Harble Ltd in the year ended 30 September 2023 and the balancing adjustments arising in the period ended 31 December 2023. (20)

4. Jack Hannah, who is 45, is a director and 10% shareholder of Modern Inventions Ltd. His salary is £150,000 per annum, paid monthly. He also receives private medical insurance at a cost to the company of £3,000 per annum.

All of the shares of Modern Inventions Ltd will be sold on 30 June 2024 and Jack will step down as a director on the same date.

His contract says that if his employment is terminated he will receive:

1) A bonus of £10,000;

2) A payment of £7,500 if notice is not given; and

3) A contribution to his pension scheme of £5,000.

However, the purchaser has offered to ensure that the company pays Jack £45,000 in lieu of the three-month notice period in his contract rather than the contractual amount of £7,500. He will also gifted his company car, which is currently worth £25,000.

All of the above amounts will be paid on 31 July 2024.

Requirement:

1) Explain the PAYE and NIC implications of each element of the termination package and calculate the total PAYE to be withheld. (12)

2) Explain the Corporation Tax treatment of the termination package. (3)

Total (15)

5. Dream Suites Ltd provides architecture services. The company has 100 £1 ordinary shares. Dorothea owns 50 of these shares and her adult children Betty and Dean each own 25 shares. These shareholdings have not changed since the company was formed in 2010. Dorothea, Betty and Dean were all appointed directors of the company on its formation.

Based on the latest management accounts, the company has cash of £800,000 and distributable reserves of £2.5 million.

Dorothea is planning to retire from the company. Her shareholding has been valued at £1.25 million.

Betty and Dean would like to continue running the company and do not wish to bring in an external shareholder. However, they do not have access to the funds required to buy Dorothea's shares. The company will therefore buy the shares from Dorothea.

Dorothea will enter into a contract to sell all 50 of her shares to the company, with completion and payment taking place as follows:

Completion	No. of shares	Proceeds
		£
Immediately	30	750,000
30 May 2025	10	250,000
30 May 2026	10	250,000

Dorothea has not made any previous capital disposals. All of the shareholders are UK resident.

Requirement:

Explain the requirements for the company to purchase shares from Dorothea and the tax implications for Dorothea of the purchase. (15)

6. Miracle Ltd is involved in the research and development of engine components, which it intends to patent. The company prepares accounts to 31 March each year. It has three full-time employees and is an SME for R&D relief purposes. The company has previously received advance assurance from HMRC that its activities constitute qualifying R&D for tax purposes.

The profit and loss account of Miracle Ltd for the year ended 31 March 2024 is as follows:

	Notes	
Sales		112,000
Non-trading income		80,000
		192,000
Staff costs	1)	(555,000)
Software costs	2)	(15,000)
Property costs	3)	(50,000)
Sub-contractor costs	4)	(50,000)
Loss before tax		£(478,000)

Notes

1) Staff costs comprise the following:

Employee	Salary	Employer's NIC	Employer pension contribution	Benefits in kind
	£	£	£	£
Karen	165,000	12,500	20,000	21,500
Ramanpreet	125,000	11,500	10,000	20,000
Daniel	140,000	13,500	16,000	
	430,000	37,500	46,000	41,500

These costs were incurred evenly throughout the year.

Karen is a director and looks after sales and strategy for Miracle Ltd. Ramanpreet and Daniel spend 20% of their time assisting Karen with sales activities, and the remainder of their time is spent working on R&D.

2) Software costs comprise:

	£
General software applications	1,000
Licence for engine modelling application	14,000
	£15,000

3) Property costs comprise:

	£
Water	1,000
Gas	1,250
Electricity	2,500
Rent and rates	36,250
Insurance	2,200
Cleaning	6,800
	£50,000

80% of the company's premises is used for R&D activities.

4) The company paid £50,000 to Raan Ltd, a wholly owned subsidiary, for testing services required as part of the R&D work. Raan Ltd incurred £40,000 of staffing costs and £3,000 on acquiring machinery to carry out these services.

Miracle Ltd has no connected companies other than Raan Ltd.

Miracle Ltd has not generated a taxable profit to date. However, it expects to generate substantial taxable profits going forwards.

Requirement:

1) Explain how the above expenditure will be treated for R&D tax relief purposes and calculate the amount of the enhanced tax deduction available to Miracle Ltd. (7)

2) Explain how Miracle Ltd can utilise the enhanced tax deduction. (8)

Total (15)