THE CHARTERED INSTITUTE OF TAXATION

ADVANCED TECHNICAL

Taxation of Owner-Managed Businesses

November 2024

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 2023/24 legislation (including rates and allowances) continues to apply for 2024/25 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. Akshar has been trading for many years, preparing accounts to 31 March each year.

On 6 April 2022, Akshar went into partnership with Ben. Profits were shared 80:20 between Akshar and Ben, after interest for Akshar of 4% on his capital invested of £160,000.

On 1 January 2024, Cora joined the partnership. They agreed to pay a salary of £45,000 per year to Cora, with the remaining profits being shared 50:40:10 by Akshar, Ben and Cora. No interest was to be paid to Akshar.

During the year ended 31 March 2024, the partnership lost a large contract, which resulted in a loss for the year. The partnership has since won a few large contracts and expects to return to profit in 2025.

The profit and loss account for the year ended 31 March 2024 is as follows:

	Notes	£
Sales		336,000
Direct costs		(79,200)
Gross profit		256,800
Expenses		
Staff costs	1	(184,000)
Premises costs	2	(95,000)
Motor and travel	3	(85,300)
Administration expenses		(46,400)
Legal and professional fees	4	(16,000)
Depreciation	5	(19,700)
Loss		£(189,600)

Notes

1) Staff costs

Staff costs include £46,000 of termination payments for staff who were made redundant, including statutory redundancy costs of £10,930.

2) Premises costs

Premises costs are as follows:

	Notes	£
Rent and rates	(a) and (b)	64,000
Heat, light and water		16,000
Repairs	(c)	15,000
		£95,000

(a) In November 2023, the partnership moved out of their original office. The annual rent on the property is £24,000 a year, and the lease does not finish until 31 March 2030. The partnership will not reoccupy the property and has sublet the offices for a rent of £17,500 a year from 1 April 2024. The only amounts included in the profit and loss account in respect of the office are the rent paid for that year of £24,000.

(b) On 1 October 2023, the partnership paid a premium of £18,000 for the 10-year lease of a new office. Only £900 of the premium has been included in rental costs.

(c) Repairs includes £7,600 for painting the new offices before occupation.

3) Motor and travel

Motor and travel costs are as follows:

	Notes	£
Car leasing payments	(a)	17,000
Other car expenses	(a)	6,500
Employee travel costs	(b)	61,800
		£85,300

(a) The cars are provided for the partners and have emissions of 100 g/km. The cars are all used 40% for private purposes.

(b) Employee travel costs includes reimbursed parking fines of £1,900.

4) Legal and professional fees

Legal and professional fees are as follows:

	£
Legal fees for new lease	5,400
Debt collection	6,200
Accountancy fees	4,400
	£16,000

5) Depreciation includes £4,600 for computer equipment acquired on a finance lease.

The partnership spent £23,320 in October 2023 on office furniture and equipment for the new offices. There were no other purchases or sales of capital assets during the year. The tax written down value of the general pool at 1 April 2023 was £6,800. There was no balance on the special rate pool.

Akshar has a number of rental properties which generate taxable income for him of £40,000 a year. In 2023/24, he sold one of his rental properties realising a chargeable gain of £165,000.

Before they were partners, Ben and Cora were employees elsewhere earning salaries of £65,000.

Continued

Continuation

Requirement:

1) **Calculate, with explanations, the tax adjusted profit or loss for the partnership for the year ended 31 March 2024 and the allocation between the partners.** (12)

2) **Explain the loss reliefs available to Akshar and Ben stating the due dates for any claims. Calculations are not required.** (8)

Total (20)

2. Virginia Davis is the sole shareholder and managing director of Magic Threads Ltd, which has carried on business as a vintage-inspired fashion retailer since 2018. Virginia takes dividends of £100,000 from the company each year, which is her only income.

Mary, Virginia's sister, is the sole shareholder of FantasyFit Ltd, which carries on business as a fitness clothing retailer.

Magic Threads Ltd has performed well historically and has generated significant distributable reserves. However, the company has recently been facing declining sales. Virginia is planning to sell the trade and assets of Magic Threads Ltd to FantasyFit Ltd immediately. She will then wind up Magic Threads Ltd on 31 March 2025. Following the sale, after accounting for Corporation Tax and other business liabilities Magic Threads Ltd will have cash reserves of £300,000, which will be distributed to Virginia on winding up.

Mary has asked Virginia to help her in the running of FantasyFit Ltd. She has proposed two alternative options:

1) Virginia becomes an employee of FantasyFit Ltd; or

2) Virginia becomes a 25% shareholder in FantasyFit Ltd.

Virginia has not yet decided whether to help Mary run FantasyFit Ltd.

Virginia has not made any previous capital disposals and her shares in Magic Threads Ltd have a base cost of £1.

Requirement:

1) **Calculate with explanations the Capital Gains Tax payable by Virginia on the winding up of Magic Threads Ltd, assuming she does not become involved with FantasyFit Ltd.** (5)

2) **Discuss how Virginia's involvement with FantasyFit Ltd could change the tax treatment of the distribution on winding up, and calculate the possible difference in her total 2024/25 tax liability.** (10)

Total (15)

3. Tson Ltd is a marketing company which has been trading for several years. Mia Turner (Managing Director) and Aida Schwartz (Finance Director) each own 50% of the share capital of Tson Ltd.

Tson Ltd also has five employees, including Olena and Devon who are each paid an annual salary of £80,000.

Employees had previously been paid a fixed salary but Mia and Aida decided to introduce a flexible benefits package for the year ended 31 March 2024. The employees were offered a range of benefits that they could take instead of their cash salaries.

Two of the employees decided to take advantage of the flexible benefits package:

<u>Employee 1 – Olena Howe</u>
Olena opted to sacrifice £5,000 salary in exchange for Tson Ltd contributing £5,000 into her pension scheme.

<u>Employee 2 – Devon Forbes</u>
Devon opted to sacrifice a total of £8,500 of his salary, as follows:

Benefit	Salary sacrificed	Cost to Tson Ltd of providing the benefit
	£	£
Company car	7,000	6,200
Private fuel	1,000	1,300
Parking space close to the office	500	600

The details of the company car as follows:

List price	£25,600
CO_2 emissions	100 g/km
Fuel type	Petrol

On 6 September 2022, Mia borrowed £44,000 from Tson Ltd. She repaid the full amount on 6 August 2023. On 6 September 2023, Mia borrowed £30,000 from Tson Ltd. She repaid the full amount on 6 February 2024. Both loans were interest free.

Tson Ltd has taxable total profits of approximately £500,000 each year.

Requirement:

1) Calculate the net annual cost to Tson Ltd of the benefits provided to Olena and Devon. (10)

2) Explain the implications for Mia and Tson Ltd of the loans in September 2022 and September 2023. (5)

Total (15)

4. Antonio previously carried on a sole trade business as a digital marketer. On 31 March 2021, he sold his business to Topolino Ltd with the consideration left outstanding as a credit to his loan account with the company.

The business's only chargeable asset was goodwill, which Antonio's accountant valued at £650,000 on that date. He included a capital gain of £650,000 in his 2020/21 self-assessment return, which was filed on 30 January 2022. The following comment was included within the "white space" on his tax return:

"A valuation of the goodwill has been carried out."

On 14 February 2023, Topolino Ltd filed its company tax return for the year ended 30 June 2021. HMRC opened an enquiry into this return on 31 March 2024.

As part of the above enquiry, HMRC obtained information which suggested that the goodwill transferred by Antonio had a market value of £1,000,000. As a result, HMRC opened a compliance check into Antonio's 2020/21 self-assessment return on 31 May 2024. The compliance check concluded with HMRC issuing a discovery assessment to Antonio on 31 October 2024 for additional Capital Gains Tax of £70,000.

Topolino Ltd filed its company tax return for the year ended 30 June 2022 on 31 May 2023. This was amended on 31 March 2024 to include an R&D tax relief claim, which was not included in the original return. HMRC opened an enquiry into this return on 30 September 2024, in relation to the R&D claim and the tax deductibility of staff bonuses.

Requirement:

Explain whether the enquiries have been validly opened and the discovery assessment has been validly issued by HMRC, and the penalty position for Antonio if the capital gain for 2020/21 is found to be understated. (15)

5. Hanfort Ltd is a UK resident manufacturing company incorporated in 2011. It has always prepared accounts to 31 December. It ceased trading on 31 July 2024 and immediately sold its trade and assets to Fargum Ltd.

Recent results of Hanfort Ltd are as follows:

	Year ended 31 December 2021	Year ended 31 December 2022	Year ended 31 December 2023	Period ended 31 July 2024
	£	£	£	£
Trading profit/(loss)	421,300	87,900	24,884	(296,000)
Chargeable gains/(losses)	(84,000)	-	-	-
Qualifying charitable donations	(12,000)	(12,000)	(12,000)	(6,000)

The results for the period ended 31 July 2024 do not include the sale of the trade and assets to Fargum Ltd, or any capital allowances available to Hanfort Ltd.

The assets sold to Fargum Ltd on 31 July 2024 were:

Description	Purchase date	Original cost	Proceeds	Notes
		£	£	
Factory	12 September 2018	170,000	236,000	1
Factory machinery	20 May 2011	850,000	120,000	2
Warehouse	1 May 2020	98,000	105,995	3
Computer equipment	18 June 2021	24,000	6,000	4
Inventory	2 July 2024	44,000	36,000	
Goodwill	N/A	0	120,000	

Notes

1) Hanford Ltd purchased this factory in September 2018. The previous factory was sold in September 2018 for £220,000, resulting in a chargeable gain of £70,000. A claim for rollover relief was made on the purchase of the new factory. None of the cost qualified for plant and machinery allowances.

2) The tax written down value of the general pool was £67,624 on 31 December 2023. There were no acquisitions or disposals in the period ended 31 July 2024, other than those set out above.

3) Structures and buildings allowance was claimed on £46,000 of these costs starting on 1 May 2020. No other capital allowances were available in relation to the building.

4) A super-deduction was claimed in the year ended 31 December 2021.

Requirement:

1) Calculate the taxable total profits, before loss relief, of Hanfort Ltd for the period ended 31 July 2024, explaining how any losses could be utilised. (15)

2) Explain the tax implications for Fargum Ltd of acquiring each of the assets. (5)

Total (20)

6. Irfaan has traded for many years as a sole trader producing luxury furniture, preparing accounts to 31 March each year.

Irfaan's profit adjusted for tax but before capital allowances for the year ended 31 March 2024 was £182,500.

During the year ended 31 March 2024, Irfaan purchased the following items:

Description	Purchase date	Cost £	Notes
Solar panels	14 April 2023	10,885	
Printers	14 May 2023	1,500	1
Shelving and desks	19 May 2023	1,775	2
Computers	7 June 2023	1,500	
Office furniture	2 July 2023	-	3
Woodworking Machine	1 January 2024	12,000	4
New work van	15 January 2024	26,000	5
Wood Saw Machine	15 March 2024	10,000	6
Personalised Number Plate	16 March 2024	3,015	7

Notes

1) The printers were purchased from Irfaan's brother at their market value.

2) The shelving and desks were previously used by Irfaan at home for private purposes. When Irfaan began to use them for his trade, the market value was £700.

3) The office furniture was gifted by a friend who works in a similar trade. The market value of the furniture on 2 July 2023 was £1,000.

4) The woodworking machine was acquired on hire purchase with payment due in four equal instalments of £3,000. The machine was acquired on 1 January 2024 and Irfaan started to use it on 3 January 2024. The first payment was made on 1 January 2024, followed by further payments on 1 April, 1 July and 1 October 2024. The interest charged under the hire purchase agreement has been charged to the profit and loss account.

5) The van is electric with no emissions and was purchased new.

6) Irfaan took delivery of the wood saw machine on 15 March 2024. Under the terms of the contract, £7,000 had to be paid one month after delivery of the machine and the balance of £3,000 five months after that.

7) The personalised number plate has not yet been registered to any vehicle.

During the year ended 31 March 2024, Irfaan also made the following disposals:

1) Irfaan gifted his old computer equipment to a charity. The market value at the date of gift was £250.

2) Irfaan sold his old van for £4,000. Irfaan originally purchased the van for £18,000 and private use of it was 50%. The tax written down value of the van at 31 March 2023 was £5,000.

3) Irfaan received £1,200 when he scrapped old equipment.

Irfaan had previously claimed capital allowances in respect of all of these assets.

At 31 March 2023, the tax written down balance on the general pool was £9,000 and on the special rate pool was £900.

During 2023/24, Irfaan received bank interest of £1,215, dividends of £2,285 from personal investments and £2,000 from NS&I Premium Bonds. He also made a donation of £1,440 which qualifies for gift aid.

Irfaan made a tax adjusted trading loss of £15,000 in the year ending 31 March 2023. £3,000 of this loss was utilised in the year ending 31 March 2023. Irfaan intends to utilise the remaining loss at the earliest opportunity.

Requirement:

1) Calculate, with explanations, the capital allowances that Irfaan can claim for the period ended 31 March 2024. (8)

2) Calculate Irfaan's Income Tax and National Insurance liabilities for 2023/24. (7)

Total (15)