THE CHARTERED INSTITUTE OF TAXATION

ADVANCED TECHNICAL

Taxation of Owner-Managed Businesses

November 2020

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, you may assume that 2019/20 legislation (including rates and allowances) continues to apply for 2020/21 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.

1. You are an assistant tax manager in a firm of accountants and your client is Dependable Glazing Ltd.

Dependable Glazing Ltd is a company which manufactures and sells double glazing and conservatories to both domestic and trade customers. It is owned and managed by Mr Blunt.

The company had operated profitably for many years, however due to the loss of trade contracts and a general downturn in the market the company made a loss in the year to 30 June 2019. The losses continued to arise and, with no prospect of improvement, Mr Blunt decided to cease trading on 28 February 2020. The company is not insolvent and continues to receive investment income.

Recent results for the company are shown in the table below. The loss of £132,000 for the accounting period to 28 February 2020 is the tax-adjusted loss before capital allowances. During 2017 the company changed its accounting reference date from September to June.

Period ended	30/09/2016	30/06/2017	30/06/2018	30/06/2019	28/2/2020
	£	£	£	£	£
Trade profit/(loss)	250,000	110,000	92,500	(210,000)	(132,000)
Non-trade loan relationship income	5,000	2,500	2,500	1,500	1,500
Property income	17,000	22,500	20,000	18,500	22,500
Charitable donations	5,000	5,000	5,000	2,500	Nil

Capital Allowances

1) At 1 July 2019 the tax written down value brought forward was:

	£
General Pool	120,000
Special Rate Pool	28,000

2) An electric car was purchased in July 2019 for £30,000. Mr Blunt used the car equally for business and for private purposes. The car was sold to Mr Blunt on 1 February 2020 for its market value of £22,000.

3) Additional lighting was added to the factory showroom in August 2019 at a cost of £3,000.

4) On 31 October 2019, the company sold a car for £5,000 which was purchased in December 2016 for £12,000 and has CO_2 emissions of 140g/km.

5) At 28 February 2020, the market value of the assets was:

	£
General Pool	102,000
Special Rate Pool	14,000

Continued

1. Continuation

Post Cessation

The following receipts and expenses arose in the period after the company ceased to trade:

Date	Receipt/ (Expense) £	Notes
5 June 2020	8,000	A trade customer who regularly paid late, settled her final invoice for £8,000. The debt, although paid late, had not been considered bad.
20 July 2020	(5,000)	Following a complaint from a customer which was upheld, the trade body levied a fine on the company.
6 August 2020	(5,000)	A defective double glazing installation was remedied. The company paid the cost of this repair.

In addition, a supplier company owned by a personal friend of Mr Blunt wrote off the outstanding balance of £15,000 owed by Dependable Glazing Ltd for trading stock purchased.

Requirement:

1) **Calculate, with brief explanations, the capital allowances available for the period ended 28 February 2020.** (5)

2) **Explain how the trading losses incurred should be utilised, showing the effect on the tax calculations for all relevant years.** (12)

3) **Explain the tax treatment of the transactions following cessation of the trade and how any surplus or deficit would be taxed or relieved.** (3)

Total (20)

2. Your client is Ravi Sharma. He sold a business in 2005 realising a chargeable gain of £1.2 million. He then set up a software company in 2006, of which he was the sole director and shareholder. This company was sold in 2012 realising a chargeable gain of £9.8 million on which entrepreneurs' relief was claimed.

In June 2013, he purchased a large farm which he operates as a sole trader, preparing accounts to 31 March each year. This purchase included the following:

1) Rough scrub land unsuitable for use in the farm business (cost allocated to this of £75,000).

2) Outbuildings (cost allocated to this of £30,000).

3) A field with development potential (cost allocated to this of £75,000).

In September 2013 he set up a business offering paintballing experiences using the outbuildings. The business was not successful and he ceased trading in October 2016. He then rented out the buildings to a local firm for storage until August 2019, when he sold the buildings for net sales proceeds of £350,000.

In July 2014, Ravi set up a partnership with James to operate off-road quad biking on the scrub land, with Ravi initially having a 10% partnership share in the business. Ravi charged the partnership rent on the land of 50% of the market rate. The following transactions took place:

1) In January 2018 Ravi sold a 6% partnership share to James, claiming entrepreneurs' relief on a gain of £50,000.

2) In June 2019, Ravi sold his remaining partnership share to James, realising a gain of £50,000.

3) In June 2019 Ravi sold the scrub land to James for £250,000.

Having obtained planning permission on the field with development potential in June 2019 at a cost of £15,000, Ravi commenced a property development trade in January 2020 to build 10 houses on the site, all of which he intends to sell. The value of the field in January 2020 was £1.2 million.

Requirement:

Draft a letter to Ravi to explain the tax implications of the land transactions carried out in 2019/20. (20)

3. You are a tax manager in a firm of tax consultants and your client is Mary Costa.

On 28 April 2020, all of the 600 shares in Aurora Enterprises Ltd were sold to a third party for £6,000 per share. Aurora Enterprises Ltd has always been a trading company.

Of the 600 shares in the company, 500 had been held by Mary since incorporation and 100 were held by Bill Thomson, the Finance Director. Bill acquired his shares immediately prior to the sale of the company, when he exercised an Enterprise Management Incentive option which was granted to him in February 2019, prior to any discussions of a company sale. His option had an exercise price of £1,750 per share and was only exercisable on a sale of the company. The grant of the option was properly notified to HMRC.

The company undertook an internal valuation at the date of grant of the options and was satisfied that the market value of the shares was £1,750 per share.

You have recently been contacted by Mary, who has received a potential warranty claim from the purchaser in respect of the exercise of the share option. Following the sale, HMRC opened an enquiry into the Enterprise Management Incentive scheme and have raised concerns about the market value of the shares when the option was granted, saying that the market value was in fact £3,000 per share.

Mary is obviously concerned by this development. Given that the company has now been sold, she expects that it may be difficult to agree a lower valuation with HMRC. She has contacted you for advice on the potential tax liabilities should HMRC's valuation prove to be correct. The company will settle any liabilities with HMRC in the first instance, but will claim the cost from Mary under the warranty.

Bill will be an additional rate taxpayer for 2020/21, due to the level of his salary from the company.

Requirement:

Write a letter to Mary which explains:

1) **The tax implications for the company if HMRC's valuation of the options is correct.** (17)

2) **The potential penalty position for the company, should HMRC identify additional liabilities.** (3)

Total (20)

4. Your client, Pippa Stephens, has run a successful design studio as a sole trader since June 2000. Her year end is 31 March.

The draft profit and loss account for the year to 31 March 2020 is as follows:

	Notes	£	£
Turnover	1		340,078
Payroll costs		135,000	
Pension costs	2	18,000	
Motor and travel expenses	3	14,500	
Premises costs	4	59,875	
Repairs and renewals	5	32,300	
Legal and professional	6	1,900	
Interest paid	7	600	
Depreciation		4,750	
Loss on sale of fixed assets		1,400	
Miscellaneous	8	3,300	
			(271,625)
			68,453
Rent received			4,500
Profit per accounts			£72,953

1) Turnover includes a receipt of £450 from a local charity. This was an unsolicited payment in recognition of the fact that, for the previous 10 years, Pippa had designed all of their marketing material for free.

2) Pension costs consist of:

	£
Contribution to Pippa's personal pension	3,200
Employer contributions for employees*	14,800
	18,000

*Due to a processing error the payment of the March 2020 employer contribution of £1,250 was delayed until 15 April 2020.

3) The motor and travel expenses do not include any costs relating to Pippa's own car. From the beginning of April 2019, Pippa rented a car personally and in 2019/20 the total costs incurred on this vehicle were £3,300. She drove 12,000 miles in the year of which 4,800 were business related. She is keen to claim maximum tax relief for this expenditure.

4) Premises costs consist of:

	£
Rent paid	10,800
Business rates	3,200
Council tax on flat	875
Lease premium	45,000
	£59,875

Until 30 September 2019 Pippa had operated rent free from premises owned by her parents. On 1 October 2019 she moved her business to a two-storey property. The lease term is 10 years and she pays a rent of £1,800 per month. The ground floor is used exclusively for business purposes and represents approximately two thirds of the value and floor area of the property. The first floor is a residential flat and is sub-let to a tenant paying a rent of £750 per month.

Continued

4. Continuation

5) Repairs and renewals consist of:

	£
Dilapidation costs	7,500
Renovation of ground floor	24,000
Decoration of residential flat	800
	£32,300

The dilapidation costs were calculated on an arm's length basis and were paid on vacating the previous premises. They were a result of general wear and tear and anticipated redecoration costs.

The ground floor of the new property was in a poor state of repair so that it could not be used for the business and required extensive renovation prior to occupation, including a charge of £2,600 for the installation of high capacity electric cabling and £1,650 for the lowering of part of the floor to allow the installation of two new printers.

6) Legal and professional costs consist of:

	£
Pursuit of bad debt	800
Drafting of business lease	1,100
	£1,900

7) Interest paid relates to a loan of £30,000 to fund payment of the lease premium.

8) Miscellaneous expenditure includes an annual business subscription of £3,000 for gym membership used by Pippa and four of her staff. Individual membership of the gym would cost £1,200 per person.

9) The tax written down value of the general pool at 1 April 2019 was £17,000.

During the year the following acquisitions and disposals were made:

	£
Acquisitions	
Two new printers	11,000
New car used by senior designer (CO_2 emissions of 165 g/km)	23,000
Fully electric car purchased second hand	14,000
Disposals	
Laptops gifted to a local school (market value £225)	0
Laptop sold for £10 to a local business start-up (market value £180)	10
Car used by senior designer (CO_2 emissions 110 g/km), originally purchased 1 June 2016	3,500

Requirement:

Calculate, with appropriate explanations, Pippa's tax adjusted profits for 2019/20.
(15)

5. You are a tax manager in a firm of accountants. Your client is Hideo Aramaki, the owner of Aramaki Restaurants Ltd, which has 25 employees of which 15 are basic rate taxpayers and 10 are higher rate taxpayers. None of the employees are Scottish taxpayers. Hideo has asked you for some advice in relation to PAYE Settlement Agreements as the company would like to enter into one for the following benefits:

Anniversary staff event

The company held a one-off staff event in June 2020, to celebrate its 20-year anniversary. The cost of the event was £3,000 and it was attended by all staff.

Staff gifts

At Christmas, each employee will be given a shopping voucher with a value of £45. This will not be redeemable for cash.

Long-service award

In August 2020, one of the employees, a basic rate taxpayer, who had worked for the business for 15 years was awarded a weekend trip to London in recognition of her service. The total cost to the company of the travel and accommodation was £650.

Requirement:

1) Explain the process by which a PAYE Settlement Agreement is agreed with HMRC and whether benefits in kind arise in respect of the above. (5)

2) Calculate the total amount payable to HMRC under a PAYE Settlement Agreement for 2020/21, stating the due date for payment. (5)

Total (10)

6. Carol and Rhea were married in January 2010. They have recently become clients of your accountancy practice. Carol has always been in part-time employment and has supplemented her income through her freelance graphic design work. Rhea reduced her employment hours and started to draw her State pension on 23 July 2018. On 1 July 2018 Rhea joined Carol's business and they formed a Limited Liability Partnership. Profits are shared equally.

Accounts were prepared for the following periods:

	Tax Adjusted Profit
	£
Year ended 30 September 2018	12,000
Period ended 31 March 2019	8,000
Period ended 31 March 2020	32,000

Previously, Carol had always made up her accounts to 30 September.

Carol has overlap relief brought forward of £19,733.

In addition to trading profits their other income for 2018/19 and 2019/20 was as follows:

	Carol		Rhea	
	2018/19	2019/20	2018/19	2019/20
	£	£	£	£
Salary	66,000	54,200	32,000	24,000
State pension			8,600	10,200
Joint rental income	6,800	7,000	6,800	7,000

Requirement:

1) Calculate the taxable trading profits for both Carol and Rhea for 2018/19 and 2019/20. (3)

2) Calculate their Class 2 and Class 4 National Insurance liabilities for 2019/20 explaining the basis of assessment and collection of the National Insurance liabilities. You should assume that all reliefs have been claimed as early as possible. (12)

Total (15)