THE CHARTERED INSTITUTE OF TAXATION

ADVANCED TECHNICAL

Taxation of Owner-Managed Businesses

November 2021

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.

- 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.

1. Gurprit Singh and Larson Yacht Consulting Ltd commenced trading in partnership as Elite Yacht Services on 1 May 2020. The first accounts were prepared to 31 March 2021.

Larson Yacht Consulting Ltd is owned by Theo Larson and his wife Jane Larson. It has traded for many years providing project management services to wealthy individuals on the build of their yachts.

As a hobby, Gurprit has, over the past few years, created and patented a new battery capable of holding more electricity than any other on the market. The battery enables yachts to be powered in an environmentally friendly way. He purchased some machinery on 1 January 2018 at a cost of £240,000 which he used to produce his prototypes and samples.

Theo and Jane were impressed with the product and Elite Yacht Services was established to make, and sell, the product on a larger scale.

Initial production and trading commenced on 1 May 2020 from rented premises using Gurprit's machinery. He retained personal ownership of this machinery, which was valued at £200,000 when it began to be used by the partnership. No charge is made for use of the machinery.

The partnership built and equipped a factory close to Southampton Quay as well as a luxury suite nearby where the partnership could host client events.

The buildings were complete and equipped by 31 August 2020 and production commenced from the new factory on 1 September 2020. The suite has been used for client drinks and dinner parties as well as hosting champagne receptions every day during the Southampton Boat Show in September 2020.

Full details of costs incurred by the partnership are:

<u>Factory</u>

	Date	Expenditure £	Notes
Land including Stamp Duty Land Tax	May 2020	1,250,000	
Planning permission costs	May 2020	8,000	
Architects and designer fees	May 2020	45,000	
Site preparation	June 2020	200,000	
Construction of factory	July 2020	600,000	
Air conditioning	August 2020	80,000	
Production machinery	August 2020	800,000	1
Delivery and installation of machinery	August 2020	50,000	2
Office equipment	August 2020	130,000	3

<u>Suite</u>

Land including Stamp Duty Land Tax	May 2020	200,000	
Planning permission costs	May 2020	2,000	
Architects and designer fees	May 2020	15,000	
Construction of building	July 2020	300,000	
Equipment	August 2020	200,000	
Air conditioning	August 2020	12,000	

<u>Other costs</u>

Five electric vans	September 2020	102,000	4
Electric vehicle charging point	September 2020	1,200	
Car for Gurprit	December 2020	86,000	5
Car for Production Manager	January 2021	24,500	6

<u>Notes</u>

1) Theo was able to negotiate a delayed payment programme. 50% of the cost was paid in August 2020, 25% in February 2021 and the remaining 25% in August 2021.

2) This was all paid in August 2020.

3) The market value of this was £150,000 but Theo was able to negotiate a discount from the supplier.

4) These were new electric vans, zero CO_2 emissions, used 100% for business purposes.

5) This was a new electric car, zero CO_2 emissions, used 80% for business purposes. VAT of £17,200 was charged.

6) This was a second-hand electric car, zero CO_2 emissions, used 60% for business purposes. VAT of £4,900 was charged.

The partnership is registered for VAT and all amounts are stated exclusive of VAT.

Requirement:

Calculate, with brief explanations, the capital allowances available to Elite Yacht Services for the period ended 31 March 2021. (15)

2. Chailit Ltd manufactures and leases tipper trucks to customers. Leases can be either short-term operating leases or finance leases of up to four years.

Accounts are prepared to 28 February each year. The draft accounts to 28 February 2021 show a profit before tax of £675,000 and before any adjustment for the following:

1) The accounts include depreciation of £45,000, of which £18,000 relates to assets held on finance leases.

2) Staff costs included in the accounts comprise:

	£
Wages	1,350,000
Employer's National Insurance contributions	145,000
Employer's pension contributions	165,000
	1,660,000

Due to a computer error, February wage payments totalling £4,650 were paid on 2 March 2021. Employer pension contributions of £13,770 were paid on 15 March 2021. Both costs were accrued in the accounts.

3) On 1 February 2021, the company vacated a leased office. The following provisions are included in the accounts under FRS 102:

	£
Redecoration of the office	8,000
Removing partition walls	12,000

4) Equipment hire in the accounts includes:

	£
Electric car for director	5,600
Employee car	3,600

The director's car is used 50% for business purposes. The employee's car has CO_2 emissions of 195 g/km.

5) Travel and entertaining costs in the accounts include £500 for hotels and meals for five customers to visit the company's factory. Each customer was also given a leather-bound notebook displaying the company's logo at a total cost of £250 and a hamper of local produce at a total cost of £300.

6) The accounts include a sponsorship payment of £10,000 to an equestrian business operated by the wife of the Managing Director. She has one horse and competes in local show jumping events.

7) During the year, an employee stole cash of £5,000 and a director stole cash of £15,000. These amounts are included in the accounts within sundry expenses.

8) Interest payable in the accounts consists of:

	£
Interest on finance leases	17,000
Interest on late paid PAYE	1,600
Mortgage interest for the company's factory	14,000
Bank overdraft interest	4,500
	37,100

9) Legal costs in the accounts comprise:

	£
Debt collection	5,670
Renewal of lease	2,450
Investor agreement	12,600
	20,720

Debt collection costs related to the company's trade debtors. The lease of a storage site used by the company was renewed for 25 years. In June 2020 an investor subscribed for shares in the company. The legal fees for the agreement were paid by the company.

10) On 1 January 2021, 10 trucks valued at £100,000 were returned by a customer at the end of an operating lease. The trucks were refurbished and sold. The draft accounts include a loss on the transfer to stock of £16,000. The original cost of the trucks was £600,000.

11) During the year, the company bought some second hand trucks for the hire fleet at a cost of £245,000, spending £145,000 in September 2020 and £100,000 in January 2021.

12) At 1 March 2020, the tax written down value brought forward was:

	£
Main pool	116,000
Special rate pool	125,000

Requirement:

Prepare the company's Corporation Tax computation for the year ended 28 February 2021, along with brief explanatory notes on the tax treatment of the items listed. (15)

3. AJ Clear Ltd is a trading company involved in the manufacture and sale of small air conditioning units to the building trade. The company was incorporated in 2011 by Alan Jones, who is the sole shareholder and one of the three directors of the company. The company has always been profitable and until recently it was retaining cash with the intention of using it to buy larger trading premises.

The company has an accounting date of 31 March and its balance sheet as at 31 March 2021 was as follows:

	2021		2020	
	£	£	£	£
Fixed assets		150,000		170,000
Current assets				
Debtors	45,000		45,500	
Stock	65,000		54,000	
Cash at bank	150,000		100,000	
	260,000		199,500	
Creditors				
Amounts due within one year	(44,000)		(37,000)	
Net current assets		216,000		162,500
Total assets less current liabilities		366,000		332,500
Provisions for liabilities		(22,000)		(21,000)
Net assets		£344,000		£311,500
Capital and reserves				
Share capital		100		100
Profit and loss		343,900		311,400
		£344,000		£311,500

Due to recent economic events, on 30 June 2021 the directors resolved to no longer consider buying larger premises and to instead use some of the cash they had retained to make the following loans on 1 July 2021:

1) An interest free loan of £35,000 to a trading partnership in which the partners are Alan's daughter, Clara Flowers, her husband Carl Flowers and their friend John Elms. The partnership used the money to repay an existing bank loan.

2) A £35,000 loan to Jones Cosmetics Ltd, a company wholly owned by Angela Jones, Alan's wife. Interest is payable on the loan at 10% per annum.

3) An interest free loan of £12,000 to Emily Hall, an employee who joined the company on 1 July 2021. Emily relocated to the area with her family and the loan was to help with the costs of the move. The loan was repayable at £1,000 a month but after three repayments Alan decided to release the remainder of the debt as a contribution towards the cost of the move.

As a result of recent events Alan has also decided to sell his shares in the company within the next 12 to 18 months.

Requirement:

1) Explain the tax consequences for the company of the loans. (12)

2) Explain any potential Capital Gains Tax issues for Alan of the loans. (3)

Calculations are not required.

Total (15)

4. Les Clark, 39, is employed as an architect by HS Designs Ltd, earning a gross salary of £4,500 per month. His contract includes a three-month notice period.

Les will be made redundant by the company on 1 December 2021. He will be issued with his P45 and will leave the company on the same day without working any of his notice period.

The company are proposing to offer Les the redundancy package detailed below, which will be paid on 31 December 2021.

	£
Gross salary for December 2021	4,500
Contribution to personal pension scheme	3,000
Statutory redundancy payment	9,350
Payment to enforce restrictive covenant in contract	1,000
Ex-gratia redundancy payment	28,000
Total	£45,850

In addition to the above, the company will:

1) Transfer his company car to him. Its market value is £6,750.

2) Offer to pay for a training course of Les's choice, at a cost of up to £1,500.

Requirement:

1) Explain the PAYE and National Insurance treatment of each element of the above package and the required reporting to HMRC. (10)

2) Calculate the PAYE and National Insurance which would be due in respect of the termination package. (5)

Total (15)

5. Matterhorn Ltd is a travel planning company and has had the following capital structure since 2012.

		Held by	Base cost
Ordinary shares:			£
A Ordinary shares of £1 each	750	Mr A	750
B Ordinary shares of £1 each	200	Mr B	200
C Ordinary shares of £1 each	50	Mrs C	50
Preference shares:			
5.5% non-cumulative non-redeemable Preference shares of £1 each	250,000	Mr B	125,000

In addition to the issued shares, the company granted Mrs D an EMI option over 45 D Ordinary shares in the company. The option has an exercise price of £150 per share, which was the agreed market value of the shares at the time the option was granted in 2012. Under the terms of the option agreement, this option must be exercised by 31 December 2021; it is anticipated that this will happen.

The rights of the shares are as follows:

Voting

Only the A Ordinary, C Ordinary and D Ordinary shares carry the right to vote.

Winding Up

Proceeds are distributed according to the following priority:

1) Repaying the capital on the Preference shares.
2) Repaying the nominal value of all classes of the Ordinary shares.
3) Any excess is distributed pro-rata on the A Ordinary, C Ordinary and D Ordinary shares only.

Sale

Proceeds are distributed according to the following priority:

1) Repaying the capital on the Preference shares.
2) Any excess is distributed pro-rata across all classes of the Ordinary shares.

Dividends

The Preference shares carry a preferential non-cumulative right to a 5.5% dividend.

Dividends may be declared independently on the A Ordinary and C Ordinary shares. The B Ordinary shares are not entitled to dividends.

Mr A, Mr B, Mrs C and Mrs D have been directors of Matterhorn since incorporation.

The shareholders have received an offer of £1,922,000 for all of the shares of the company. The first £250,000 would repay the Preference shares in full. The remainder would be split between the four classes of Ordinary share in existence at the date of sale, in proportion to their shareholdings. If accepted, the sale is expected to complete on 1 May 2022.

None of the shareholders have previously made any capital disposals and each of the shareholders are higher rate taxpayers.

Requirement:

Explain, with supporting calculations, the Capital Gains Tax implications for each shareholder of the proposed sale of their shares and any relevant beneficial claims or elections which could be made. (20)

6. For several years, Anton and Nico have been in partnership as software consultants. Accounts have been prepared to 30 April each year. Nico contributed capital of £400,000 on forming the partnership. Anton has not contributed any capital.

On 1 October 2020 they asked Natasha to join the partnership. Natasha did not contribute any capital. Prior to joining the partnership, Natasha was a director of Softcheck plc earning a salary of £178,000 per annum. She will continue as a non-executive director on an annual salary of £20,000.

On 31 December 2020, Anton retired from the partnership, as he reached state retirement age on 1 January 2021.

The profit-sharing arrangements for the year ended 30 April 2021 were as follows:

	Anton	Nico	Natasha
Prior to 1 October 2020			
Interest on capital	-	5%	-
Salary (per annum)	£25,000	-	-
Balance	50%	50%	-
1 October 2020 to 31 December 2020			
Interest on capital	-	8%	-
Salary (per annum)	-	-	£45,000
Balance	45%	30%	25%
Post 31 December 2020			
Interest on capital	-	8%	-
Salary (per annum)	-	-	£45,000
Balance	-	60%	40%

The draft tax-adjusted trading profit of the partnership for the year ended 30 April 2021 was £380,000. This is expected to be £400,000 for the year ended 30 April 2022.

Anton had taxable partnership profits of £126,000 for the year ended 30 April 2020 and overlap profits brought forward of £64,000.

As well as trading income, the partnership also received rental income from their former office building, Ebor House, and dividend income from an investment in a digital marketing company.

Ebor House was rented out on a five-year lease, which started on 1 December 2015. When the lease ended on 30 November 2020, the building was sold. No gain was made.

The following dividends were received in the year ended 30 April 2021.

Date	£
1 September 2020	2,400
1 March 2021	5,600

The partners are considering admitting Peter as a member in May 2022. Peter is currently a manager earning a salary of £58,000. He would be given the title of partner and his salary would increase to £63,000. He would not participate in the management of the partnership or make any capital contribution and neither would he receive any further profit share until he became an equity partner.

Requirement:

1) **Calculate the assessable trading profits for Natasha and Anton for each tax year during which they are a partner, identifying any overlap profits.** (10)

2) **Explain how the partnership rental and dividend income will be taxed.** (5)

3) **Explain which classes of National Insurance contributions each of the partners will be liable to pay in 2020/21, and Peter's National Insurance position if he becomes a partner.** (5)

Total (20)