Chartered Institute of Taxation

Excellence in Taxation

The Chartered Tax Adviser Examination

May 2018

Taxation of Owner-Managed Businesses

Suggested solutions

1. JOHN

The partnership is transparent for Capital Gains Tax ("CGT") purposes, and therefore the chargeable assets are treated as owned by the partners in their respective partnership shares. Any gains/losses will therefore be assessable on the partners directly.

Land and buildings

As the building is being transferred to one of the partners, John, this will be treated as being transferred at its market value of £500,000.

The gains which would have arisen on a market value disposal are as follows.

	John 50%	Becky 25%	Aiden 25%
	£	£	£
Market value	250,000	125,000	125,000
Less: cost	130,000	65,000	65,000
Gain	120,000	60,000	60,000

As Becky and Aiden are giving up their 25% shares, their gains will be taxed at the time the property is transferred to John.

However, John is not making a disposal of any part of the asset and so his gain will not be charged to CGT, as it is only a 'notional' gain.

John is treated as having acquired the property at its market value of £500,000. However this is reduced by the notional gain of £120,000 to £380,000.

Reduction in partnership interest

When John retires from the partnership, his share in the goodwill and investments owned by the partnership will reduce from 50% to 0%. Becky and Aiden's shares will each increase by 25% - from 25% to 50%. This change in partnership sharing ratios is a disposal event for CGT purposes.

In each case, the consideration for the disposal is the relevant percentage of the book value of the asset on the balance sheet at the time of the change in partnership sharing ratios.

Goodwill

As the goodwill has been revalued in the accounts, the carrying value is not the same as the original cost of the asset and a chargeable gain will arise for John.

John has disposed of his 50% interest in the goodwill:

	John 50%
	£
Proceeds (50% x £100,000)	50,000
Less: cost (50% x £65,000)	32,500
Gain	17,500

John's base cost will reduce to zero. Becky and Aiden's base cost will each increase by 25% of the balance sheet value, so £25,000. This will be added to their original base costs of £16,250 (25% x £65,000), to give each a total of £41,250 to carry forward.

Investments

As the investments are carried in the accounts at their original cost, this will be treated as a no gain no loss disposal for John.

John's base cost will reduce from £75,000 to zero and Becky and Aiden will each acquire £37,500 of John's base cost, to add to their original base costs of £37,500 – a total of £75,000 each.

Capital and current accounts

No capital gain or loss will arise when John withdraws any balance remaining on his capital and current accounts. This is simply him withdrawing funds which belong to him as a partner.

CGT payable

The total of the gains and losses for each partner are as follows:

	John	Becky	Aiden
	£	£	£
Land and buildings	-	60,000	60,000
Goodwill	17,500	-	-
Listed investments	-	-	-
Total	17,500	60,000	60,000

As John is disposing of his interest in the partnership's assets, this is treated as a disposal of the whole of the partnership's business by John for entrepreneurs' relief purposes. As the partnership is a trading partnership, and John has held his interest for more than twelve months, he may make a claim for entrepreneurs' relief in respect of the gain on the goodwill which remains chargeable. This would reduce his rate of CGT to 10%. This claim should be made by 31 January 2021. This relief will not be available to the other partners, as they are only disposing of their interest in an asset and not the partnership business itself.

Aiden has made a capital gain on the disposal of his share in the property used in the partnership's trade. However, in November 2017, he spent £100,000 on land and buildings for use in his sole trade. Upon making a claim for roll-over relief, Aiden could reduce his gain to the £25,000 of proceeds of £125,000 in relation to the building which are not 'reinvested' in the warehouse. The warehouse was purchased in the qualifying window (June 2017 to June 2021), is a qualifying asset (property), and will be used in his business. The asset being used in a different business from that in which the asset is sold does not affect the ability to make a claim, as both businesses are treated as one in Aiden's hands (s.152(8) TCGA 1992). A claim should be made by 5 April 2023 (four years following the end of the tax year of disposal, as this is later than the acquisition).

Assuming both claims are made, the partners' CGT payable is therefore as set out below:

	John	Becky	Aiden
	£	£	£
Gains	17,500	60,000	60,000
Rolled-over			(35,000)
Losses brought forward		(7,000)	
Annual exemption	(11,300)	(11,300)	(11,300)
Capital gains	6,200	41,700	13,700
CGT @ 10%	620		
CGT @ 20%		8,340	2,740

The partners' CGT is payable by 31 January 2020.

Inheritance tax position

Currently John's partnership share qualifies for business property relief ("BPR") in his estate. This would be given at a rate of 100%, as the partnership is a trading partnership and he has held his interest in the partnership for more than 24 months.

When John leaves the partnership, he will no longer receive BPR. The property which he will be transferred and will rent to the company will not qualify as a 'business' for BPR purposes, as it is passive investment activity. Similarly, any cash/loans from his capital and current accounts will not qualify for relief. John's IHT position has therefore been negatively affected as a result.

However, if John reinvests in other qualifying business property within three years of leaving the partnership, BPR will be given again if the aggregated ownership periods of John's partnership share and the new property covers at least two of the previous five years. During this time, the amount of BPR cannot exceed that which would have been given on the partnership share.

MARKING GUIDE

TOPIC	MARKS
Part 1	
Assets treated as owned by partners	**0.5**
Distribution to partner	
Calculation of gain	2
Notional gain not charged	0.5
Base cost	1
Change in PSR – revaluation	
Revalued amount	0.5
Calculation of gain	1
Calculation of base costs	2
Change in PSR – no revaluation	
Disposal and acquisition on change of PSR	0.5
No gain no loss – uses current BS value	0.5
Calculation of new base costs	1
Capital and current account – no gain	**0.5**
Calculation of CGT payable	
Entrepreneurs' relief potential	1.5
Rollover relief	1.5
Loss relief	0.5
Annual exemption	0.5
Rate of tax	0.5
Calculation of tax payable	1
Date for payment	**0.5**
Part 2	
BPR previously available on partnership share	0.5
Rate of BPR	0.5
Conditions – trading, ownership	1
Loss of BPR on selling out of partnership	1
Potential replacement property	1
TOTAL	**20**

2. MR AND MRS EDWARDS

Land and buildings

Transferring the land and buildings of Quik-Stores Ltd ("Quik-Stores") to Warrington Wholesalers Ltd ("Warrington") will give rise to a chargeable gain within Quik-Stores of £50,000 (calculation in Appendix 1). This will be the case regardless of the transfer value used, as market value is always used for tax purposes between connected companies.

As Quik-Stores has capital losses brought forward, these will be utilised against the chargeable gain of £50,000.

Stock

For tax purposes, stock will transfer at market value of £40,000, due to the companies being connected. This will give rise to a taxable income profit of £15,000, based on the carrying value in the accounts. However, as the two companies are connected, a joint election could be made to transfer the stock at the higher of the transfer value and the original cost (both £25,000). This would eliminate the taxable profit of £15,000 and Warrington would acquire the stock at its cost of £25,000. However, it may not be beneficial to make this election if Quik-Stores's loss for the year ended 30 June 2018 could absorb these income profits, as this would increase the cost of the stock in Warrington and reduce their profits when the stock is finally sold.

Plant & machinery

Plant and machinery would normally transfer at the agreed transfer value, resulting in potential balancing adjustments in the capital allowances pool. However, as you and your wife between you own at least 75% of both Quik-Stores and Warrington at the time of the transfer, the transfer of the trade from Quik-Stores will be treated as a 'succession' for tax purposes. As a result, the plant and machinery will transfer to Warrington at the tax written down value of £45,000 and therefore no balancing adjustments will arise. This treatment is automatic and cannot be disapplied. It should be noted that Warrington cannot claim the 100% annual investment allowance on the assets acquired from a connected company and will continue to claim writing down allowances at 18% and 8%, as appropriate.

Losses

Another implication of the transfer being a 'succession' is that the trade losses of Quik-Stores will transfer to Warrington, which would not normally happen in a transfer of trade. In a succession, the expected trading losses of £75,000 carried forward at the date of the transfer would normally transfer to Warrington. However, as Quik-Stores will be left in a net liabilities position following the transfer, the transferred losses will be restricted by the same amount. I have attached a calculation of the net liabilities position of Quik-Stores following the transfer at Appendix 2. This shows that Quik-Stores will be left with net liabilities of £30,000 following the transfer. As a result, losses transferred to Warrington will be restricted to £45,000. Quik-Stores will therefore be left with losses of £30,000. As the trade of Quik-Stores is continuing (albeit in Warrington), these cannot be relieved against any taxable profits of the company arising in the previous three years under the terminal loss relief rules. These losses will therefore be eliminated.

The £45,000 of losses transferred can be used by Warrington, but only against profits made by the former Quik-Stores business. Therefore, it will be necessary to keep separate business records for the Quik-Stores 'division', until such times as the losses are utilised. Any losses generated after the date of the transfer can be utilised by either 'division' in a current year claim.

In addition, if there has been, or will be, a material change in the nature of Quik-Stores's business (even within Warrington) within the three years either side of acquiring the shares, these losses will not be able to be carried forward from the date on which the shares of Quik-Stores were acquired (s.676(3) CTA 2010). This will be the case where there is a significant change in the nature or customers of the business, such as from general retailing to trade cash and carry.

The remaining capital losses of £10,000, after being relieved against the gain on the building above, will not transfer from Quik-Stores to Warrington.

Appendix 1 – Chargeable gain

	£
Proceeds	300,000
Cost	200,000
Unindexed gain	100,000
Indexation	50,000
Indexed gain	£50,000

Appendix 2 – Net liabilities position

	£
Consideration:	
Land and buildings	300,000
Plant and machinery	30,000
Stock	25,000
	355,000
Other retained assets:	
Debtors	20,000
Assets remaining	£375,000
Liabilities:	
Bank overdraft	40,000
Creditors	365,000
Liabilities remaining	£405,000
Net liabilities	£30,000

MARKING GUIDE

TOPIC	MARKS
Land and buildings	
Calculation of gain	1
Loss utilisation	0.5
Stock	
Market value	0.5
Income profit	0.5
Election	1.5
Consideration of benefit of election	0.5
Plant and machinery	
Normal position	0.5
Succession – definition	1
TWDV transfer	0.5
No AIA in recipient company, claim WDAs	1
Losses	
Succession	0.5
Net liabilities position and implications	2.5
No terminal loss relief for remaining losses	1
Loss streaming	1
Change in nature of trade in recipient company	1.5
Capital losses	1
TOTAL	**15**

3. STEVE BISHOP

MEMO

To: Joe Mills
From: A Tax Manager
Client: Prospect Developments Limited / Steve Bishop
Subject: Proposals for company purchase of own shares etc.

As discussed Steve Bishop has suggested that the company purchase 50% of his shares currently for £250,000 and the remaining 50% in six months' time also for £250,000. Meanwhile he will remain as a director of the company.

A company purchase of own shares ("PoS") is a distribution for tax purposes under s.1000 CTA 2010 and therefore liable to income tax unless the requirements of s.1033 to s.1043 are met in which case the payment received is treated as a capital distribution. I understand that Steve would qualify for CGT Entrepreneurs' Relief but agree with your advice that Steve's proposals in their existing form would not meet those requirements for the reasons outlined below.

1. The first requirement is that the company must be an unquoted trading company or holding company of a trading group, and subject to two alternative conditions A and B (s.1033). The applicable condition (A) is that the PoS must be wholly or mainly for the purpose of benefiting the trade of the company. The first part of this requirement is met. Although the company owns an investment property with a balance sheet value of £700,000, the test of a trading company is one whose business consists wholly or mainly of carrying on a trade, which seems clearly the case. Also the question states that Steve has been advised that he qualifies for Entrepreneurs' Relief and therefore it must follow that the company meets the wholly or mainly test for the purposes of s1048(1).

2. The second part of the condition also appears to be met as Steve is unable to carry out all of his former duties and it will benefit the company's trade for his children to take over those functions, who are also keen to do so. HMRC's views on what is regarded as being for the benefit of the trade are set out in SP2/82, though these are not exhaustive but do give as an example of an "unwilling shareholder" who is retiring as a director and wishes to make way for new management. Steve's intention to remain as a director is however problematic and may call into question whether it is for the benefit of the trade for him to retire if his services are still required.

3. The company and the shareholder must be UK resident. This test is met.

4. The shares must have been owned by the seller for at least five years. This test is met.

5. The combined interests of the seller and their associates must be "substantially reduced" to less than 75% of their interests prior to the PoS. For this purpose Steve is associated with his wife Laura but not with their adult children. Steve and Laura's shareholdings before the PoS represent a combined interest of 60% in the company so their combined interests must reduce to below 60% x 75% = 45%. If the company buys 22 of Steve's shares (being half of his holding) the issued capital of the company would reduce to 78 shares. Steve and Laura would own 38 of those shares i.e. a 48% interest. The substantial reduction test would not therefore be met.

The seller must not be "connected" with the company immediately after the PoS. The seller is connected with the company broadly if they possess or are entitled to acquire an interest of more than 30% of the company's issued share and loan capital. Again, the rights of associates are combined for this purpose. As Steve and Laura would still own 48% of the issued capital after the first leg of the PoS Steve would remain connected with the company.

My advice would therefore be as follows:

a) The PoS should be carried out as one transaction for the purchase of the whole of Steve's holding, as soon as the company is able to raise the funds to do so. Laura would still retain 15 shares out of a reduced issued capital of 55 shares i.e. an interest of 27%. This would meet the substantial reduction test.

b) Steve should retire as a director on completion of the PoS for the purposes of the trade benefit test.

c) It is possible to apply to HMRC in advance of the PoS for clearance that capital treatment will be available, which I would strongly advise. I shall be pleased to draft the clearance application on behalf of Steve and the company.

With regard to the Steve's overdrawn director's loan account of £100,000, whether Steve repays this out of the proceeds of the PoS or this is written off, the company will be able to recover the £25,000 tax paid under s.455 CTA 2010 nine months after the accounting period in which the repayment/write-off takes place. As the company's year-end is 31 October that would be nine months after 31 October 2018 i.e. on 1 July 2019.

If the company writes-off or releases the debt Steve would be liable to income tax under s.416 ITTOIA 2005 at the dividend tax rates. Steve's liability at 32.5% would be £32,500 (or more if the additional income brings him within the additional rate at 38.1%).

The CGT payable on £100,000 at 10%, with the benefit of Entrepreneurs' Relief, is only £10,000 and therefore it is clearly better that Steve repay the loan in cash on receipt of the sale proceeds for his shares.

Additionally, HMRC regard the release of a loan to an employee as earnings for national insurance purposes and the company may therefore be required to pay NICs of £100,000 @ 13.8% = £13,800.

My advice is therefore for Steve to repay his loan account as soon as he receives the cash for his shares.

MARKING GUIDE

TOPIC	**MARKS**
POS income	1
Capital if meet requirements	1
Trading company test met	2
Benefit to trade and possible issues	2
UK resident/ held 5 years	1
Substantial reduction test and not met	2
Connection test and still connected	2
Clearance application recommendation	0.5
Treatment of loan write off	1
Comparison between loan write off and capital & recommendation	2
Potential NIC on loan write off	0.5
TOTAL	**15**

4. MARLOWE LTD

Marlowe Ltd
Capital Allowances Computation
Year ended 31 December 2017

	Note	AIA/FYA Expenditure	Main Rate Pool	Special Rate Pool	Allowances
		£	£	£	£
WDV brought forward			250,000	200,000	
Un-pooled expenditure re Red site	1			40,000	
Additions:					
AIA	2	200,000			200,000
FYA	3	35,000			35,000
Main rate pool	2		20,000		
Special rate pool	4			45,000	
Total			270,000	285,000	
Disposals:					
Main rate pool	5		(159,000)		
Special rate pool	5			(175,000)	
Total			111,000	110,000	
WDA 18% / 8%			(19,980)	(8,800)	28,780
Total allowances					263,780
WDV carried forward			91,020	101,200	

Note

1. The pooling requirement as agreed with the purchaser of the Red Site is met and so the further expenditure of £40,000 in relation to the installation of the lift should be added to the pool in this accounting period.

2. See working 1 below

3. First year allowances of 100% are available on the Nissan Leaf cars as they are low emission vehicles

4. No AIA are due on cars and the emissions on the Mercedes mean it falls in the special rate pool

5. See working 5 below

Working 1: additions for capital allowances purposes

The expenditure which qualifies for AIA is as follows:

	Note	£
Central heating Red Site		35,000
Floodlights and support	1	12,000
Thermal insulation	2	25,000
Hoist and installation costs	3	55,000
Fire extinguishers and blankets		8,000
Air conditioning	4	45,000
Vans		40,000
Total		220,000

The maximum AIA available is £200,000. The AIA is allocated to the items to be included in the special rate pool in priority as the writing down allowance is less for such assets with the balance of expenditure (£20,000) being allocated to the main rate pool.

Note:
1. S23 List C item 26 refers
2. S28 refers
3. S25 allows the cost of alterations to building for installation of plant to be included for capital allowances purposes
4. Where payments are deferred, s5 allows an initial allowance only for payments made within 4 months of the date on which the obligation to pay becomes unconditional. The relevant date was 1 October 2017 so the amount of relief available in this period is £15,000 plus (4 x £7,500)

Working 2: disposals for capital allowances purposes

An amount can be brought in as disposal proceeds on the fixtures sold as part of the Red Site. The amounts agreed under the s198 election meet the fixed value requirement in s187A CAA 2001 and so are used as the disposal proceeds, allocated to the relevant pool

Main rate pool:

	Note	£
Plant at Red Site		70,000
Fixtures in Red Site building		
Storage cupboards etc		20,000
Alarm system		15,000
Sprinkler system		30,000
Sanitary ware etc		15,000
BMW 525d	1	9,000
Total		159,000

Note:
1. A main rate car due to level of emissions

Special rate pool

	Note	£
Fixtures at Red Site:		
Central heating		30,000
Electrical system		25,000
Lift and installation		100,000
BMW M4	1	20,000
Total		175,000

Note:
1. A special rate car due to level of emissions

Non-qualifying expenditure

1. The fire doors do not qualify for capital allowances as they form part of the building as per s21 CAA2001 List A item 1.
2. The mezzanine floor storage platform is part of the premises and not within the definition of allowable integral plant so will not qualify for capital allowances.

MARKING GUIDE

TOPIC	**MARKS**
Treatment of un-pooled expenditure	1
Expenditure qualifying for AIA	1
Allocate in priority to Special rate expenditure	1
Floodlights	0.5
Thermal insulation	0.5
Hoist & building alterations re hoist	0.5
Fire extinguishers & blankets	0.5
Restricted CAs re aircon	1
FYA electric car	1
FYA re electric cars	1
No AIA on car	0.5
Allocate car to SPR given level of emissions	0.5
Disposal value/fixed value requirement – correct treatment of disposals/allocation to pools of fixtures per s.198 election	1
Sale of assets per SPA, allocation to pools	2
Allocation of disposal value of BMW 525 & M4 to correct pools	1
Non qualifying expenditure – fire doors & mezzanine	2
Calculation of total disposal and acquisition costs correct	1
Correct allocation of disposal proceeds	1
WDV bf	1
WDA	1
WDV cf	1
TOTAL	**20**

5. ALLEGRA GARUTI

Cessation of Trade

Adjusted trading profit

The tax adjusted profit for the 14 months to 30 June 2017 is:

	Note	£	£
Loss per accounts			(4,100)
Add:			
Depreciation		1,000	
Entertaining		500	
Legal	1	3,500	
Staff party	2	1,500	
Deemed proceeds on dress taken from stock	3	1,600	
Balancing charge	4	3,000	
Profit on stock sale	5	2,000	
			13,100
Adjusted profit			9,000

Notes:

1. The legal fee relating to the sale of the business premises will be disallowed in the profit adjustment as not wholly and exclusively incurred for the business.

2. The cost of the staff party will be disallowed as not being wholly and exclusively for the benefit of the trade as it is in connection with the closure of the business

3. Trading stock taken by a sole trader for their own use is deemed to be sold at open market value

4. Capital allowances:

	Pool	Van (PU)	TOTAL
	£	£	£
Tax written down value b/f	2,000	0	
Disposal proceeds	(3,000)		
Deemed disposal proceeds		(2,500)	
Private use adjustment 20%		500	
Total	(1,000)	(2,000)	
Balancing charge	1,000	2,000	3,000

5. s.173 ITTOIA 2005 states that, on cessation of trade, stock is treated as sold at market value. The sale to a third party shortly after cessation of trading indicates a market value of £11,000.

Basis periods and profits to date

The taxable profits and basis periods from inception are:

Tax year	Basis period		£
2012/13	1 March 13 to 5 April 13	1/14 x £14,000	1,000
2013/14	6 April 13 to 5 April 14	12/14 x £14,000	12,000
2014/15	1 May 13 to 30 April 14	12/14 x £14,000	12,000
2015/16	1 May 14 to 30 April 15		30,000
2016/17	1 May 15 to 30 April 16		32,000
2017/18	1 May 16 to 30 June 17 Less overlap relief (Note 6) Loss available for relief	14/14 x £9,000 (11,000)	 (2,000)

Note 6

Overlap relief is the period 1 May 2013 to 5 April 2014: 11/14 x £14,000 = £11,000

Income Tax and Capital Gains Tax liability

	£		£
Salary and benefits	130,000		
Less loss relief	(2,000)		
			128,000
Personal allowance			nil
Tax charge:			
£33,500 x 20% £94,500 x 40%	6,700 37,800		
Income tax			44,500
	Entrepreneurs' Relief Gain	Non-ER gains	
Net capital gains	130,000	7,600	
Annual exemption	3,700	(7,600)	
	126,300	nil	
Capital gains tax (note 7)	10%		12,630
Total tax payable			57,130

Note 7
The capital gain arising on the sale of the freehold premises will qualify for Entrepreneurs' Relief

Capital gains 2017/18:

	Goodwill	Freehold	Net gains
	£	£	
Proceeds	10,000	413,500	
Cost	(30,000)	(260,000)	
Legal fees (Note 8)		(3,500)	
Gain/(loss)	(20,000)	150,000	130,000

Note 8

The legal expenses disallowed in the profit adjustment will be an allowable deduction for CGT purposes.

MARKING GUIDE

TOPIC	MARKS
Add back depreciation	1/2
Add back entertaining	1/2
Disallow legal cost on sale of freehold	1/2
Disallow cost of staff party	1
Extraction of stock taxed at retail value	1
Stock deemed to be sold at market value	1
Disposal proceeds brought into capital allowances computation	1
Van deemed market value disposal proceeds £2,500	1
Private use adjustment	1
2013/14 basis is tax year	1/2
2014/15 basis is 12 months to 30 April 2014	1/2
Final basis period is the 14 months to cessation	1
Overlap relief £11,000	1
Deduction of overlap relief results in loss	1/2
Offset loss against general income	1/2
No personal allowance available	1/2
Income tax calculation	1/2
Deduct CGT Annual allowance, priority to non ER gains	1
Gain qualifies for entrepreneurs' relief at 10%	1
Deduct legal fees from capital gain on property	1/2
TOTAL	**15**

6. FRANS LTD

Briefing Note:

Frans Limited

2017/18 P11D completion

Outlined below is a summary of the PAYE and NIC implications of the benefits in kind provided by Frans Ltd during 2017/18.

- **Mobile phones**: The provision of a mobile phone to employees is a tax free benefit, whereas the cost of the provision of a phone to family members is a taxable benefit which the company must report on the P11D.
  The level of the benefit is the cost to the company i.e. £20 per month. Where a salary sacrifice arrangement is in place then the benefit to be disclosed is the higher of the taxable benefit and the salary sacrificed. Therefore the benefit in this case would be £25 per month, despite the fact that the provision of the phone is a tax free benefit. The benefit will attract a class 1A NIC charge at 13.8%

- **Private medical insurance**: Where the company arranges and pays the provider directly then this must be reported on the P11D again with the level of the benefit being the cost to the company and with a Class 1A NIC charge being payable at 13.8% on the benefit. Where the employee arranges the benefit but the company pays the provider directly, then this is disclosed on the P11D. However, this is liable to Class 1 NICs and the value of the benefit should be added to the employee's salary and Class 1 NIC collected through the payroll. Where the employer reimburses the employee's personal expenditure then this is simply treated as additional earnings in the month paid and so tax and Class 1 NIC are collected through the payroll and there are no further reporting requirements.

- **Employee car ownership**: On the basis that the company has legal title to the cars and these are provided to employees then they will attract a benefit charge based on the list price and CO_2 emissions of the car. The annual benefit charge will be reduced by reimbursement costs. The benefit will be disclosed on form P11D and the company must account for Class 1A NIC at 13.8%.

- **Mileage reimbursement**: An employer may reimburse their employee tax free for business mileage incurred in their own cars at a rate of up to 45p per mile for the first 10,000 miles per annum and 25p per mile thereafter. The company has no reporting obligations for the reimbursement of business mileage at 20p per mile and there are no NIC implications of making these payments. The company may wish to advise the employees that they can claim tax relief for the shortfall thorough their own self-assessment returns, or directly with HMRC where no returns are completed. However, the company is under no obligation to do this.

- **Interest free loans**: The company may make loans to an employee without attracting a taxable benefit, provided the maximum amount outstanding in the tax year does not exceed £10,000. There are no reporting requirements for such loans.
  The loan of £15,000 to the Finance Director will be a taxable benefit as it exceeds £10,000 and is not for an allowable purpose. The taxable benefit is calculated by applying the official rate (2.5%) to the outstanding loan. The benefit is time apportioned where the loan is made available part way through the year. The benefit must be disclosed on the P11D and the company must account for Class 1A NIC at 13.8% on the notional interest

- **Non-cash vouchers**: These will represent a taxable benefit. Under the PSA, the company must 'gross up' the benefit at the relevant employees' marginal tax rates and account for Income Tax on this figure together with Class 1B NIC at 13.8% on the gross benefit. The company has to apply to HMRC for the PSA before 6 July 2018 and the Income Tax and Class 1B NIC must be accounted to HMRC by 22 October 2018 for 2017/18. There is no obligation to report these benefits on the P11D if they are included in the PSA.

- **Gift of bouquet**: This will fall under the trivial benefits exemption as it cost less than £50, it is not in the form of cash and there is no contractual entitlement or recognition of services provided. As it is a trivial benefit, there are no reporting requirements. However, the employer should maintain a careful record of such expenditure in order to demonstrate that it falls within this relief.

- **Gift of wine**: As the individual benefit exceeds £50 then it will not fall within the trivial benefits exemption. As such the full cost must be disclosed on the P11D and the company will have to account for Class 1A NIC at 13.8%. The company could use a PAYE Settlement Agreement for this benefit too.

Payrolling of benefits

Frans Limited may choose to "payroll" all of the above benefits, with the exception of beneficial loans. The company must notify HMRC before the beginning of the tax year of its intention to participate so it cannot use payrolling for 2018/19 as the tax year has commenced. In addition the company must advise their employees what benefits have been included in the payrolling arrangement. The value of benefits covered are added to the gross pay of the employee and Income Tax, but not Class 1 NIC, is deducted through PAYE. This removes the requirement to disclose the benefit on Form P11D. The company must still record the benefits and account for Class 1A NIC by 6 July following the end of the tax year. The company must notify their employees of the following information not later than 31 May in the year following the end of the tax year:

- Details of benefits that have been payrolled
- The cash equivalent of each payrolled benefit
- Separate details of all benefits not payrolled

MARKING GUIDE

TOPIC	**MARKS**
Second mobile phone is taxable benefit	1/2
Benefit is cost to company	1/2
Salary sacrifice benefit is higher cost and salary sacrificed	1
Direct employer arrangement: P11D and Class 1A	1/2
Employee arrangement, employer contract: P11D but class 1 NIC	1/2
Employee reimbursement: subject to PAYE	1/2
Car benefit charge	1
Reduced by employee payments	1/2
Correct tax free mileage rates	1/2
Employee tax relief on shortfall	1
Tax free loans up to £10,000	1
Benefit based on official rate	1/2
Time apportioned	1/2
Gross up benefit	1/2
Class 1B NIC charge	1/2
Account to HMRC by 22 October following	1/2
Trivial benefit exemption	1
As over £50 then fully taxable, P11D and Class 1A	1
Exclude beneficial loan from payrolling	1/2
Notify before tax year	1/2
Tax but not NIC is collected through payroll	1/2
No requirement to complete P11D	1/2
Must record and account for Class 1A	1/2
Notification requirements to employee post year end	1/2
TOTAL	**15**