Institution **CIOT - ATT-CTA**
Course **CTA Adv Tech Owner-Managed Business**

Event **NA**

Exam Mode **OPEN LAPTOP + NETWORK**

Count(s)	Word(s)	Char(s)	Char(s) (WS)
Section 1	**876**	**3912**	**5285**
Section 2	**628**	**3212**	**4340**
Section 3	**1018**	**4641**	**5829**
Section 4	**721**	**3374**	**4169**
Section 5	**650**	**3089**	**3725**
Section 6	**246**	**1024**	**1246**
Total	**4139**	**19252**	**24594**

Answer-to-Question-_1_

1. Tax adjusted profits for YE 31 March 2021

Draft profits	19,000
Add: Depreciation (N1)	30,600
Leasing costs (N2)	540
Repairs to access road (N3)	-
Repairs to fence (N4)	6,500
Cottage costs (N5)	2,813
Lamb (N6)	100
Tax adjusted trading profit (pre capital allowances)	59,553

Notes

1. Depreciation on a finance lease is allowable.
36,000 - 5,400 = 30,600

2. Leasing costs

As the Co2 emissions exceed 110g/km, a 15% disallowance is applid to the the rental costs. No disallowance in respect of private use by employee. However, he may have a Benefit in Kind arising on the private use of the car.

3,600 x 15% = 540

3. Repairs are aallowable as a revenue expenditure.

4. As the fence was not in a usable condition in the trade, the repairs are classed as capital in order to bring the asset

into a usable condition and therefore are disallowed.

5. The costs of £4,000 in respect of the farm cottage used by the employee are allowable. However, the cost in respect of the private use of the cottage by the owner are disallowed.

75% x 3,750 = 2,813

6. Any goods such as lamb taken out of the business by the owner would need to be added back. As no adjustments appear to have been made to the acounts in respect of this drawing, the sellig price of £100 would need to be added back.

2. Capital allowances in respect of the YE 31 March 2021

|---------|---------|---------|---------|---------|---------|

18m period to 31 March 2021

		MP	SP	CAs
TWDV b/f		4,000	7,000	
ADD:				
Lightweight panels (N1)	4,000			
Solar panels (N3)	10,000			
Tractor (N4	60,000			
Less: insurance (N4)	(45,000)			
Deposit (N5)				
Water sytem (N7)	2,600			
Electrical instal (N8)	5,500			

Alteration (N10)	14,000			
Less: AIA (N11)	(51,100)			51,100
Add: Car (N2)		12,000		
Less:				
Scrap value		(6,000)		
		10,000	7,000	
WDA x 18% x 18/12		(2,700)		2,700
WDA x 6% x 18/12			(630)	630
SBA (N6,N8,N9)				277
Total CAs				54,707

Notes

1. The lightweight panels qualify as plant and machinery as item 13 from List C in respect of movable partition walls used in the trade. Hence AIA would be available as well as CA at 18%.

2. Assuming that the business is not VAT registered, the VAT inclusive price of the car can be considered when claiming capital allowances.

No disallowance in respect of the private use by the employee.

As less than 110g/km, the car qualifies for Capital allowances at 18% in the main pool. No AIA is available in respect of cars.

3. The solar panels qualify as integral features and therefore both AIA and/or CA at 6% are available.

In this case, AIA should be claimed in priority to WDA at 6%

to obtain all of the allowances at once.

4.The new tractor acquired from the brother needs to be added to the MP at cost of 60,000. However, insurance proceeds of £45,000 also need to be deducted along with the scrap value of £6,000 of the old tractor.

5. If a deposit is paid under a contract which provides that business will own the asset upon performance of the contract, the deposit can be included as qualifying expenditure for Capital Allowances. In this case, the deposit of £12,000 will be included in the Capital allowance compution and qualify for AIA.

As the repayments start after the end of the year, they would not be included in the computation for the YE 31 March 2021.

6. The drainage system is included in List A of s.21 CAA 2001 and therefore represents a part of a building and does not qualify for Capital Allowances. However, it should qualify for Structural Building Allowance at 3%

3% x 3,750 x 9/18 = 57

7. The provision of the cold water system qualifies as integral feature and therefore eligible for AIA as well as WDA at 6%.

8. In respect of the £45,000 costs included in the rennovation of the barn, these costs should qualify for SBA, noting that:

4,000 for the preparation of the land would be eligible for SBA.

1,500 for planning costs are not eligible for SBA. This represents a capital costs which would be added to base cost of the asset on a future sale.

5,500 for electrical systems do not qualify for SBA but qualify as integral features and therefore AIA and WDA at 6% can be claimed on them.

SBA = 45,000 - 1,500 - 5,500 = 38,000

38,000 x 3/18 x 3% = 190

9. The building of a new slury store would also qualify for SBA as it was built after 29 October 2018.

3,000 x 3% x 6/18 = 30

10. The planning costs regaring the alteration of walls would not qualify for CA, but the as per s.25 CAA2001, the alteration of a building for the purposes of installing plant and machinery qualifies for CA under AIA and WDA at 18%. The alteration occured prior to the ene dof the end of the year ended on 31 March 2021.

11. The standard AIA available in a year is £1m. In this case, as the period covers an 18m period, it would be extended to 1.5m which would be more than enough to cover all of the expenditure identified above.

--------------ANSWER-1-ABOVE---------------

--------------ANSWER-2-BELOW---------------

Answer-to-Question-_2_

|---------|---------|---------|---------|---------|---------|

Net Profit		99,150
Add:		
Depreciation	10,500	
Loss on sale of assets	5,200	
Depreciation (N1)	12,000	
Cheese (N7)	750	
Travel (N8)	4,350	
Legal fees (N9)	1,000	
Insurance (N9)	500	
Interest on CT and VAT(N10)	600	
	41,650	
Less:		
Loss on sale of asset	(5,200)	
Excess share of profit (N2)	(65,500)	
	(70,700)	
Tax adjusted profit before CA		70,100
Less: CAs (N14)		(50,160)
Trade profit		19,940
Other income:		
Interest on VAT (N10)		(500)

Taxable total profits	19,440
CT x 19%	3,694

The above CT liability needs to be paid before 1 October 2021.

Notes

1. Depreciation is disallowed when computing the taxable trading profits.

In respect of the depreciation included in stock, the add back is:

2,500 + 14,000 - 4,500 = 12,000

2. in respect of an LLP, irrespective of whether the company draws any income, it will be taxed on its share of the partnership profits. in respect of the YE 31 December 2021, it will be taxed on its profits realised as follows:

1 Jan 2020 - 31 March 2020 = 3/12 x 108,000 = 27,000
1 April 2020 - 31 December 2020 = 9/12 x 56,000 = 42,000
Taxable profits in YE 31 December 2020 = 69,000

Therefore, the excess of 65,500 between the amount currently shown of £134,500 and 69,000 needs to be disallowed.

3. Assuming that no improvements are made, the replacement of office kitchen should qualify as a revenue expenditure.

4. The painting of interior is allowed as revenue expenditure.

5. Assuming that the replacement of the air con does not constitute a technological advancement and therefore that the same quality of air con is used, it should qualify as revenue expenditure.

6.The general repairs would also qualify as a revenue expenditure.

7. The advertising costs of £4,000 qualify as revenue expenditure as they appear to have been incurred wholly and exclusively for the purposes of the trade, except for the free samples of cheese which represent food.

8. In respect of travel and entertainment, assuming that the corporate hospitality represents client entertainment is would be disallowed expenditure. I have assumed that the hospitaly does not qualify as adveritising. In this case the travelling with the client would also be disallowed.

Similarly the business lunches with clients would also be disallowed.

Staff travel to lunches would be allowed assuming that this represents staff entertaining.

The general business travel and subsitence would also be allowed asuming that wholly and exclusively for business purposes.

9. legal fees of £1,000 are disallowed as incurred for capital expenditure. Any interest payable on the business loan would be allowable.

£500 insurance would also be disallowed as not wholly and exclusively for the purposes of the trade.

10. Normally, interest payable in respect of late paid CT is allowable as Non-Trading Debit under loan relationship rules. However, as this relates to a prior period, it is not allowed in this case.

VAT interest is allowable as it covers the period ended on 31 December 2020.

11. Payment of employees' parking fine expenses is allowed for a company. However, a benefit in kind might arise to Dean.

12. A customer bad debt written off is allowed.

13. Assuming that the sundry office costs are wholly and exclusively for the purposes of the trade, they are allowable.

14. Capital allowances computation

YE 31 December 2020

		MP	SP	CA	
TWDV b/f		18,000	0		
Add:					
Steam machine	30,000				
Racking	3,550				
Cold store	14,000				
Less: AIA	(47,550)			47,550	

Less:		
Sale of old machine	(3,500)	
Total	14,500	
WDA x 18% x 12/12	2,610	2,610
Total		50,160

The cold store and installation work should qualify as an integral feature and therefore be eligible for AIA.

As the racking and sheling have a function of storing items, they should qualify as plant and machinery.

--------------ANSWER-2-ABOVE---------------

--------------ANSWER-3-BELOW---------------

Answer-to-Question-_3_

From a tax perspective, a purchase of own shares by a company would be classed as an income distribution unless the following conditions are met in which case the capital treatment applies:

- the repurchase if by an unquoted trading company who is not a 51% subsidiary of a quoted company;
- repurchase is wholly or mainly for the benefit of the trade
- the shares are bought back from a UK resident vendor who has held the shares for at least 5 years;
- the vendor as a result of the buy-back, reduces their interest in the company by at least 25%;
- the vendor is not connected with the company following the buy-back;

Taking each of the shareholders' situations in turn.

<u>Lesley Khan</u>

As the purpose is to realise some value rather than for the benefit of the company's trade, Lesley would not meet the second condition mentioned above and therefore the capital treatment would not apply on his proposed sale of 10 shares. In addition, on the basis that only 10 shares are sold and he would retain 70 (i.e. 51% of the company post sale) he would be deeemd to be conected with the company post sale.

In this case, the sale of the shares would be taxed as a distribution, except for a small capital repayment as follows:

Capital repayment
Subscription price: 10
Less: Cost
10 x 4,500 (45,000)
Capital loss 44,990

lesley would be able to relieve the above capital loss against other capital gains realised in the tax year.

In addition, a dividend distribution arises as follows:

10 x 18,000 - (10) = 17,990
17,990 x 38.1% = £6,854

Assuming that the buy-back occurs in the 2021/22 tax year, the above dividend liability would need to be paid to HMRC before 31 January 2023 when the self-assessment reutrn in respect of the above period would also be due.

Afan Khan

Even though following the sale of the 10 shares, Afan would only hold 10 shares, by virtue of him being Lesley’s husband and he would be deemed to be connected with Lesley. Therefore, following the sale of his shares he would be deemed to be connected with the company as holding more than 30% ownership in the business. Therefore, the sale would also be treated as dividend distribution.

On the receipt of its shares from his husband, this transfer would have been done on a nil gain nil loss basis and therefore Afan would have inherited a cost of £4,500 per shares. This means that the same tax implication arises to Afan as for Lesley and implicitly a tax liability of £6,854 is due to HMRC.

Gareth Ripley

In Gareth’s case, assuming that the reason is for Gareth to retire and for a new diretor to join the business (rather than for Gareth to tax efficiently extract funds from the company), the sale should qualify for the capital treatment. This is on the basis that Gareth has held the shares for more than five years and he will not be connected with the company (not holding any shares) post the sale.

The company also appears to have enough distributable reserves to make this payment. In addition, as the company’s principal trade is the manufacture and distribution of food, it should qualify as a trading business.

In this case, a capital gain would arise to Gareth as follows:

18,000 x 8	144,000
Less:	
8 x £1	(8)
Gain	143,992
AEA	(12,300)
Taxable gain	131,692

As Gareth has not been an employee/director of the business within the last two years, he would not qualify for Business Asset Disposal Relief. Hence, in this case, some of the gain would be taxed at 10% and some at 20% as follows:

26,000 - 12,500 = 13,500

(37,500 - 13,500) x 10%=	2,400
(131,692 - 24,000) x 20% =	21,538

Total CGT	23,938

The above CGT liability would need to be declared on Gareth's self-assessment return in respect of the tax year 2021/22 with the CGT due to HMRC before 31 January 2023.

Paula Andrews

In this case, Paula would also meet the necessary conditions for the capital treatment to apply. A dissenting shareholder clearly meets the necessary criteris for the disposal of its shares to qualify as for the benefit of the company's trade. Paula has also held her shares since 2007 which is more than 5 years while she will also not be connected with the company post sale since she is looking to sell all of her shares. As mentioned in Gareth's case, the company also meets the necessary conditions.

In Paula's case, as less than market value at the date of grant was paid for the shares when the EMi options were exercised, an Income Tax liability would have arisen on the difference between the market value at the date of grant and exercise price which would have been clased as employment income.

Employment income = 28 x (5000 - 2000) = 138,000

However, in respect of the purchase of own shares, the base cost is formed of both price paid by Paula (i.e. 2000 per share) plus the amount subject to income tax (3,000 per share). A gain arises as follows

18,000 x 28	504,000
Cost (28 x 2,000)	(56,000)
Amount subject to IT	

(28 x 3,000)	(84,000)
Gain	364,000
AEA	(12,300)
Taxable gain	351,700
CGT x 10%	35,170

Paula's gain would qualify for Business Asset Disposal Relief in full as Paula has been a director for more than two years and she has also held the options from which shares arose for more than two years. In addition, as the shares were acquired as part of an EMI option, the 5% requirement is relaxed. However, Paula's 28 shares entitle her to approximately 20.6% ownership in the business. She does not appear to have utilised any of the lifetime allowance of £1m so all of this amount should be available to her.

The above CGT liability would need to be declared on Paula's self-assessment return in respect of the tax year 2021/22 with the CGT due to HMRC before 31 January 2023.

--------------ANSWER-3-ABOVE---------------

--------------ANSWER-4-BELOW---------------

Answer-to-Question-_4_

Unless roll-over relief is claimed as explained below, the sale of the Old Foundry property will give rise to a chargeable gain and a CT liability as follows:

Proceds	1,100,000
Cost	(370,000)
Gain	730,000
CT x 19%	138,700

Similarly, the sale of the 11 Marston property would also give rise to a chargeable gain and a CT liability as follows:

Proceds	650,000
Cost	(410,000)
Gain	240,000
CT x 19%	45,600

However, on the sale of a qualifying asset and the replacement of it with another qualifying asset, a company can claim for roll-over relief to apply. If all of the proceeds from the sale of the old asset are reinvested into the new asset, the gain on the old asset is not charged but instead is deducted from the base cost of the new asset. Therefore there will be a bigger gain in the future when the new asset is sold.

However, the amount of chargeable gains that can be rollover is restricted where the a part of an asset has not been used for trading purposes throughout its ownership by its owner.

Hence, in respect of the Old Foundry property as the building was let for the first two years out of its 19.5 years of total ownership, the proportion of the gain that can be rolled over is 653,157 (730,000 x 17/19). The remaining amount of 76,843 remains taxable at 19% giving rise to a CT liabiity of £14,600. In addition, when assessing how much of the proceeds should have been reinvested, only the amount relating to the period of trading use should be considered i.e 984,210 (1,100,000x17/19).

Similarly, the amount of gain subject to roll-over relief in respect of the property at 11 Marston street would also be restricted since only 60% of the property has been used for trading purposes throughout its ownership. Therefore, only 60% of the gain (i.e. 144,000) can be subject to roll-over relief. The remaining amount of 96,000 remains taxable to CT at 19% giving rise to a CT liability of £18,240 payable to HMRC before 1 October 2021. The amount of proceeds assessable for rollover relief are 390,000 (650,000 x 60%).

In order for rollover relief to apply, the new assets need to be acquired in the period 12 months before to 36 months after the sale of the old asset. In this case, as all of the 3 assets are intended to be acquired before 31 December 2021, they would also meet this threshold.

However, as the parsons road property would not be immediately taken into the use of the trade but let for two years, this property would not qualify for rollover relief.

Contrary, as the property at 4 Dean Row would be used for trade as soon as all the necessary fitting are set, this property would qualify. However, as 20% of it would be used for non-trading puroses, the cost of this investment to be compared withe above proceeds needs to be adjusted to 1,300,000 (1,625,000 x

0.8).

The expenditure on Dire Avenue would also qualify for roll-over relief. However, this asset would represent a depreciation asset since it has a lifetime of less than 60 years. Hence, in this case, roll-over relief works differently in the sense that the gains arising on the sale of the two properties mentioned above would not be rollover into the cost of this lease. These gains would be frozen and would crystallise at the earliest of:

- the lease is sold;
- the property ceases to be used for trading purposes;
- 10 years from the acquisition of the lease;

Hence, the maximum amount of time for which the gains can be deferred is 10 years.

As the cumulating proceeds to be reinvested of 1,374,210(984,210 + 390,000) exceed the amount of qualifying proceeds of 1,300,000, an excess of £74,210 of proceeds arises. 65,000 of £74,210 should be reinvested into the lease on dire avenue property. Hence, only £9,210 of the proceeds would remain uninvested. Hence, in addition to the taxable gains mentioned above, another gain of £9,210 would also arise in respect of the proceeds not reinvested.

Rollover relief should be claimed before 31 December 2025, being 4 years from the later of accounting period of disposal of the assets and the accounting period in which the new assets are acquired.

--------------ANSWER-4-ABOVE---------------

--------------ANSWER-5-BELOW---------------

Answer-to-Question-_5_

Circumstances in which HMRC can make a discovery assessment

The first issue is whether an assessment can be raised as the window for enquiring into the 2018/19 Self-assessment return closed on 1 October 2020.

The inspector has powers to raise a discovery assessment if they discover than an under-assessment has been made, no assessment has been made or too much relief has been given provided that either:

- the loss of tax was the result of careless or deliberate behaviour by the taxpayer, or;
- HMRC could not have reasonably expected to have been aware that the assessment was insufficient on the basis of the information presented by the taxpayer in the SA return or related information;

The general rule is that the discovery assessment can be raised within 4 years from the end of the tax year in question (i.e. before 6 April 2023 in this case). However, if the first condition above applied then a valid assessment may be raised within 6 years from the end of the tax year in question to recover the tax due, i.e. on or before 6 April 2025 which appears to be the case here. Also, the deadline is extended to 20 years from the end of the tax year in question where the loss of tax is caused deliberately which does not appear to be the case here since there appears to be a misunderstanding about the complex tax treatment of an expense.

In respect of the second condition, the usual deadline is 12 months from the due date of the filing of the return. Considering the due date in this case of 31 January 2021, the deadline would be of 31 January 2022.

Careless behaviour is not defined but would include failure to take reasonable care when preparing and filing the tax return. On the information provided it seems that reasonable care was not taken to evaluate the proper tax treatment of the expenses reported in the 2019/20 tax return. If Jack has evidence to the contrary then an appeal may be made to vacate all or part of the assessment. This must be made within 30 days of the date of the issue of the assessment. An example of reasonable care would be if Jack received and followed advice from his accountant - based on the applicable tax treatment on the respective expenditure.

As the discovery assessment re-opens the 2018/19 tax year, Jack will be witin time to make any necessary amendments, by making an appeal against the amount of the assessment within 30 days of issue.

Penalties

The penalty notice has not yet been issued by HMRC. Jack’s compliance record and the background surrounding the under-asessment to Income Tax need to be considered in more detail. If the disclosure of the error was prompted by HMRC (as is the case here since HMRC opened the enquiry) and was due to careless (rather than deliberate) behaviour (which might be the case here since Jack failed to take advice from an accountant), the tax geared penalty might be 15-30% of the additional tax payable. Cooperation is advised in order to minimise the penalties.

If HMRC regards Jack’s behaviour as deliberate, then it may increase the penalty to 100% of the additional tax where there is concealment (minimum of 50%) or 70% if there is no concealment (minimum of 35%). It will be necessary to establish the facts surrounding the original disclosure of information when Jack originally replied to HMRC’s enquiry letter.

However, where it is a careless action which could be Jack’s case here, the penalty can be suspended for two years in which Jack will need to demonstrate that he is taking much more care when preparing his self-assessment tax returns.

Interest on overdue tax will accrue on underpaments of Income Tax and Class 4 National Insurance. Early settlement of the liabilities is recommended once the amounts are established.

--------------ANSWER-5-ABOVE---------------

--------------ANSWER-6-BELOW---------------

Answer-to-Question-_6_

1. Annual cost of providing the company car

BIK on car:

31,850 x 37% = 11,785

(150 - 75) /5 = 15
18% + 15% + 4% = 37%

Employer NIC on above BIK = 11,785 x 13.8% = 1,626

BIK on fuel:

24,500 x 37% = 9,065

Employer NIC on above BIk = 9,065 x 13.8% = 1,251

Therefore, total annual cost are:

1,626 + 1,251 + 5,050 + (410 x 12) = 12,847

However, the company could also obtain CT relief as follows:

1,626 +1,251 + 5,050 + [(410 - 50)x12x85%] + (50 x 12) = 12,199
12,199 x 19% = 2,318

Net annual cost to the company is:
12,847 - 2,318 = 10,529

2. Max additional salary

19% - 13.8% = 5.2%
10,529 x 105.2/100 = 11,077
11,077 x 13.8% = 1,529
CT relief = (11,077 + 1,529) x 19% = 2,395
11,077 + 1,529 - 2,395 = 10,211

3. Reimbursement of travel costs

As the new manager would need to travel to the Swansea office on a permanent basis rather than on a temporary basis (i.e. more than 24 months), the Swansea office would also qualify as a permanent workplace since this would be required in order for the manager to perform his duties.

Therefore, any travel expenses incurred by the manager in travelling between the two offices would be allowed. However, ordinary commuting such as travelling between home to work (i.e. either of the Cardiff or Swansea office) would be disallowed.