Application and Interaction

Chartered Institute of Taxation
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Date of Examination

☐ Tick box if you have answered in accordance with Scots Law
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Instructions

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

(a) Complete the details on this page and on the answer pages using BLACK or BLUE ballpoint pen only.

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

	Tick question attempted	For use by examiner only
1		
2		
3		
4		
5		

FORMAT & STYLE OF ANSWER	MAXIMUM MARKS	MARKS AWARDED
The answer is set out in the format demanded. Thus, if it is a letter, it will be properly set out as a letter with addresses, date, "Dear X" and conclude "Yours sincerely" etc. If it is a report, it will give some indication as to what it is about and who it is for.	1	
The report or letter should contain an introduction setting out the terms of reference, information being relied on etc. It should also contain a summary of the key findings and recommendations.	2	
The body of the letter or report should be laid out in a clear way with appropriate headings so that the reader can navigate around it easily and spot the key areas without reading the entire document to try to find a discussion of, for example, income tax on some employment related shares.	1	
The answer "flows" so that a logical chain of thought presented to the reader rather than a series of random comments (which may nevertheless be technically correct).	1	
The style of writing should be appropriate to what is being produced. For example, a report to a client or lay person (which will always be the main element of a question) should not contain large numbers of legislative references whereas a technical note to the tax partner should. Technical advice should be conveyed in style appropriate to the reader.	2	
RELEVANCE OF ANSWER		
The answer does not contain large amounts of irrelevant material which would only serve to confuse a client.	2	
Technical knowledge (which will be rewarded through the technical marks and should not affect the awarding of these marks) has been directly applied to the specific circumstances of the reader and has this resulted in an answer tailored to their circumstances.	3	
The question(s) posed has/have been answered.	2	
PROVISION OF ADVICE		
The report gives advice. This means that where possible it should come off the fence and suggest the best option rather than simply giving a list of unweighted possibilities which fail to give the client an answer to their real problem: what should I do?	4	
Advice should include relevant and appropriate planning for the future.	2	
Advice should be commercial. This means that candidates should consider the bigger picture rather than narrowly focussing on saving tax.	2	
TOTAL HIGHER SKILLS AND PRESENTATIONAL MARKS	22	

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Report

Covering the tax implications of the transactions mentioned in your letter of 22 April 2017.

For: The partners of Masie's Restuarant

By: Bowham on Sea Tax Consultancy

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Introduction

This report is for the partners of Masies Restuarant, covering the tax implications of the matters mentioned in your letter of 22 April 2017.

This report is intended for use by you only and we ~~except~~ accept no responsibility for who ever else may rely on it.

Please note the following abbreviations:

IT - income tax
NIC - National Insurance Contributions
CGT - Capital Gains Tax
ER - Entrepreneurs Relief
CAs - Capital allowances

If you have any queries once you have read this report please let me know, I would be happy to meet with you

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Part 1 – Closing position for Aaron ("AA")

As AA is ceasing to trade, he will be taxed using the closing year rules in the year of cessation, being 2016/17.

Under the closing year rules, any profit not taxed from the closing date of the last basis period (31.10.15), to the date of cessation (31.03.17) is taxed in the year of cessation. This profit can be reduced by any available overlap profits, I have calculated AA's overlap profits at Appendix 1.

Therefore, AA will be taxed on his share of profits arising in the 2016 and 2017 accounting periods. The profit adjustments and allocations for these periods are at appendices 2 and 3 respectively, with the CAs computation at appendix 4.

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You will note that no CA's are available for Davina's car as it is used solely for private purposes.

Some other points to note from the profit adjustments are that the legal provision has been added back to reflect the actual amount that is likely to be paid.

Staff entertaining is allowable but expenses incurred in relation to third party entertaining have been added back. As ~~those~~ has the private use element of the motor expenses.

AA's 2016/17 tax computation is at Appendix 5, for the purposes of this computation I have assumed that the payments on account due 31 January and 31 July 2016 have been made.

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I have also assumed that a claim will be made to reduce 2017/18 payments on account to ~~A~~ nil as his income will now be taxed at source.

You will note that a CGT liability arises on AA'S exit from the partnership, I have calculated this position at appendix 6.

AA will have been paying class 2 NIC at a rate of £2.80 per week. He should inform HMRC that he has ceased to trade so that they stop expecting this.

AA'S 2016/17 tax payment will be due by 31 January 2018.

AA being able to keep his car will have no CGT consequences. A balancing allowance will arise in the CA comp based on it's market value.

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You will note that when there is a change in the profit sharing ratio, the profits for the year are apportioned and allocated in relation to whether they arose before or after the change.

The repayment of AA'S current/capital account balances will not give rise to a tax charge.

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Part 2 - Disposal of current property

When a partnership disposes of an asset, each partner is deemed to dispose of their fractional share in that asset.

However, that is also the case when there is a revaluation of an asset that preceeds a change in capital profit sharing ratio.

When AA leaves the partnership he is also deemed to have disposed of his interest, ~~[illegible]~~ the deemed proceeds are his share of the balance sheet value. At this point Bill and Chloe are deemed to acquire and additional share for a corresponding value.

When Davina joins she acquires a share in the property, Bill and Chloe are each therefore deemed to dispose of a 10% interest at this point, again the balance sheet

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value is the proceeds.

To calculate the gain on the property we need to ensure that all of these transactions are followed through so the correct base costs are allocated.

I have done this at appendix 7 and you will see that a chargeable gain arises on its disposal. Davina's gain will be covered by her annual exemption.

For Bill and Chloe the gain after annual exemption will be taxed at 10% to the extent you have basic rate band remaining, with the balance at 20%. If the restuarant was being sold as a going concern then ER would be available on the gain and it would be taxed in full at 10%.

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When Davina joins the partnership she is also deemed to acquire a share of the goodwill for it's balance sheet value.

This means Bill and Chloe are deemed to dispose of a corresponding amount. Bill and Chloe will have a base cost equal to the balance sheet value that they acquired from AA. ER will be available on these chargeable gains. Any payments made outside of the accounts will need to be brought into the CGT Comp as additional proceeds.

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Part 3 - Purchase of new property

When you purchase this property you will incur a Stamp Duty Land Tax liability of £2000. That is assuming a purchase price of £250 000.

The SDLT inclusive price of £252,000 will be your base cost for CGT purposes.

Rollover relief

When a trader sells a qualifying asset (such as land and buildings) and replaces it in the period beginning 12 months before and ending 36 months after, a claim can be made to defer any capital gains ~~tax~~ arising.

Each partner is free to claim relief or not for their gain, Davina would be advised not to as she can ~~set~~ cover her gain with her annual exemption.

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The relief works by rolling the arising gain against the base cost of the replacement asset. The gain therefore does not become chargeable until the replacement asset is sold.

Refurbishment works

The roof and chimney repairs are reflected in the purchase price of the property and are therefore capital in nature. These costs will increase the base cost of the building carried forward for CGT purposes.

Including these costs, the total proceeds recieved from the sale of the current property will have been re-invested, meaning that the entire gain can be rolled over so no CGT liability will arise for any partner if you make this election. The election must be made within 4 years of the end of the tax year of the disposal.

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The internal alterations will also be a capital expense, I assume the wooden panels will be stuck to the floor in which case they won't be eligible for CA'S. If this is not the case please let me know and I will evaluate the position.

The building alterations to facilitate the installation of ~~a~~ kitchen equipment will attract capital allowances in the main pool. I have calculated the available CA'S on the refurbishment works at appendix 8.

Re-wiring the property will also qualify for capital allowances in the special rate pool as an integral feature (?) the specialist cable will be eligible for the main pool.

The supply and installation of the heating system and sanitary ware will also qualify for capital allowances in the special rate pool. ~~as integral~~

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The decoration costs are revenue expenses and will be deductible in full against profit for the period.

Capital allowances will also be available on the other expenditure incurred. The kitchen equipment and furniture will attract CA'S in the main pool.

Artwork generally is not an eligible addition for CA'S. However, where ~~it is provided~~ decorative ~~to~~ assets are provided for the enjoyment of the public in a restuarant trade capital allowances will be available. The £5,000 spent on artwork will fit this definition.

Because the pooling requirement has not been met, you will not be able to claim CA'S on any fixtures that are purchased with the building, for example a cold water system.

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The business is making taxable supplies (mainly zero rated) for VAT purposes well in excess of the registration threshold and should therefore already be VAT registered. As VAT can therefore be recovered, it is the VAT exclusive amount that goes into the CA comp.

If you do dispose of any equipment with your current property, any proceeds you receive will give rise to a balancing charge. This is because there is no balance on the general pool due to the availability of the AIA (annual investment allowance). Any balancing charges will reduce the total CA's that can be deducted from profits.

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Part 4 - Other matters

General

A temporary break in business while the property is being refurbished does not constitute a cessation of trade.

Selling an interest ~~[illegible]~~ in a partnership is a qualifying disposal providing the asset is trading (which yours is), the seller has a material interest (which you all do) and the interest has been held for at least 12 months.

Personal Liability

~~[illegible]~~ AA will not be responsible for any liabilities arising after he departs. In the same way Davina will not be responsible for liabilities arising before she joined, for example the compensation payment for the food poisoning.

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If you wish to limit personal liability going forward you should consider trading as a Limited Liability Partnership (LLP), ~~this way you will the~~

This way your liabilities will be limited to your contributions to the LLP and you will still have the simplicity of drawing funds when you require and trading as a partnership.

Where an LLP has a member who gets a fixed profit share, there are anti avoidance provisions which could result in the profit share being taxed as salary, and therefore subject to PAYE and employers NIC.
If you would consider trading as an LLP please let me know and I can review Davina's arrangement in detail.

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to discuss.

Executive Summary

- Aaron is ceasing to trade and will be taxed on the closing years rules in 2016/17.
- Aaron will need to make a payment of £18,203 to HMRC by 31 January 2018.
- Aaron leaving and Davina joining are both events for CGT purposes.
- Disposal of the current property will also give rise to a capital gain. Bill and Chloe should claim rollover relief on this.
- Relief is available for refurbishment expenses as CA'S.

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Appendix 1

Aaron Aries - Overlap profits

Commenced 1 January 2012

Tax year 2011/12:

Taxed on 3months profit from date trade started; $3/12 \times (1/3 \times 23400) = 1950$

Tax year 2012/13:

Taxed on profits for first 12 months of trading:

9 m to 31 Oct 2012 = 23400

3/12 × profit to 31 Oct 2013 = 8925 (1/3 = 2975)

32325

1/3 Share = 10775

Tax year 13/14:

Taxed on 1/3 of profits to 31.10.13

Overlap profits: 1950 + 2975 = 4925 (6months)

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Appendix 2

31/10/16

Profit per the accounts	105050
+ Partners Salary (£1000 x 9)	9000
+ Depriciation	6500
+ Overstated provision	7500
+ Third party entertaining (1450-600)	850
+ Motor expenses (5800 x 80%)	4640
- Capital allowances	(432)
Adjusted profit	133108

Allocation

1 November 2015 to 31 January 2016 (3months):

	AA	BB	CC	Total
3months profit	11092	11092	11093	33277

1 February 2016 to 31 October 2016 (9months):

	AA	BB	CC	Total
9m profit				99831
Salary	9000			(9000)
	30277	30277	30277	90831
Profit for period	39277	30277	30277	
Total profit for year to 31.10.16	50369	41369	41370	

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Appendix 3

Year to 31.10.17

Profit per accounts	88650
+ Partners Salary (5x1000)	5000
+ Depriciation	5500
+ Motor expenses	1517
(5900x80%)	4720
- Capital allowances	(516)
Adjusted profit	104871

Allocation:

1 November 2016 to 31 March 2017 (5months):

	AA	BB	CC	Total
5 months profit				43696
Salary	{5000}			(5000)
	12898	12899	12899	38696
	17898	12899	12899	

1 April 2017 to 31 October 2017:

	BB	CC	DD	Total
				61175
fixed 20%	12235			(12235)
		24470	24470	48940
Total for year	12235	37369	37369	

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Appendix 4

Capital Allowances

31/10/16:	AA Car	BB Car	CC Car
B/f	4000	4000	4000
WDA @ 18% =	(720)	(720)	(720)
C/f	3280	3280	3280

Total WDA: 2160

@20% business use percentage = 432

Year ended 31/10/17:

	AA car	BB Car	CC car	Total
b/f	3280	3280	3280	
Disposals	(3000)	–	–	
Balancing allowance	280			280
		3280	3280	
WDA @ 18%		(590)	(590)	
		2690	2690	

WDA: 1180 @20% = 236

Balancing allowance = 280

516

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Appendix 5

Aaron Amie's

Income tax Computation (2016/17)

	63342
Taxable profit in the year (50369 + 17898 - 4925)	~~68264~~
Less: Personal allowance	(11 000)
	~~57267~~ 52 342

Income tax:

32 000 @ 20% =	6400
~~25267~~ 20342 @ 40% =	~~10107~~ 8137

Class 4 NIC:

8060 @ 0% =	-
34940 @ 9% =	3145
~~25267~~ 20342 @ 2% =	~~505~~ 407
	~~20577~~ 18089

Capital gains

53900 @ 10%	5390
less: payments on account	(5276)
2016/17 tax payable	~~[illegible]~~ 18203

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Appendix 6

Aaron – Capital gains

Proceeds:

1/3 ~~Market~~ Balance Sheet value of – goodwill	15 000
– Property	80 000
Cost:	
1/3 cost of property	(30 000)
	65 000
Annual exemption	(11 100)
	53 900

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Appendix 7

12 Front Street :	AA	BB	CC
1 January 2012	30000	30000	30000
31 March 17 Revalued			
AA leaves, ~~B~~ BB and CC equally acquire AA Share at balance sheet value	(30000)	40000	40000
Base costs	-	70000	70000
1.4.17		(24000)	(24000)
		46000	46000

DD joins, BB and CC both dispose of 10% interest :

Proceeds :	10% x 240k	24000
Cost :	10% x 70k	(7000)
Gain		17000

Davina :

Acquires 20% for base cost of 48000 (24k x 2)

Sale October 2017 :	40% BB	40% CC	20% DD
Proceeds (260k)	104000	104000	52000
Base cost	(46000)	(46000)	(48000)
Gain	58000	58000	4000

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7 Cont

1 April 2017 Goodwill :

	BB	CC
Proceeds	22500	22500
Cost	(7500)	(7500)
	15000	15000

Davina Base cost = 45000

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Appendix 8

Capital allowances associated with acquisition of new property (y/e 31.10.18)

		General ~~Pool~~ Pool	Special rate pool		Total Allowances
B/f		–	–		–
Disposals		–	–		–
Additions:					
Kitchen eqpt	35000				
furniture	15000				
Artworks	5000				
Alterations r.e					
installation of eqpt	2500				
Re wiring	15000				
Heating System	15000				
Sanitary ware	15000				
AIA	(102500)	–	–	–	102500
C/f	–	–	–	–	

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