

THE CHARTERED INSTITUTE OF TAXATION

APPLICATION AND PROFESSIONAL SKILLS

Taxation of Owner-Managed Businesses

November 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 are a tax manager in AC Accounts LLP, a firm of Chartered Accountants.

Your client, Hack Marketing Ltd, is a successful family company producing marketing and promotional material. Paul Links, your tax partner, has received an email from Phoebe Tanner (**EXHIBIT A**), who is a director of the company. Phoebe said that they have received an offer for the company from Market International Ltd and she has asked for advice on how to proceed. Paul has asked you to prepare a draft letter to Phoebe for his review.

The following exhibits are provided to assist you:

EXHIBIT A: Email from Phoebe Tanner

EXHIBIT B: Letter from Market International Ltd to Phoebe Tanner

EXHIBIT C: Email from Adul Franks to Paul Links

EXHIBIT D: Pre-seen information

Requirement:

Write a draft letter to Phoebe Tanner advising her on how best to proceed in relation to the offer from Market International Ltd.

Continued

EXHIBIT A

Email from Phoebe Tanner

From: PT@HackMarketing.co.uk
To: paul.links@ACLLP.com
Date: 30 October 2021
Subject: Possible sale of Hack Marketing Ltd

Hi Paul

As you know, with mum looking to retire and my brother Phil no longer involved in the business, we have been considering a sale of the company for some time. I have received the attached letter (**EXHIBIT B**) from Market International Ltd and as you can see, they have made a preliminary offer to buy Hack Marketing Ltd.

Rather surprisingly they have indicated that they wish to purchase the trade and assets rather than the shares of the company. The principal reason appears to be that they don't want La Mabelle, the Swiss ski chalet the company purchased in 2006. As the family used to visit the chalet for skiing holidays I'm very attached to it and would like to hold on to it, perhaps by extracting it from the company before sale.

Whilst a sale of the company would be an excellent retirement opportunity for my mother, I will almost certainly need to continue working. Dean Marks and I have been investigating the possibility of forming a new company in the sports marketing sector if Hack Marketing Ltd is sold. This is not a sector that Market International Ltd operate in and they have indicated that they would not object provided we had satisfied the 12 month employment lock-in mentioned in their letter.

We have a shareholders' meeting next Wednesday (my brother will join by video conference) and I should be grateful if you could advise us on how best to proceed in order to maximise the funds available to each of the shareholders on a sale.

I look forward to hearing from you

Regards

Phoebe Tanner
Director, Hack Marketing Ltd

Continued

EXHIBIT B

Letter from Market International Ltd to Phoebe Tanner

Ms Phoebe Tanner
Hack Marketing Ltd
West Lane
Big Town
BL9 5LL

Pablo Horte
Market International Ltd
Apple Business Park
London
WH1 2LE

21 October 2021

Dear Phoebe

Thank you for providing the company's financial information following our meeting in July. I have just returned from the US and have received authority to make an offer for the following trade and assets of Hack Marketing Ltd.

	<u>Purchase price</u>
	£
Goodwill	1,200,000
11-13 Rose Road	625,000
Stock	324,000
Fixtures and fitting and plant and machinery	<u>25,000</u>
Total purchase price payable on completion	<u>£2,174,000</u>

In addition we wish to purchase Hack House from Mrs Mary Hack at a price of £565,000.

A condition of purchase would be that the senior management team, with the exception of Mary Hack, remain in employment with the company for at least 12 months post completion.

I appreciate that we had originally discussed a share purchase but this will not be possible whilst the company holds the investment property, La Mabelle. If you are able to extract this property from the company then we would consider a share purchase. The consideration payable on a share purchase will reflect the above asset values together with any adjustments to reflect any other assets or liabilities of the company as at the date of completion.

Could you please discuss this with your fellow shareholders and advise whether the above preliminary offer is acceptable and how you would prefer to structure the sale? If you are in agreement we will instruct our legal team to prepare formal heads of terms.

If you have any questions please do not hesitate to contact me.

Yours sincerely

Pablo Horte
CFO Market International Ltd

Continued

EXHIBIT C

Email from Adul Franks to Paul Links

From: adul.franks@ACLLP.com
To: paul.links@ACLLP.com
Date: 28 August 2021
Subject: Hack Marketing Ltd Property Holdings – Property Details

Hi Paul

I understand that you are meeting with Phoebe Tanner at the end of this week. You indicated that she was looking to either sell or raise finance against the Hack Marketing Ltd properties. I have asked Maria in our audit team to review the old accounts and tax files and she has collated the details below. I also asked her to check what we had on Hack House which, as you know, is owned personally by Mary Hack. For completeness I have also included the up to date property valuations which I think Phoebe had already obtained from their agents:

11-13 Rose Road

A warehouse and distribution centre owned by Hack Marketing Ltd. It was acquired in September 2004 for £325,000 to replace the company's previous facility. A capital gain of £85,000 that had arisen on the sale of the previous premises was rolled over against the cost of 11-13 Rose Road. The current market value is believed to be between £615,000 and £630,000.

La Mabelle

A Swiss ski chalet bought by Hack Marketing Ltd in June 2006 for a sterling equivalent cost of £49,000. It is used principally to entertain clients. It is also made available to company directors and staff for private use for three weeks each year. The current market value is approximately £117,000.

Hack House

A commercial office block owned by Mary Hack personally. It was purchased on 1 December 2001 for £245,000 and let to third party businesses until 1 December 2012. Since that date it has been fully occupied by Hack Marketing Ltd on a rent free basis. The current market value is between £550,000 and £580,000.

I hope that the above is useful and any questions please give me a call.

Adul Franks
Senior Manager
AC LLP

Continued

EXHIBIT DPre-seen informationClient

Directors of Hack Marketing Ltd.

Company Details

Hack Marketing Ltd provides marketing and promotional materials.

The company was formed in 1984 by George Hack. The initial share capital was 1,000 £1 ordinary shares issued at par value to George on incorporation. George died on 10 January 2020.

Shareholdings

	<u>£1 ordinary shares</u>	<u>Acquisition history</u>
Mary Hack, widow of George Hack	650	Gifted 325 shares by George Hack on 1 June 2004; inherited 325 shares on George's death on 10 January 2020.
Phoebe Tanner, daughter of Mary and George	175	Gifted by George Hack on 1 June 2004. Subject to a gift relief claim under s.165 TCGA 1992.
Phil Hack, son of Mary and George	175	Gifted by George Hack on 1 June 2004. Subject to a gift relief claim under s.165 TCGA 1992.
Issued share capital	<u>1,000</u>	

The company has had no non-trade chargeable assets.

Mary and Phoebe have been directors since June 2004, but Phil is neither a director nor an employee of the company. Mary and Phoebe are UK resident and domiciled. Phil was resident and domiciled in the UK, but he emigrated to Australia on 10 October 2017 and has been non-UK resident since that date.

All of the UK resident shareholders are higher rate taxpayers and none of them have previously realised chargeable gains on the disposal of business assets.

On 7 January 2020 Dean Marks was appointed as the company's Sales Director. As part of his recruitment package he was granted Enterprise Management Incentive share options over 35 £1 ordinary shares exercisable immediately prior to a sale of the company or a disposal of its trade and assets. The exercise price is £1 per share and the market value at the date of grant was agreed with HMRC at £625 per share.

None of the UK shareholders have capacity to make additional pension contributions.

Continued

Continuation

Profit and loss account for the Year Ended 30 September 2021

	£	£
Sales		1,264,250
Opening stock	297,000	
Purchases	665,000	
Closing stock	<u>(324,000)</u>	
		<u>(638,000)</u>
Gross profit		626,250
Expenditure		
Wages	118,420	
Utilities	19,420	
Advertising	12,130	
Telephone and computing	28,360	
Motor, travel and subsistence	87,420	
Printing and stationery	22,400	
Accountancy	17,500	
Depreciation	<u>16,000</u>	
		<u>(321,650)</u>
Net Profit		<u>304,600</u>

Balance Sheet at 30 September 2021

	£	£
Fixed assets		
Freehold property	374,000	
Plant and machinery	<u>88,000</u>	
		462,000
Current assets		
Stocks	324,000	
Debtors	173,000	
Cash at bank	<u>87,000</u>	
	584,000	
Creditors amounts falling due within one year	<u>(94,000)</u>	
Net current assets		<u>490,000</u>
Total assets less current liabilities		952,000
Creditors more than one year		
Bank loans and overdraft	250,000	
Other creditors	<u>92,000</u>	
		<u>(342,000)</u>
Net assets		<u>610,000</u>
Capital and reserves		
Called up share capital		1,000
Profit and loss account		<u>609,000</u>
		<u>610,000</u>

Continued

Continuation

Tax Information

The tax adjusted profit of the company for the year to 30 September 2021 was £318,000.

There are no trading or capital losses brought forward.

The capital allowances general pool tax written down value at 30 September 2021 is £6,400.

VAT Registration number: 123556264

Registration date: 1 September 1984

All supplies are standard rated.