THE CHARTERED INSTITUTE OF TAXATION

ADVANCED TECHNICAL

Taxation of Owner-Managed Businesses

May 2022

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 in the question, you may assume that 2021/22 legislation (including rates and allowances) continues to apply for 2022/23 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. Saratoga Ltd is a spring manufacturing company, which has recently moved to a much larger, purpose built, factory.

Former factory

The company's former factory was acquired in 2010, for a cost of £835,000. Of this, the company allocated £85,000 to the fixtures installed within the building and claimed capital allowances accordingly. Legal fees on acquisition were £2,500.

The company spent £150,000 in 2015 on an extension to the factory, containing fixtures costing £10,000. Capital allowances were claimed on these fixtures.

The factory was sold to a third party on 31 December 2021 for £920,000. A fixtures election was signed with the purchaser for £1 in relation to each of the main and special rate capital allowances pools. Legal fees on disposal were £3,000.

New factory

Land was purchased from a local farmer in May 2021 for £550,000. Legal fees on acquisition were £3,500. Planning permission was obtained by the company in June 2021 at a cost of £30,000 and construction of the new factory began shortly thereafter.

The construction work undertaken by the building firm comprised:

	£	Notes
Structural expenditure	650,000	
Factory sign	5,000	
Internal office fit out costs	16,000	1
Environmentally friendly heating system	55,000	
Electric vehicle charging points	4,800	
Other main pool expenditure	25,000	
	£755,800	

The company also paid a removal company £2,000 to transport the company's equipment from the former factory, and a further £3,000 to install the equipment in the new factory.

The factory was completed on 31 October 2021 and the company began using it on 30 November 2021.

During the remainder of the year ended 31 March 2022 the company also incurred the following expenditure on plant and machinery:

	Date	Expenditure £	Notes
New steel rolling machine	January 2022	160,000	2
Deposit for spring forming machine	March 2022	35,000	3

Notes

1) Internal office fit out costs consist of:

	£
Decoration of offices	3,000
Kitchen installation	5,500
Suspended ceiling	2,500
Office furniture	3,000
Carpet tiles	2,000
	£16,000

2) The steel rolling machine was purchased for £160,000. The company then received a government development grant of £40,000 in respect of the purchase.

3) The company paid a deposit of £35,000 to secure production of a new spring forming machine, costing £135,000. The machine will be completed on 31 May 2022 and the company will take delivery on that date, paying the balance of the machinery in equal instalments on the last day of July to October 2022.

The company also disposed of its previous steel rolling machine in February 2022. As this was a specialised piece of machinery, they were able to dispose of it for £100,000, having originally paid £80,000 for it.

At 1 April 2021, the tax written down values brought forward were:

	£
General pool	109,278
Special rate pool	23,000

Requirement:

1) Calculate, with explanations, the maximum capital allowances available to Saratoga Ltd for the year ended 31 March 2022. (16)

2) Calculate, with explanations, the chargeable gain or loss arising on the disposal of the former factory. (4)

Total (20)

2. Esther commenced trading on 1 January 2021 as a clothes designer and manufacturer and prepared her first accounts to 30 April 2022. Her draft profit and loss account for this period is as follows.

	Notes	£	£
Turnover	1		324,650
Cost of sales	2		(48,700)
Gross profit			275,950
Expenses:			
Payroll costs		48,600	
Premises costs	3	35,250	
Office and administration costs		7,800	
Motor and travel expenses	4	12,000	
Professional fees	5	3,500	
Bad and doubtful debts	6	19,800	
Depreciation		14,000	
			(140,950)
Net profit			£135,000

Notes

1) Turnover

Turnover includes deposits received of £3,500 for wedding dresses to be made and invoiced in May and June 2022.

2) Cost of sales

Cost of sales includes:

	£
Cost of fabric taken by Esther to make a dress for herself	175
Cost of materials used in finished dress taken by Esther from stock	200

Esther's gross profit margin is 85% on sales.

3) Premises costs

Premises costs includes a premium of £25,000 paid on 1 January 2021 for a 10 year lease on a commercial property.

4) Motor and travel expenses

	£
Van expenses	4,200
Esther's car running expenses	2,400
Hire purchase payments	5,400
	£12,000

Motor expenses includes six payments of £900 under a hire purchase agreement. The five year agreement, dated 1 November 2021 was for a car costing £45,000. The car was delivered on 5 November 2021. The car has CO_2 emissions of 125 g/km and is used 75% for business purposes.

5) Professional fees

Professional fees include legal fees of £2,000 for the arrangement of the 10 year commercial property lease.

6) Bad and doubtful debts:

	£
Loans written off:	
- to Susy, a friend	4,500
- to Marie, an employee (including relevant National Insurance)	3,600
Provision of 10% against debt due from Quefit Ltd, a customer	6,000
Provision of 5% against all other customer debts based on historical recoverability	5,700
	£19,800

7) In preparation for trading, Esther spent £26,000 on equipment. On 10 January 2021 her mother gave her sewing machines worth £4,000. She also made the following purchases:

Date		£
1 June 2021	Electric van (50% business use)	15,000
1 February 2022	Computer design software	2,500

Esther was employed on a salary of £12,000 per month until her employment ceased on 31 December 2020. She had no other income or tax relevant outgoings in either 2020/21 or 2021/22.

Esther reached state retirement age on 1 March 2022, but decided to defer taking the state pension for five years.

Requirement:

1) Calculate with explanations, Esther's taxable income for 2020/21 and 2021/22. (15)

2) Explain Esther's liability to National Insurance Contributions on her self-employment income for 2020/21 (calculations are not required) and explain and calculate her contributions for 2021/22. (5)

Total (20)

3. A113 Technology Ltd is a company which develops, licences and maintains virtual reality technology for the theme park industry. The company is wholly owned by James Sullivan.

The company employs 80 people and its turnover for the year ended 31 December 2021 was £20 million.

During the year ended 31 December 2021, the company worked on two projects, which are detailed below.

1) The development of wireless augmented reality headsets which would allow guests to experience an artificially enhanced version of the real world for entertainment purposes, whilst queuing for their chosen attraction.

2) The development of immersive virtual reality experiences which also allow the user to move through a physical environment and simulate heat, contact etc.

Both projects represent substantial advancements in technology, and advance clearance has been obtained from HMRC to confirm that they qualify for enhanced tax relief for expenditure on research & development.

The company's Finance Director has provided the following information relevant to both projects above during the year ended 31 December 2021.

Staff costs

Name	Role	Salary	Employer's NIC	Company pension contributions	Benefits in kind
		£	£	£	£
Fred McMurray	Operations director	100,000	12,000	20,000	15,000
Ruth Thomson	Technical designer	50,000	5,000	1,000	-
Ken Anderson	Developer	40,000	4,000	-	1,000
Mary Jones	Product technician	23,000	2,000	-	500
Tim Conway	Product tester	23,000	2,000	-	250

The above costs were incurred evenly throughout the period.

Fred McMurray spent 40% of his time meeting with customers and visiting their sites to view the company's technology in operation. He also spent 15% of his time in board meetings discussing the company's financing of the projects. The balance of his time was spent on the projects.

Approximately 10% of the four other staff members' time was spent receiving training on new virtual reality software which they used in the projects. A further 10% was spent on non-project administration work.

Software

	£
Development and modelling software licence	10,000
Payroll software – research & development department allocation	1,000

Property and other business costs

	£
Allocation to research & development department of:	
Rent and rates	12,500
Heat, light and power	3,500
Telephone	500

Subcontractor payments

The company subcontracted testing of the software to Luxo Ltd, which is wholly owned by Richard Sullivan, the son of James Sullivan, at a cost of £50,000. Of Richard's salary from Luxo Ltd, £40,000 related to the testing work.

The company also subcontracted some of the hardware integration work to an unrelated third party company based in the US, at a cost of £25,000.

Due to the development work, the company's taxable profit for the year ended 31 December 2021, before any enhanced deduction for the research & development expenditure was £225,000. In the year ended 31 December 2020, the comparable figure was £735,000.

Requirement:

1) **Explain how much of the above expenditure will qualify for enhanced research & development relief and calculate the amount of the enhanced tax deduction.** (10)

2) **Explain how tax relief will be given for the enhanced deduction and calculate the maximum benefit as a result of the research & development claim.** (5)

Total (15)

4. The payroll manager of Ash LLP, a partnership operating a number of hardware stores, is in the process of preparing the forms P11D for the tax year ended 5 April 2022. He has completed most of the forms without any issues but he is having difficulty in deciding how to deal with the items listed below.

1) With effect from 1 March 2022 all sales staff were given a 30% discount on any goods purchased in their stores.

2) In July 2021 the senior partner of Ash LLP purchased a holiday cottage in Cornwall in his personal name for £250,000. Bob Charles was named employee of the year and was rewarded with a free two week holiday in the cottage with his family in March 2022. The senior partner received no money for the use of his property other than a contribution from the partnership towards the bills for the two weeks it was used by Bob.

3) An employee, Sally Moss, retired on 1 March 2022 after working for the partnership for 15 years. As a leaving gift, the partners decided to reimburse Sally for a holiday in Portugal which she had booked. The partners do not want Sally to suffer any tax on this gift.

4) Until 31 December 2021 an employee, Colin Dean, had been given a vehicle allowance in his pay. With effect from 1 January 2022 the vehicle allowance was given up by Colin for the provision of a company van.

5) An employee, Chloe Knight, has for many years been provided with a car for business and private use. The payroll manager understands the basic car benefit rules and needs no detail on these. He does not however know what to do in respect of the following changes in the year:

   (a) A roof rack was added at a cost of £75.

   (b) The standard steel wheels were replaced with new alloy wheels at a cost of £240.

   (c) As the running costs for the car have increased, Chloe was from 1 October 2021 required to pay £50 per month for use of the car.

Requirement:

Explain how the above items should be dealt with by the partnership for employment tax and National Insurance purposes. Calculations are NOT required. (15)

5. Corndev Property Ltd builds and sells residential properties.

Aaron Black, the Managing Director, has held all of the 100 issued ordinary shares of £1 each since incorporation in 2010. The current market value of the shares is £15,000 per share. Aaron wishes to make the following transfers of shares:

1) 20 shares as a gift to his adult daughter Crystal, who has no involvement with the company.

2) 10 shares to his step-son Edward, who is employed by the company. Edward is to pay £7,500 for each share.

3) 10 shares to Francois Gerald for £1 per share. Francois was recently recruited and, after a short period of training, will move to France to establish a new company office there.

The company has an accounting reference date of 31 December and its balance sheet as at 31 December 2021 was as follows:

	£	£	Notes
Fixed assets:			
Tangible assets	455,000		1
Investment property	155,000		2
		610,000	
Stock and work in progress	240,000		3
Debtors	55,000		
Cash at bank and in hand	25,000		4
	320,000		
Creditors (amounts falling due within one year)	(160,000)		
Net current assets/(liabilities)		160,000	
Total assets less current liabilities		770,000	
Provisions for liabilities: Deferred taxation		(20,000)	
Net assets		750,000	
Capital and reserves:			
Called up share capital		100	
Revaluation reserve		60,000	
Profit and loss account		689,900	5
		750,000	

Notes

1) Tangible Assets include:

	£	
Freehold property	375,000	(at cost but the market value is £500,000)
Plant and machinery	45,000	(no individual items are worth more than cost)
Cars	35,000	
	455,000	

2) The investment property is included at its open market value and is let for an annual rent of £15,000.

3) Stock and work in progress consists of land for residential development and is included at cost. The market value of the land is however £300,000.

4) Cash at bank and in hand represents a current account used for working capital requirements.

5) Annual profits are in the region of £270,000, from sales of £1.35 million.

Aaron has made no other chargeable gains in the year to date nor has he ever disposed of an interest in any other business.

Requirement:

Explain the Capital Gains Tax and Income Tax issues arising from the three share transfers and any reliefs which may be available. Detailed calculations are NOT required. (15)

6. In 2010, Raqeeb, Roman and Mason set up a partnership selling luxury soaps.

Raqeeb provided all of the £400,000 opening capital for the partnership and he receives interest on capital of 10% per annum as a first share of partnership profits. Apart from attending partners' meetings each month, he does not work in the partnership.

Roman works full-time and Mason works one day per month in the business with remaining profits and losses split as follows:

1) Annual salaries of £50,000 for Roman and £5,000 for Mason.

2) Residual profits and losses are allocated between Roman and Mason in the ratio 80:20.

In the year ended 30 March 2021, sales fell following a shift in consumer taste toward sustainable products. The partners, therefore, approached Philip to join the partnership as he had significant experience as Sustainability Officer for a large company. His earnings had averaged £120,000 per annum. Philip became a partner on 1 April 2021.

It was agreed that from that date profits and losses would be split as follows:

1) Raqeeb continues to receive interest on capital of 10% per annum.

2) Annual salaries of £50,000 for Roman, £5,000 for Mason and £50,000 for Philip.

3) Residual profits are split between Roman, Mason and Philip in the ratio 40:20:40.

Problems associated with the development of new products in Philip's first year resulted in losses of £410,000 in the year ended 31 March 2022. Substantial profits are, however, projected for the year ending 31 March 2023.

Each year, Raqeeb has non-partnership income of £60,000, Roman has no non-partnership income and Mason has non-partnership income of £84,000. Since joining the partnership, Philip has had no non-partnership income but sold a portfolio of shares on 1 May 2021 resulting in chargeable gains of £54,000.

Historical and projected profits for the partnership and the appropriation of these profits are:

Year	Partnership profits	Raqeeb	Roman	Mason	Philip
	£	£	£	£	£
31 March 2019	140,000	40,000	86,000	14,000	
31 March 2020	150,000	40,000	94,000	16,000	-
31 March 2021	120,000	40,000	70,000	10,000	-
31 March 2023 (projected)	620,000	40,000	240,000	100,000	240,000

Requirement:

1) Calculate the profit/(loss) allocated to each partner for the year end 31 March 2022.
(5)

2) Discuss the options for Income Tax loss relief available and recommend, for each partner, the optimal use of Income Tax losses. Detailed calculations are NOT required.
(10)

Total (15)