THE CHARTERED INSTITUTE OF TAXATION

ADVANCED TECHNICAL

Taxation of Owner-Managed Businesses

May 2023

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 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.
- 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. Robinson's Fixings Ltd is involved in the development and sale of innovative new types of wall fixings. The company is wholly owned by Dominic Robinson and is the only business with which he is involved. The company prepares accounts to 30 April each year.

The company has prepared management accounts to 30 April 2023 which include the following profit and loss account:

	Notes	£
Turnover		820,000
Cost of sales	1)	(334,000)
Gross profit		486,000
Employment costs	1)	(189,800)
Establishment costs	2)	(44,500)
General administrative costs	3)	(26,500)
Depreciation and profit on fixed assets	4)	(8,000)
		217,200
Other income	5)	1,500
Interest payable		(19,500)
Profit before tax		£199,200

Notes

1) Cost of sales and employment costs include the following in respect of the development of an innovative new wall fixing, which were all incurred prior to 1 April 2023:

	£
Gross salaries of development staff	74,950
Employer's National Insurance thereon	7,800
Sub-contracted cost	8,500
Overhead costs	3,750
	£95,000

The development staff spent 80% of their time directly working on development of the product, 10% in research meetings discussing specific product issues and 10% on general administration matters. The sub-contracted costs relate to payments made to an unconnected company who advised on specific product development issues.

Advance clearance has been obtained from HMRC to confirm that the project qualifies for enhanced tax relief for expenditure on research & development under the small and medium enterprise regime.

2) Establishment costs comprise the following:

	£
Rent payable	27,300
Premium paid on 1 November 2022 for new nine year lease	6,000
Removal costs to new premises	1,200
Replacement double glazed windows	5,000
Replacement of entire water heating system	3,000
Re-tiling of kitchen	2,000
	£44,500

3) General administrative costs include the following:

	£
Fees for unsuccessfully disputing a late filing penalty	1,420
Property valuation fee for bank purposes	1,200
Fees for creating a Save As You Earn scheme for staff	2,500

4) The company incurred the following capital expenditure in the year:

	Date	Expenditure £
Extension of car park	1 July 2022	8,000
Second hand van	22 August 2022	8,750
New office furniture	30 September 2022	4,500

The company also disposed of a van in the year for proceeds of £3,000. The van originally cost £4,500 in January 2021 and at the time of disposal it had a net book value of £2,000.

The depreciation charge for the year was £9,000 and there was no tax written down value in the general pool or special rate pool at 1 May 2022.

5) Other income represents a £500 dividend received on quoted shares and a gain of £1,000 following revaluation of those shares.

6) The company has the following accruals on its balance sheet:

	Balance as at 30 April 2023 £	Balance as at 30 April 2022 £
Rates	2,500	2,200
Insurance	1,100	800
Provision for staff bonuses	12,000	10,000
Employer pension contributions	1,400	900
Sundry items	500	100
	£17,500	£14,000

Staff bonuses are always paid in full in June each year.

Requirement:

Calculate with explanations, the taxable profits and Corporation Tax liability of Robinson's Fixings Ltd for the year ended 30 April 2023. (20)

2. Remi is an electrician and has operated as a sole trader for many years. He has always worked alone but has recently employed Heidi to help him in the business.

Heidi is 54 and became an employee of Remi's business on 6 April 2023. She is responsible for all administration aspects of the business.

Heidi is employed for four hours a day, five days a week. She works from home but travels to meetings with suppliers and occasional meetings with Remi. In return Heidi receives:

1) A salary of £16,400 per year, paid monthly.
2) Private medical insurance at a cost to Remi of £80 per month.
3) A mobile phone which costs Remi £25 per month.
4) A laptop which cost Remi £580. Any personal use by Heidi is insignificant.
5) 60p per mile for business travel – it is expected Heidi will do 2,600 business miles each year.
6) A contribution of 5% of her gross salary to a workplace pension.

Heidi also contributes 5% of her salary into the workplace pension, which gives tax relief at source.

Remi expects to have trading profits of £120,000 in 2023/24, before taking into account the costs of employing Heidi.

Remi does not expect to receive any additional income as a result of employing Heidi. His additional costs will be as set out above, plus an extra £10 per month for including payroll on his accounting software.

Remi has no other income and makes no pension contributions for himself.

Requirement:

1) Calculate the net cost to Remi of employing Heidi in 2023/24. (9)

2) Explain the ongoing employment tax and National Insurance compliance requirements of the business employing Heidi on the package described. (6)

Total (15)

3. Star Trading Ltd is currently wholly owned by John Hench and operates a large retail store.

John intends to retire from the business in June 2026. As part of his succession plan, Star Trading Ltd granted an EMI-qualifying option on 1 June 2018 to Bill Watkins, a key member of the management team. The option can be exercised at any time on or before 30 June 2026 and gives Bill the right to acquire 100 shares in the company at £0.01 per share. The market value of the shares on 1 June 2018, as agreed with HMRC, was £65 per share.

Star Trading Ltd has recently acquired and moved into larger premises. John is now considering what to do with the old premises, which the company still owns. The three options he is considering are:

1) Selling the property and retaining the proceeds for working capital. The property is currently valued at £750,000, which represents 20% of the market value of the company's current net assets.

2) Retaining the property and renting it to a third party immediately. Annual rental income would be £75,000 per year, which would be equivalent to 30% of the company's annual turnover.

3) Applying for planning permission to develop the property into flats. These would then be sold in 2024 for a substantial sum.

John is concerned that the chosen option may have a negative impact on the EMI-qualifying option held by Bill.

Star Trading Ltd's shares are currently worth £85 each.

Requirement:

1) Explain the trading requirement for Enterprise Management Incentive purposes and the potential implications of each of the three options for the old premises on the qualifying status of the Enterprise Management Incentive share option. (7)

2) Explain the Income Tax and Capital Gains Tax implications for Bill if the old premises are rented out immediately and the share options are exercised on:

(a) 30 June 2023, when the shares are worth £85 each; or

(b) 30 June 2026, when the shares are worth £140 each. (5)

3) Explain the PAYE, employer's Class 1 NIC and Corporation Tax implications of the exercise of the share options. (3)

Total (15)

4. Megan owns three hotels: Lakeside, Seaside and Moorside. She has been trading for many years, preparing accounts to 30 September. In 2022 she decided to change her accounting date to 31 March, and prepared accounts for the 18 months ended 31 March 2023.

During the period ended 31 March 2023, she purchased the following capital assets:

Date		Notes	Cost
			£
1 October 2022	Air source heating system	1)	34,000
31 October 2022	Wood panelling	2)	17,000
31 October 2022	Pictures	3)	5,000
1 November 2022	Car	4)	18,000
1-31 January 2023	Building costs	5)	80,200
12 February 2023	New lift	6)	5,000
1 March 2023	Electric car	7)	5,000

On 30 June 2022, she sold a commercial vehicle for £25,000 which was originally purchased in March 2017 for £15,000. This type of vehicle is no longer manufactured and has become a collectors' item.

Notes

1) The heating system was installed in Lakeside. Megan occupies 25% of Lakeside as her own home. Lakeside was previously heated by old fashioned electric storage heaters.

2) Plain wood panelling was fitted to the walls of the restaurant at Seaside.

3) 80% of the pictures were bought and hung in the Seaside restaurant, the remainder were hung in the offices.

4) The car has CO_2 emissions of 150 g/km and will be used by an employee 75% for business purposes.

5) Building costs can be broken down as follows:

Date	Details	£
1 January 2022	Legal and planning fees	6,000
10 January 2022	Demolition costs	4,500
20 January 2022	Electrical and plumbing work	6,700
31 January 2022	Construction costs	63,000
		£80,200

All costs related to the conversion of a garage into guest bedrooms at Seaside. The electrical and plumbing work was for the installation of a bathroom, heating and lighting in the conversion. The new bedrooms were available to let from 1 February 2023.

6) The payment on 12 February 2023 was the deposit on a new lift at Seaside. The balance of £16,000 will be paid after completion of the work in July 2023.

7) On 1 March 2023, a hire purchase agreement was signed to buy an electric car for Megan and a deposit was paid of £5,000. The balance of £40,000 will be paid over five years. The car was delivered on 23 March 2023 and will be used 60% for business purposes.

8) The balances on the general and special rate pools at 1 October 2021 were £17,000 and £23,000 respectively.

Megan previously incurred costs of £200,000 for an extension at Moorside which came into use on 1 May 2020. Structures and buildings allowance was claimed in respect of this expenditure.

Megan is considering buying another hotel in a nearby village: Woodside, which was originally built in 2005. The unconnected sellers of the hotel, Allron Ltd, have agreed an overall price for the property. There has been no agreement yet on any allocation to fixtures and fittings. Megan is considering selling Moorside to fund the purchase of Woodside.

Requirement:

1) Calculate, with explanations, the capital allowances that Megan can claim for the period ended 31 March 2023. (10)

2) Explain the capital allowance implications of the purchase of Woodside and the potential sale of Moorside. (5)

Total (15)

5. James Cora, a sole trader, has carried on a restaurant business for many years, preparing accounts to 5 April each year.

Taxable profits for the year ended 5 April 2023 were £115,000, which is representative of a normal trading year for the business.

James also receives interest income of £2,500 and dividend income of £15,000 each year from an investment portfolio.

James's wife, Betty, works as a nurse and has annual employment income of £25,000. She has no other income.

James would like to know if he and his wife could reduce their annual tax liabilities by incorporating his business, at market value, in exchange for cash and/or shares.

The forecast assets and liabilities of the business and their estimated market value on 5 April 2024 is as follows:

	Book value	Market value	Cost
	£	£	£
Fixed assets:			
Land and buildings	250,000	500,000	300,000
Plant and machinery	60,000	25,000	100,000
Motor vehicles	12,500	15,000	60,000
Goodwill	-	465,500	-
Stock and work in progress	28,000	45,000	28,000
Debtors	13,500	13,500	
Cash at bank and in hand	12,000	12,000	
Prepayments	3,500	3,500	
Creditors (amounts falling due within one year)	(79,500)	(79,500)	
Non-current liabilities:			
Bank loan	(100,000)	(100,000)	
Net assets	200,000	900,000	

James has not made any previous capital disposals.

Requirement:

1) **Explain the Capital Gains Tax implications of the incorporation of the business.** (10)

2) **Calculate the difference in the total Income Tax liabilities of both James and Betty for 2024/25 if:**

   (a) The business continues to be operated as a sole trade;

   (b) The business is incorporated on 5 April 2024, in exchange for shares held equally by James and Betty, and expected profits are extracted in full by way of dividend. (10)

Total (20)

6. Gustav operates two businesses as a sole trader: a furniture shop which opened in 1991 and an art gallery, which opened in 2001. Separate accounts were prepared for each business to 30 April each year. He ceased the furniture shop business on 30 September 2022, when the lease came to an end.

The tax adjusted profits for the furniture shop for the year ended 30 April 2022 were £47,000.

The tax adjusted profits for the art gallery for the year ended 30 April 2022 were £27,000.

The draft profit and loss account for the furniture shop for the period ended 30 September 2022 is as follows:

	Notes	£
Sales		255,000
Cost of sales	1)	(87,000)
		168,000
Rent, rates and insurance		(26,000)
Employee costs	2)	(45,000)
Repairs	3)	(18,000)
Administration expenses		(12,000)
Legal and professional fees	4)	(5,500)
Depreciation		(16,800)
Loss on disposal of fixed assets	5)	(4,900)
Profit for the period		£39,800

Notes

1) Gustav took furniture with a cost of £1,800 and a retail price of £4,000 for his personal use during the period. The cost is included in cost of sales, but no further adjustment has been made.

2) Employee costs includes a redundancy payment of £17,000 to a former employee, John. John was entitled to £3,300 of statutory redundancy pay.

3) Repair costs are analysed as follows:

	£
Removal of fixed partition walls	6,000
Redecoration of shop exterior	4,500
General building repairs	7,500
	£18,000

The fixed partition walls had to be removed at the end of the lease.

4) Legal and professional fees are analysed as follows:

	£
Debt collection costs	2,400
Accountancy and legal advice on closure of shop	1,500
Accounts preparation	1,600
	£5,500

5) The loss on disposal of fixed assets was calculated as follows:

	Cost	Depreciation	Sales proceeds	Profit/(loss)
	£	£	£	£
Fittings scrapped	17,000	17,000	-	-
Van	26,000	11,100	10,000	(4,900)
	£43,000	£28,100	£10,000	(£4,900)

6) The balances on the general and special rate pools as at 1 May 2022 were £7,000 and £4,800 respectively. No fixed assets were acquired in the period.

Requirement:

1) Explain the basis periods for Gustav for both businesses for the tax years 2022/23, 2023/24 and 2024/25. Calculations are not required. (8)

2) Calculate the tax adjusted profits for the furniture shop for the period ended 30 September 2022 and the total National Insurance payable by Gustav for 2022/23. (7)

Total (15)