



# The Chartered Tax Adviser Examination

May 2020

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## Application and Professional Skills

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### Taxation of Owner-Managed Businesses

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TIME ALLOWED – 3 ¼ HOURS

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- The first 15 minutes is designated as reading time. During this time you may read your question paper and legislation, annotate your question paper and use your calculator. You are not permitted to start writing your answer. The Presiding Officer will inform you when you can start writing.
- In order to secure a pass in this paper, 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.

- Write on one side of the paper only. Do not write in the margins.
- 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 tick the appropriate box on the cover sheet.
- 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, you may assume that 2019/20 legislation (including rates and allowances) continues to apply for 2020/21 and future years. Candidates answering by reference to more recently enacted legislation or tax cases will not be penalised.

You are a tax manager at Cowley Taxation, a firm of Chartered Tax Advisers.

Andrea Atkins and Bob Bass run and equally own A & B Footwear Ltd a company specialising in the manufacture and sale of sporting footwear. Bob and A & B Footwear Ltd have been clients of Cowley Taxation since Bob set up the company in March 2010. Andrea became a client when she became a shareholder of A & B Footwear Ltd in July 2015.

A & B Footwear Ltd has been profitable since it was formed but recently its profitability has come under pressure from overseas competition. This has caused tension between Andrea and Bob and has caused Andrea to reconsider her future. As a result, she has recently met with your firm's Principal, Camilla Cowley, to discuss her concerns, which are detailed in the notes of that meeting (**EXHIBIT A**). Andrea has also provided further information regarding her future plans in a telephone conversation with Camilla (**EXHIBIT B**).

Camilla has asked you to prepare a draft report to address the issues arising from the recent meeting and the subsequent telephone conversation.

The following exhibits are provided to assist you:

**EXHIBIT A:** Notes of a meeting between Andrea Atkins and Camilla Cowley

**EXHIBIT B:** Notes of a telephone conversation between Andrea Atkins and Camilla Cowley

**EXHIBIT C:** Extract from Articles of Association of A & B Footwear Ltd

**EXHIBIT D:** Accounts of A & B Footwear Ltd for the year ended 31 March 2020

**EXHIBIT E:** Pre-seen information

**Requirement:**

**Prepare a draft report advising on the issues arising from the meeting between Andrea Atkins and Camilla Cowley on 24 April 2020 and their subsequent telephone conversation on 30 April 2020.**

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## **EXHIBIT A**

### Notes of a meeting between Andrea Atkins and Camilla Cowley

Present: Andrea Atkins  
Camilla Cowley

Date: 24 April 2020

Andrea explained that she had arranged today's meeting with the full knowledge and consent of Bob Bass, her fellow director/shareholder at A & B Footwear Ltd. At this stage she simply wanted to explore the possibility of disposing of her shares in the company, because of a disagreement over the future direction of the company, and to use the funds generated to set up another business.

Andrea explained that A & B Footwear Ltd has been profitable since it began trading in April 2010. Both Andrea and Bob anticipate that the company's profitability will come under serious pressure from overseas imports in the near future.

To counter this competition Andrea is of the view that the company should stop production in the UK and move it overseas where she believes production costs would be much less. This would allow the company to maintain its current full product range. She explained, however, that Bob has expressed concerns regarding this potential strategy. He does not believe the company has the required experience to satisfactorily control the quality of overseas production, something that could prove disastrous for the company if it gets it wrong.

Andrea further explained that Bob has come up with a different strategy. He believes the company should move towards a limited range of higher quality products, still manufactured in the UK, that can be sold to produce a higher margin. His belief is that this higher margin will more than compensate for any reduction in sales volumes and therefore improve the company's profitability.

Andrea made it clear that there is a need to do something to break the impasse that has been reached. Indeed, she is now so seriously concerned that she is considering disposing of her shares in A & B Footwear Ltd as soon as possible, and certainly by 31 July 2020. She did stress, however, that even if she left, Bob continues to see a successful future for the company following his strategy and would therefore continue to run it following her departure. Andrea believes that her shareholding in the company is worth around £150,000 and wants to know how she could best realise this investment. Andrea also mentioned, if it helps, that Bob is not averse to using some of the company's cash reserves. Despite previous attempts to get one agreed Andrea confirmed that there was no shareholder's agreement in place between Bob and herself.

Andrea, who is a trained graphic designer, went on to say that for a while now, as a result of the disagreement, she has been considering returning to her roots and setting up her own graphic design business. To do this she will need the funds resulting from the sale of her shares in A & B Footwear Ltd to set up this business. She mentioned that she would like some preliminary advice concerning this new business and agreed that she would provide more information regarding this later (**EXHIBIT B**).

Camilla agreed to draft a report to Andrea that will cover how she could dispose of her shares in A & B Footwear Ltd. Since Andrea will seek advice from her own solicitor it was agreed that there will be no need for the report to comment upon any procedural aspects of a legal nature concerning the transfer of her shares. Based upon the further information provided the report will also cover the preliminary advice she requires regarding her proposal to set up a new graphic design business.

Camilla Cowley

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## **EXHIBIT B**

### Notes of a telephone conversation between Andrea Atkins and Camilla Cowley

Date: 30 April 2020

Subject: Proposed new business

Andrea phoned to provide further details regarding her future plans. Assuming she can obtain the funds needed by disposing of her shares in A & B Footwear Ltd Andrea reconfirmed that she would like to set up a graphic design business in the near future. She expects that Bob will agree to her departure, at the latest by 31 July 2020, with the new business commencing on 1 September 2020.

Andrea mentioned that to start with she will run the business from a large spare room she has at her home. She still has some good contacts with a small number of medium sized businesses that would form her customer base. Even though the business will be small, because the industry is now so digitalised, she would, however, require the purchase of some specialised equipment which together with other required office furniture and equipment will cost approximately £120,000 (inclusive of VAT).

We then discussed figures. Her current projections based on discussions with her contacts indicate that whilst profits for the first complete year of trading will be around £12,000 (£1,000 per calendar month) they will then increase to around £60,000 per year (£5,000 per calendar month).

For simplicity, she is thinking of setting this business up on a sole-trader basis and would like to know, from a tax point of view, whether this would be a suitable way to proceed. We also discussed the accounting date to use. For the purposes of drafting the report it was agreed that an accounting date of 30 April would be used (with the first accounts for the period ending 30 April 2021) and at this stage there would be no need to consider any alternative accounting dates.

Andrea would also like to know about any other preliminary tax matters that she needs to consider although in this regard she is already aware of the need to register the business with HMRC and the need to pay Class 2 and Class 4 National Insurance contributions, so she does not need any advice regarding these aspects.

Camilla Cowley

## **EXHIBIT C**

### Extract from Articles of Association of A & B Footwear Ltd

A member desiring to transfer shares otherwise than to a person who is already a member of the Company shall give notice in writing of such intention to the Directors of the Company giving particulars of the shares in question. The directors as agents for the member giving such notice may dispose of such shares to members of the Company at a price to be agreed between the transferor and the Directors, or failing agreement, at a price fixed by suitably qualified accountants as the fair value thereof. If within twenty-eight days from the date of said notice the Directors are unable to find a member or members willing to purchase all the shares, the transferor may dispose of so many of such shares as shall remain undisposed of in any manner he may think fit within twelve months from the date of the said notice.

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**EXHIBIT D**

Accounts of A & B Footwear Ltd for the year ended 31 March 2020

Profit and Loss Account

Year ended 31 March 2020

	<u>2020</u>	<u>2019</u>
	£	£
Turnover	743,216	691,667
Cost of sales	<u>(392,100)</u>	<u>(364,924)</u>
Gross Profit	351,116	326,743
Administration costs	<u>(159,770)</u>	<u>(144,125)</u>
Operating profit	191,346	182,618
Interest receivable	<u>1,980</u>	<u>1,845</u>
Profit before tax	193,326	184,463
Tax on profit	<u>(40,678)</u>	<u>(38,562)</u>
Profit after taxation	<u>152,648</u>	<u>145,901</u>

Balance Sheet

As at 31 March 2020

	<u>2020</u>	<u>2019</u>
	£	£
Fixed assets	87,712	75,400
Current assets		
Stock	45,600	39,500
Debtors	85,302	74,912
Cash at bank	<u>282,110</u>	<u>244,002</u>
	413,012	358,414
Creditors: amounts falling due within one year	<u>(78,046)</u>	<u>(71,456)</u>
Net current assets	<u>334,966</u>	<u>286,958</u>
Total assets less current liabilities	422,678	362,358
Creditors: amounts falling due after one year	<u>(107,105)</u>	<u>(99,433)</u>
	<u>315,573</u>	<u>262,925</u>
<u>Capital and reserves</u>		
Called up share capital	10,000	10,000
Profit and loss account	<u>305,573</u>	<u>252,925</u>
	<u>315,573</u>	<u>262,925</u>

For the year ending 31 March 2020 the company was entitled to exemption from audit under section 477 of the Companies Act 2006 relating to small companies.

Director's responsibilities

- 1) The members have not required the company to obtain an audit of its accounts for the year in accordance with section 476.
- 2) The directors acknowledge their responsibilities for complying with the requirements of the Act with respect to accounting records and the preparation of accounts.
- 3) These accounts have been prepared in accordance with the provisions applicable to companies subject to the small companies regime of the Companies Act 2006.

The financial statements were approved by the board of directors on 26 April 2020 and were signed on its behalf by:

Robert Bass  
Director

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## EXHIBIT E

### Pre-seen information

#### Client Name

Andrea Atkins

#### Client Background

Andrea was born on 25 May 1979 and is single.

She is and will remain UK resident and domiciled.

Andrea is a director and shareholder of A & B Footwear Ltd.

She takes a salary equal to the personal allowance each tax year.

She has also received the following dividends from A & B Footwear Ltd, which are based upon the previous accounting year's profits.

<u>Payment date</u>	£
6 July 2017	50,000
6 July 2018	50,000
6 July 2019	50,000

The next dividend of £50,000 is due to be paid on 6 July 2020.

Apart from the above she does not have any other income for the tax years 2017/18 to 2019/20 inclusive.

#### A & B Footwear Ltd

A & B Footwear Ltd is registered in England & Wales and was incorporated on 10 March 2010 with a share capital of 10,000 ordinary shares of £1 each, all of which were issued to Bob Bass.

The company commenced its trade of manufacturing footwear products on 1 April 2010 and makes up its accounts to 31 March each year.

The directors are Andrea Atkins and Bob Bass.

On 10 July 2015 Bob sold half of his shares to Andrea for their market value at that time of £20,000 when she joined the company.

Andrea and Bob are not connected for taxation purposes.

#### Corporation Tax

The company's taxable total profits in recent years have been as follows:

<u>Year ending</u>	<u>31/3/2018</u>	<u>31/3/2019</u>	<u>31/3/2020</u>
	£	£	£
Trading income	154,300	201,113	212,115
Interest receivable	<u>1,750</u>	<u>1,845</u>	<u>1,980</u>
Taxable total profits	<u>156,050</u>	<u>202,958</u>	<u>214,095</u>

#### VAT

Registered entity	A & B Footwear Ltd
Registration number	000000002
Effective registration date	1 October 2010

All of A & B Footwear Ltd's sales are standard-rated.