THE CHARTERED INSTITUTE OF TAXATION

APPLICATION AND PROFESSIONAL SKILLS

Taxation of Owner-Managed Businesses

May 2025

TIME ALLOWED

3 HOURS 30 MINUTES

- In order to secure a pass in this exam, you will be required to demonstrate competence in each of three skills.

  You will be assessed across your answer as a whole for Structure. A pass or fail grade will be awarded.

  You will be assessed for competence in a number of broad topics for the following skills:
    - Identification and Application
    - Relevant Advice and Substantiated Conclusions

  For each topic for each of these two skills, a grade will be awarded. The grades for those topics will be weighted and averaged to produce a final grade for each skill of 0, 1, 2, 3 or 4. A grade of 3 or 4 is required to demonstrate competence.

- 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 required by the question, candidates may answer the question using Scottish Income Tax rates or Income Tax rates applying elsewhere in the UK.

- Unless otherwise indicated by the provision of additional information in the question, you may assume that 2024/25 legislation (including rates and allowances) continues to apply for 2025/26 and future years. 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.

You are a tax manager employed by Askbridge, a firm of Chartered Accountants, where you work for Nicola Askbridge.

Nicola has recently met with John and Margaret Austin (**EXHIBIT A**), who own a farm, which they operate as a partnership. They have been clients of Askbridge for many years. The farm includes a farmhouse and a number of outbuildings and barns.

John and Margaret are planning for the future of the farm, including potentially developing one of the outbuildings for other uses and bringing their son Fred into the partnership.

It was agreed that Nicola would draft a report to John and Margaret advising on their plans.

The following exhibits are provided to assist you:

EXHIBIT A: Notes of a meeting between Nicola Askbridge, John and Margaret Austin

EXHIBIT B: Pre-seen information

Requirement:

Prepare a draft report for review by Nicola, providing advice and recommendations to John and Margaret on Fred's admission into the partnership and the development of the outbuilding and its potential transfer to Fred.

Continued

EXHIBIT A

Notes of a meeting between Nicola Askbridge and John and Margaret Austin

Date: 1 May 2025

Present: Nicola Askbridge, John and Margaret Austin

Subject: Future planning for the farm

John and Margaret explained that they have managed to operate their farm for many years with one full-time employee (George), who earns £24,000 per annum. Their son (Fred) helps out weekends, without payment. George has decided that he wants to retire at the end of June 2026. As John and Margaret are both in their fifties, they are considering how they will manage in the future.

Fred is their only son. He is aged 24 and has a building business which he operates as a sole trader. He has a turnover of around £60,000 per annum and a taxable profit of around £25,000. He has no employees and uses subcontractors where he doesn't have the necessary skills. He is not registered for VAT. He is single and lives in a rented home.

Fred is keen to become more involved in the farm and John and Margaret want to bring him into the business from 1 July 2025, so they can reduce their own involvement. For the first year, he will spend about eight hours a week working on the farm. From April 2026, he will reduce his building business to two days per week and split the rest of his time equally between the farm and developing one of the outbuildings (see below).

John and Margaret wish to continue with their existing partnership structure.

The profits are currently divided equally between John and Margaret and they are unsure of how Fred could be more involved in the business. They are considering either employing Fred on a salary of £25,000 per annum or making him a partner with a 25% share of the partnership profits or losses. Under either approach, the remaining balance of profits/losses would then be shared equally between John and Margaret. They are not expecting a capital contribution from Fred.

The farm partnership has been run successfully for many years making up accounts to 31 March and John and Margaret have been subject to higher rates of Income Tax for several years up to and including 2023/24. Based on the management accounts for the year to 31 March 2025, the taxable profit for the year will be around £80,000. They think that for the year to 31 March 2026, the taxable profit will be about the same, although they may incur some capital expenditure.

Fred is keen to develop an outbuilding on the farm. This is currently being used as storage for farm machinery. Fred thinks that the building could be emptied and then he would like to convert it into a residential building. Once completed, it would be rented out. It is estimated that it would generate a rental income of around £30,000 per annum, before expenses. The building currently has a value of about £50,000. Once planning permission has been given, the value will increase to approximately £150,000. The building work to convert would cost £200,000 at which point it would be worth £500,000. The funds to cover the conversion costs would come from the sale of a field owned by John in his own name, which he inherited from his mother. This would realise £250,000. The field is currently used by the partnership for grazing farm animals. No rent is charged by John to the partnership.

John and Margaret are wondering when to transfer the outbuilding to Fred. They are happy to either gift the building immediately, wait until the building is converted or leave it as part of the farm to Fred in their wills. They estimate the current total value of the partnership farm buildings, including the outbuilding to be approximately £1,950,000.

They also mentioned that although Fred's building business has been doing well for the last few years, when he first started out, he made some bad decisions which resulted in a couple of large losses.

Continued

EXHIBIT B

Pre-seen information

Client names

John Austin
Margaret Austin

Client address

Low Beck Farm
Anytown
Cumbria

Client background

John was born on 17 April 1970 and Margaret was born on 10 May 1972.

They married on 26 September 1998.

They have one son, Fred Austin, born 1 June 2000. Fred is single and lives in a rented home. He has his own sole trade building business and is not a client.

All are UK resident and domiciled.

John and Margaret are trading in partnership as Low Beck Farm.

The farm is a 400 acre arable farm. John and Margaret have lived in the Low Beck farmhouse since their marriage. There are various outbuildings used for storage.

John inherited Low Beck Farm from his father on his death on 26 June 1999 and started farming it as a sole trader. Margaret was made an equal partner on 1 August 2000. There is no formal partnership agreement and all profits/losses are shared equally. All the assets inherited from John's father are on the farm balance sheet at their probate value.

John also inherited a field from his mother on her death on 27 July 2000 with a probate value of £100,000. He continues to own this in his own name outside the partnership. The field is used by the partnership, but no rent is charged by John.

Capital Gains

Losses brought forward – nil.

Previous claims for business asset disposal relief – nil.

VAT

Registration date 26 June 1999.
Registration number 987 6543 21.
Registered entity John and Margaret Austin.

Wills

John and Margaret have wills that mirror each other leaving all their assets to each other and then to Fred on the second death.

Inheritance Tax

Gifts in the last seven years – none.

Other information

Neither John nor Margaret have any other taxable income nor any other assets. No previous gifts have been made by either John or Margaret.

Continued

Summary of profit and loss account	Year ended 31 March	
	2024	2023
	£	£
Turnover	656,000	523,000
Cost of sales	(178,000)	(139,000)
Gross profit	478,000	384,000
Administrative expenses	(334,000)	(265,000)
Profit for the year	£144,000	£119,000

Balance Sheet	As at 31 March	
	2024	2023
Fixed assets:	£	£
Land and buildings	1,200,000	1,200,000
Plant and machinery	182,000	216,000
	1,382,000	1,416,000
Current assets (stock/debtors/cash)	123,000	154,000
Current liabilities	(148,000)	(162,000)
Net assets	£1,357,000	£1,408,000
Partners capital and current accounts (joint)	£1,357,000	£1,408,000