

(Ensure this number matches your candidate number on your desk label and on your candidate attendance letter)



**Chartered
Institute of
Taxation**

Excellence in Taxation

(am)

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 Date of Examination

Tick box if you have answered in accordance with Scots Law

Tick box if you have answered in accordance with Northern Ireland Law

Please tick which Advisory Paper you have attempted (if not already ticked below)

Taxation of Owner-Managed Businesses

Taxation of Individuals

VAT on UK Domestic Transactions, IPT & SDLT

VAT on Cross-Border Transactions & Customs Duties

Inheritance Tax, Trusts & Estates

Advanced Corporation Tax

Human Capital Taxes

Please tick here if you have used an extra answer booklet (ensure you attach your second answer booklet to the first using a treasury tag which will be provided).

Advisory

You must ensure that the Advisory Papers chosen are not the same as the corresponding Awareness Modules you have sat or will be sitting.

- For those candidates on the Indirect Tax Route you must sit the VAT on UK Domestic Transactions, IPT & SDLT Advisory Paper.
- For those candidates on the Indirect Tax Route you must sit the VAT on Cross-Border Transactions & Customs Duties Advisory Paper.

Instructions

Your script will be scanned electronically. Failure to comply with these instructions may lead to your script not being marked. You must:

- Complete the details on this page and in the booklet using BLACK or BLUE ballpoint pen only.
- Write on both sides of the page.
- Not write in the margin areas indicated.
- Start a new page for each question you answer and indicate the question number in the box provided at the top of each page.
- Not remove any pages from this answer booklet or damage it in any way.

Please do all of the above before the end of the examination.

For use by examiner only

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1) Taxable profits 31 March 2017:

Alex Barlow

£

Net profit 153,000

Add: depreciation - other fixed assets 22,000

new shed (capital) 6,000

running costs - transit (5,000 x 15%) 750

hilux (4,000 x 15%) 600

private use - audi (3,000 x 50%) 1,500

legal - pension scheme (capital) 2,750

farm land (capital) 5,000

general provision (NI) 5,000

interest 60,000

Less: profit on sale (2,500)

capital allowances (N2) (25,000)

Taxable trading profit 229,100

Interest - non trade loan relationship (60,000)

Total taxable profits 169,100

Allocated to Alex. - 50% 84,550

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	(N1) Provisions are only allowable if there is a present obligation from a past event. As no actual legal fees have arisen there is no obligation and therefore the provision is disallowed	
	Main pool	
	TWDV b/f.	60,889
	Additions	95,000
	Disposals	(17,000)
	New shed addition	<u> </u>
		138,889
	WDA @ 18%	(25,000)
	TWDV c/f	113,889
	New shed - assume not moveable and therefore non-qualifying	
	No AIA available as mixed partnership	

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This is because Alex owns Bartow Ltd so the conditions for the individual partner being able to 'enjoy' the corporate partner's profit share will apply.

As Bartow Ltd provides no services to the partnership, the profits that it is entitled to are restricted to its return on capital being £40,000.

The remaining share of the company's profits (being 50% of £167,600 less £40,000) of £43,800 will be taxed on Alex.

This is on the assumption that the partnership has been set up this way with the main purpose, or one of the main purposes, to be to minimise the overall tax liability.

The profit share of £43,800 will remain in the company.

Note - no private use adjustment on the Audi in calculating the company's profit share.

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$$\begin{aligned} \text{Alex's total profit share} &= \text{£}84,550 + \text{£}43,800 \\ &= \text{£}128,350 \end{aligned}$$

$$\text{Bartow's profit share} = \text{£}40,000$$

2) Alex's liability

	£
Profit share	128,350
Personal allowance (NI)	-
Taxable profit	128,350

32,000 @ 20%	6,400
96,350 @ 40%	<u>38,540</u>
	44,940

NIC:

Class 2 - 52 x 2.80	146
Class 4 - (43,000 - 8,060) x 9%	4,595
(128,350 - 43,000) x 2%	<u>1,707</u>
	6,448

Total	51,388
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(NI) The personal allowance is reduced by £1 for every £2 of income over £100,000 so Alex is not entitled to any allowance.

As Alex has already made payments totalling £55,000 he will not have a liability to pay on 31 January 2018. He can claim a repayment of £3,612.

3) The profits should be on a time apportioned basis so the amount included for 31 December 2016 is:

$$9/12 \text{ m} \times 40,000 = £30,000$$

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Spitklean capital allowances				
	£	£	£	£
	Main pool	SRP	FYA	Allowances
TWDV b/f	80,000	250,000		
Additions - solar panels			30,000	
- installation (IF)		6,500		
- boiler			10,000	
- s198 election	1	1		
- moulding	40,000			
- granulator	40,000			
- moulds	9,000			
- assembly	60,000			
- BMW		30,000		
- Porsche			65,000	
	<u>229,001</u>	<u>286,501</u>	<u>105,000</u>	
WDA @ 18%	(41,220)			41,220
WDA @ 8%		(22,920)		22,920
FYA @ 100%			(105,000)	105,000
	<u>187,781</u>	<u>263,581</u>	-	<u>169,140</u>
TWDV c/f				

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Notes

The expenditure on the property, SDLT, legal fees and roof all class as buildings and are therefore non-qualifying for capital allowances under s21 CAA2001.

The internal corridors and rooms are also building costs, assuming they are fixed rooms and do not include expenditure on moveable partitions or similar

The painting and decorating costs are revenue costs and should be deducted from the company's trading profits.

The site management costs could be pro-rata against the rest of the expenditure ~~over that~~ and treated the same as that expenditure, i.e. the amount of costs allocated to the installation of the solar panels would qualify for F4A. However, no indication has been given as to how the costs should be split so it would be prudent to treat them as non-qualifying.

No capital allowances can be claimed for the fixtures included in the warehouse as the s198 election has fixed the amount at £1 for each pool. In order to claim on the full £100,000 a s198 election would have had to have been agreed for this amount.

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The grant of £40,000 has been set against the machinery it was used for so the addition for the granulator is only £40,000, rather than the full cost of £80,000.

Only the deposit for the assembly line has been brought in as an addition as the machinery has not been brought into use. If it had been used within the year the full amount could have been brought in as the final payment is due less than 4 months after the obligation to pay.

The BMW car only attract allowances at 8% as it has emissions over 130g/km. The Porsche car have FYA of 100% as it has emissions not more than 75g/km.

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Retro Limited

The company began trading on 1 January 2017 and that causes a new accounting period to begin, so ~~the~~ tax returns will have to be prepared for:

1 July 2016 - 31 Dec 2016
1 January 2017 - 30 June 2017

31 December 2016.

	£
Net profit before tax	34,000
Less: dividends received	(8,000)
rental income	(25,000)
interest	(1,000)
Trading profit	-
Rental income	25,000
Non-trade loan relationships	1,000
Total taxable profits	26,000

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30 June 2017			
			£
	Net profit before tax		138,000
	Less: dividends received		(2,000)
	profit on sale		(16,000)
	capital allowances (w1)		(104,500)
	Add back: depreciation		10,000
	investment management remuneration		1,500
	Trading profit		27,000
	Mgmt expenses		(1,500)
	Total taxable profits		25,500
		£	£
(w1)		Pool	AIA
	TWDV b/f	-	
	Additions - shelving		100,000
	- plant	25,000	
		25,000	100,000
	WDA @ 18%	(4,500)	4,500
	AIA @ 100%		(100,000)
	TWDV c/f	20,500	
			104,500

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Notes

- Dividends received are not taxable
- Overdraft fees, including personal guarantees, are allowable as costs of loan finance under s58 ITTOIA 2005
- The £1,500 remuneration for managing the investments is not deductible against the trading profits as it is not wholly and exclusively for the trade. However, they will be allowable as a management expense.
- The shelving systems are treated as being incurred on the first day of trade, under s12 GA 2001. AIA is only available up to £100,000 as it is only a six month period so it is pro-rata. The AIA wouldn't be available for the warehouse assets anyway as they are not being purchased new, they are being transferred into the trade.

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The excess management expenses brought forward are treated as though incurred in the period, so they can be offset against the profit in 31 Dec 16.

2) CT liabilities:

		£
31 Dec 2016 :	Taxable profits	26,000
	Mgmt expenses	<u>(12,000)</u>
		14,000
	14m @ 19% CT @ 20%	<u>£2,800</u>

Due 1 Oct 2017

		£
30 June 2017 :	Taxable profits	25,500
	3m CT @ 20%	2,550
	3m CT @ 19%	<u>2,423</u>
		£4,973

Due 1 April 2018.

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Firm address

Ms M Rossi

Bellissimo Ltd

Client address

November 2017

Dear Maria

Following our recent conversation I have set out below the Capital Gains Tax consequences of the proposed sale for you and Alan.

Sale of shares

The sale of the shares will result in a chargeable gain for both you and Alan.

As you and your father previously entered into a hold-over election, the base cost of your shares will be £900.

This means you will have a gain of £4,499,100 (being £4,500,000 proceeds less £900).

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This would normally be subject to capital gains tax at 20% as you are a higher rate taxpayer.

However, you should be able to claim Entrepreneur's Relief^(“ER”) on the gain, meaning it will only be taxed at 10%.

The requirements of ER are as follows:

- it must be a material disposal of business assets
- If shares, the company must be the individual's personal trading company and the individual is an officer or employee.
- This must be the case for at least 12m prior to the disposal.

You appear to meet these requirements.

The base cost of Alan's shares will ^{be} the price he paid for them in December 2016. This will be set against his proceeds of £500,000.

Alan will not be able to claim ER as he is not an officer or employee so his gain will be taxed at 20%.

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given he is a higher rate taxpayer.

Alan will be able to use his annual exemption of £11,100 against some of the gain if he has not made any other gains in the tax year.

Sale of property

If Bellissimo is granted the five-year lease and then acquires the freehold in December 2022 this will give rise to a chargeable gain for you in 2022.

The proceeds will be equal to the market value of the property in 2022.

It is possible to claim ER on disposals of a business asset when it is associated with a material disposal of shares but one of the conditions is that the asset must be disposed of within three years of the share disposal. This will not be met if you sell the property in 2022 so no ER will be available.

The gain will be charged at 20%, assuming you

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are still a higher rate taxpayer.

If you were to grant, say a three year lease to the company and sell the property within the three year time limit above then this may save you tax ~~as your capital gain should be taxed at 10%~~ as you can claim ER.

However, if you do this the ER will still be restricted as you have charged, and will charge market value rent for the property. This limits the ER such that it is only available for the proportion of your ownership period in which you didn't charge rent.

I hope the above is helpful, please let me know if I can help further.

Yours sincerely

Tax Adviser

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		Firm address
	Mr Morse	
	Builders R Us	
	Client address	
	November 2017	
	Dear Mr Morse.	
	Further to your recent letter I have set out below some further information regarding HMRC's discovery assessment and the recommended next steps.	
	Discovery assessments	
	Firstly, you are correct in thinking that, under normal circumstances, HMRC can only enquire into a return up to 12 months after it was filed (assuming it was filed on time) and so this window has closed for your 2013/14 return.	
	However, it is possible for HMRC to open a discovery assessment after this time if one of the following scenarios apply:	

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- 1) The loss of tax resulting from the assessment in question was brought about carelessly or deliberately
- 2) The HMRC officer could not have reasonably been expected to ~~know~~ be aware of the situation before the end of the normal enquiry window.

The time limit for making a discovery assessment is at least six years.

As most of the information that HMRC seem to be referring to in their letter appears to have been taken from your 2015/16 tax return, which they would not have had before the 2013/14 enquiry window closed, it seems they are reasonable in opening a discovery assessment.

As you did not include any additional information in your 2013/14 return this also backs up their position.

You have 30 days from the date of HMRC's letter to appeal against their decision, which must be done in writing.

Trading transaction

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The inspector is saying ~~that~~ in his letter that he thinks the sale of Station Road is a trading transaction, whereas you have treated it as a capital transaction.

In order to determine whether a transaction is trading or not we need to look at the 'badges of trade' as no definition is given within the tax legislation.

No one badge of trade is conclusive but we have to look at the full picture. The badges include:

Subject matter

~~Profit motive~~ - what was the reason for purchasing the asset in the first place, what was its intended use?

If you purposefully bought the property with an aim to 'doing it up' and selling it then this would point to a property development trade.

Frequency - how often were similar transactions undertaken?

As you have not renovated or sold any further properties

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this would indicate there is no property trade.

Improvements - has any work been performed on the asset to make it more attractive to buyers.

The repairs you carried out appear to be minimal at £5,000.

Ownership period - you only owned the property for four months so this implies it was a trading transaction.

Finance - as the company had to raise an overdraft to fund the property purchase this would indicate that it was meant to be a short-term purchase as having an overdraft is not sustainable long-term.

The same badges must also be looked at with regards to Winston Road as well.

I think it is worth having a further conversation regarding the sale of the properties to determine whether they should be treated as trading or capital based on

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The above badges.

It is worth noting that if any further tax is applied due to HMRC's proposed changes, you will be liable to penalties on the 'potential lost revenue' which could be up to 100% of the additional tax if HMRC think it is concealed and deliberate.

You can help minimise any such penalties by offering full disclosure to HMRC now.

Yours sincerely

Tax Advisor.

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firm address

Ms Barnes

Lothian Engineering Ltd

Chief address

November 2017

Dear Sally

Thank you for your recent phonecall. I have set out below some more information regarding the potential awarding of shares to your management team.

Share schemes

One way to incentivise your team would be to grant them share options to the company.

Options give them the right to purchase shares at a later date (known as exercising the option) at a price that is fixed now.

If you only want the managers who remain at the

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company to benefit this is useful as ~~they~~ you can stipulate that the shares can only be exercised after a certain time, five years for example.

There are a couple of share schemes that would allow the employees to purchase the shares, and then sell them, in a tax efficient way.

The first is known as a CSOP scheme. This allows you to grant a maximum of £30,000 of shares to an ~~employee~~ individual who is a full time director or an employee.

You will grant an option for the shares so the individual is able to exercise that at a later date. The price of the option cannot be less than the current market value.

There is no tax implication for the company or the individual on the grant of the option.

If the individual exercises their option between three and ten years after the grant then there is no

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income tax implications for them.

A capital gain will arise on the sale of the shares; equal to the proceeds received less the ~~market value~~ amount paid.

When exercised, the company will be able to take a deduction equal to the market value at exercise less the amount paid by the employee.

If the option is exercised outside the time limits mentioned above, an income tax charge will arise equal to the market value less amount paid.

The amount will also be subject to National Insurance Cont. if arrangements are in place to sell the shares at that time as they will be treated as readily convertible assets.

The second tax efficient share scheme is the EMI scheme.

Under this scheme you can grant up to £250,000 of shares per individual (including and CSOP shares).

~~EMI options will attract~~ Again, there is no income tax consequences of granting the option.

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There will only be an income tax charge at exercise if the option was granted at a discount on market value or the exercise took place more than 10 years after the grant.

A corporation tax deduction will be available for the company equal to the market value at exercise less amount paid.

It is worth noting that the individuals may be able to claim Entrepreneurs Relief on the sale of EMI shares.

If the company does not qualify for the CSOP or EMI schemes, it can still grant options to its employees, they just won't receive the tax advantages set out above.

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