

THE CHARTERED INSTITUTE OF TAXATION

APPLICATION AND PROFESSIONAL SKILLS

Taxation of Owner-Managed Businesses

November 2023

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.
- Unless otherwise indicated by the provision of additional information in the question, you may assume that 2022/23 legislation (including rates and allowances) continues to apply for 2023/24 and future years. 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 manager in Able Accounting LLP, a firm of accountants and Chartered Tax Advisers.

Your clients are WA Ltd and Tim Peach, the company's director and only shareholder.

Your tax partner, Pearl Farook, has received an email from Tim (**EXHIBIT A**) asking for advice on the appropriate structure for a new project with Tim's nephew, Kieran Peach. The project, to be known as "Project Shield", is to develop a new device and will require the financing and expertise of WA Ltd.

The following exhibits are provided to assist you:

EXHIBIT A: Email from Tim Peach to Pearl Farook

EXHIBIT B: Email from Kieran Peach to Tim Peach

EXHIBIT C: Pre-seen information

Requirement:

Prepare a report to Tim, for review by Pearl Farook, providing advice and recommendations on how to structure "Project Shield" in the most tax efficient manner for WA Ltd, Tim, Kieran and Natasha.

Continued

EXHIBIT A

Email from Tim Peach to Pearl Farook

From: T.Peach@WALtd.co.uk
To: P.Farook@ablellp.co.uk
Date: 31 October 2023
Subject: "Project Shield"

Dear Pearl

I have recently received the attached email from my nephew Kieran Peach and his girlfriend Natasha Field (**EXHIBIT B**) concerning "Project Shield".

They have been together since university, having met whilst completing their post-graduate studies in Exeter. They have both worked as part of the product development team at Drawn Avionics plc in London for the past three years. They're very bright individuals and I am keen to help them.

I believe that Project Shield has real merit, but it will require fairly substantial investment in both consumables and staff time. Based on past experience, I believe that we could be looking at total expenditure of £400,000 – £500,000.

If we proceed with Project Shield then this will bring forward the intended expansion of our own research facilities. This could fit well into our intended construction of a replacement production facility following the sale of our Southampton property last year. We have budgeted construction costs of £950,000 for the replacement production facility. If we add in a new laboratory for Project Shield then this will bring the capital costs up to approximately £1.2 million.

Given the potential risk involved with the new project, I would like it to be carried out within a limited company.

I would be a director of any entity undertaking Project Shield and Kieran and Natasha would be employed full-time on this project. I think that it would be reasonable to offer them some form of equity participation to reflect their ideas and work. I was considering something in the region of 25% in total. I appreciate that we have discussed the possibility of share option schemes in the context of my management team in the past. However, I am not keen on share options in this context and believe that an immediate shareholding would be better for Kieran and Natasha.

Finally, I wish to ring-fence the value of my interest in the profits and assets of the existing core business of WA Ltd.

As Kieran mentions, it is likely that, if successful we would look to sell Project Shield in the short to medium term. Although I have no intention of disposing of my existing WA Ltd shares, I would like to realise some value personally from this project if successful.

I would therefore like your advice on how we can structure this project so that it is tax efficient for WA Ltd, myself and Kieran and Natasha.

Regards
Tim Peach
WA Ltd

Continued

EXHIBIT B

Email from Kieran Peach to Tim Peach

From: KP23@gcom.co.uk
To: T.Peach@WALtd.co.uk
Date: 30 October 2023

Hi Tim

It was great to see you last weekend and as promised I have set out below our thoughts on how we could develop our ideas with WA Ltd.

Since we left Drawn Avionics plc in March last year, Natasha and I have been doing some freelancing and also working on the radio frequency shielding mechanism we discussed at lunch on Saturday. I like your idea of calling it "Project Shield". It sounds very exciting. We believe that with sufficient time and investment this can be made to work. If successful it could be highly profitable.

We appreciate that development could be a two – three year project and will represent a substantial investment of time and resources. I believe that Drawn Avionics plc would be interested but Natasha and I have had enough of working for a large organisation and would like to benefit more directly from our work and ideas. Unfortunately whilst we both have great faith in the project our personal resources are limited. Hence why we believe that the support of you and WA Ltd will be essential.

I appreciate that this is not necessarily a core activity for WA Ltd and, if successful, it is likely that all of us will want to sell this project to a third party in three – four years. This fits in well with our timescales as Natasha is committed to returning to her family in Australia in a maximum of four years and I would be joining her.

Natasha and I would be very excited to work with you on this and look forward to hearing from you once you have had time to consider our proposal and also consult with your accountant.

Hope to hear from you soon.

All the best.

Kieran and Natasha

Continued

EXHIBIT CPre-seen informationClients

WA Ltd and Tim Peach. Tim is the company's director and only shareholder.

Tim Peach details

Tim is 52. He and his late wife formed WA Ltd and initially held 50% of the shares each. His wife died in February 2016 and Tim inherited all of her shares. He has no children.

Tim draws a combination of salary and dividends from WA Ltd of approximately £240,000 per annum.

In April 2016 he realised a capital gain of £4.2 million. This gain qualified for Business Asset Disposal Relief (Entrepreneurs' Relief at the time of disposal).

Tim is resident and domiciled in the UK.

WA Ltd details

WA Ltd is a successful manufacturing business. Its principal activity is the design and manufacture of radio equipment for the aviation industry. It was first registered on 10 July 2010 and commenced trading on 1 August 2010. The accounting period is to 31 December.

Tax information

VAT Registration number: 187756214
Registration date: 1 August 2010

All supplies are standard rated.

The tax written down value of the fixed assets at 1 January 2022 was zero.

WA Ltd Profit & Loss account for the year ended 31 December 2022

	<u>31 December 2022</u>	<u>31 December 2021</u>
	£	£
Turnover	7,425,000	6,328,000
Cost of Sales	<u>(5,712,500)</u>	<u>(4,844,400)</u>
Gross Profit	1,712,500	1,483,600
Administrative Expenses	(1,211,212)	(941,200)
Profit on disposal of fixed assets	<u>323,712</u>	<u>0</u>
Profit before Taxation	825,000	542,400
Tax on profit	<u>(122,200)</u>	<u>(108,100)</u>
Profit after Taxation	<u><u>702,800</u></u>	<u><u>434,300</u></u>
Average number of employees	27	25

Continued

WA Ltd Balance Sheet for the year ended 31 December 2022

	<u>31 December 2022</u>	<u>31 December 2021</u>
	£	£
Fixed Assets:		
Tangible assets	2,174,000	2,894,600
Current Assets:		
Stock	1,232,020	998,400
Debtors	815,400	724,600
Cash and Bank and in hand	<u>2,312,300</u>	<u>1,006,900</u>
	4,359,720	2,729,900
Creditors: Amounts Falling due within One Year	<u>(1,980,150)</u>	<u>(1,222,400)</u>
Net Current Assets/(liabilities)	2,379,570	1,507,500
Creditors: amounts falling due after more than one year	(964,000)	(1,515,330)
	<u>£3,589,570</u>	<u>£2,886,770</u>
Capital and Reserves		
Called Up Share Capital	20,000	20,000
Profit and Loss Account	<u>3,569,570</u>	<u>2,866,770</u>
	<u>£3,589,570</u>	<u>£2,886,770</u>

WA Ltd Adjusted profit computation for the year ended 31 December 2022

Profit per accounts	£ 825,000
Add:	
Depreciation	28,400
Entertaining	4,200
Legal & Professional	14,000
Less:	
Profit on disposal	(323,712)
Bank interest received	(1,421)
Capital allowances	(128,300)
Enhanced R&D relief	(98,200)
Trading profit	<u>319,967</u>
Capital gain (Note 1)	248,200
Bank interest received	1,421
Taxable profit	<u>£569,588</u>

Note 1: Capital gain:

Business premises: Gate House, Pine Street, Southampton SO11 2AB

	£
Sale proceeds 11 November 2022	1,100,000
Disposal costs	<u>(14,000)</u>
Net sale proceeds	1,086,000
Acquisition cost 19 April 2014	(660,000)
Incidental acquisition costs	(39,000)
Improvement expenditure February 2018	(77,288)
Indexation relief: £699,000 x 8.8%	<u>(61,512)</u>
Taxable gain	<u>248,200</u>