THE CHARTERED INSTITUTE OF TAXATION

ADVANCED TECHNICAL

Taxation of Owner-Managed Businesses

November 2023

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 2022/23 legislation (including rates and allowances) continues to apply for 2023/24 and future years. Candidates answering by reference to more recently enacted legislation or tax cases will not be penalised.

- Additional marks may be awarded for presentation.

- You must type your answer in the space on the screen as indicated by the Exam4 guidance.

1. Veronika, currently aged 61, purchased the trade and assets of a small cake manufacturing business on 31 May 2015, for £280,000. The values of the assets at that date were:

Asset	Value
	£
Factory	112,000
Plant and machinery	54,000
Goodwill	96,000
Net current assets	18,000

Veronika prepares accounts to 31 March each year and the business has always been profitable.

In January 2016, Veronika bought another property for £140,000. The ground floor was immediately opened as a cake shop. The first floor, a flat of equal size to the ground floor, was immediately occupied rent-free by Veronika's daughter, who continues to occupy it.

On 1 January 2023, Veronika transferred the plant and machinery and net current assets of the business into a newly incorporated company, V-Cakes Ltd, in exchange for all the shares in V-Cakes Ltd.

On the same date, Veronika gifted the shop and flat and goodwill to V-Cakes Ltd. Veronika retained the factory, but charged a market rent to V-Cakes Ltd from 1 January 2023.

The business was valued on 1 January 2023 as follows:

Asset	Value	Notes
	£	
Factory	240,000	
Shop and Flat	190,000	
Plant and machinery	32,000	1
Goodwill	385,000	
Net current assets	54,000	2

1) The plant and machinery have an original cost of £74,000 and a tax written down value of nil. None of the assets are valued at more than cost.

2) All net current assets have a market value equal to original cost.

Since 1 January 2023, Veronika has received a monthly salary from V-Cakes Ltd. She also received a dividend from the company on 31 March 2023.

Veronika was a higher rate taxpayer in 2022/23.

Requirement:

1) Explain the Capital Gains Tax and Income Tax implications of the transfer of the business assets to V-Cakes Ltd, considering any beneficial claims and elections. (12)

2) Explain the Inheritance Tax relief and National Insurance implications of the change in business structure. Calculations are NOT required. (8)

Total (20)

Continued

2. Claire Poulet is the sole shareholder and director of Towering Media Ltd, a company which she incorporated on 1 July 2022.

Until 30 June 2022, Claire was employed as a travel writer with Hotel Guide Ltd on a salary of £7,500 per month. On 1 July 2022, Hotel Guide Ltd engaged Towering Media Ltd to perform similar tasks to those previously carried on by Claire.

Under the contract between Towering Media Ltd and Hotel Guide Ltd, Claire has to personally provide services to Hotel Guide Ltd and cannot send a substitute. She works for Hotel Guide Ltd for four days a week. Any holidays must be agreed in advance with Hotel Guide Ltd and the details of her work are controlled by a Hotel Guide Ltd employee.

Hotel Guide Ltd is a standalone company with turnover of £15.2 million, a balance sheet total of £4.2 million and 35 employees in the year to 31 December 2021.

In the year ended 30 June 2023, Towering Media Ltd received income of £6,250 per month from Hotel Guide Ltd, with payments received on the final day of each month.

Claire has taken a gross salary of £1,500 at the end of each month from Towering Media Ltd since the company was formed. The company has also contributed £1,000 per month to Claire's pension fund, which is paid on the final day of each month.

In the year ended 30 June 2023, Towering Media Ltd paid the following expenses on Claire's behalf:

		£
Subscription to Institute of Journalists	September 2022	300
Training course	October 2022	250
Personal tax return preparation fee	January 2023	400
Private medical insurance	May 2023	500
Reimbursed travel expenses to Hotel Guide Ltd offices		1,000
		£2,450

In July 2022, Towering Media Ltd bought a brand-new laptop costing £1,500 for Claire to use in her work with Hotel Guide Ltd. In March 2023, this was sold for £1,000 and a new laptop was acquired for £2,000.

Towering Media Ltd received £6,500 of income from its only other client, Sterling Stories Ltd, on 1 June 2023. Claire has received a status determination statement from Sterling Stories Ltd and PAYE and employee's Class 1 NIC was deducted from this payment. This amount has not been withdrawn from Towering Media Ltd.

Towering Media Ltd has a tax adjusted profit, before capital allowances, of £45,500 for the year ended 30 June 2023.

Claire's tax code for 2022/23 was 1257L and she paid total tax under PAYE of £4,686 in 2022/23.

Requirement:

1) **Explain why the income received from Hotel Guide Ltd would be treated as income from a relevant engagement and calculate, with explanations, the total PAYE and employer's Class 1 NIC payable by Towering Media Ltd on the deemed employment payment for 2022/23.** (14)

2) **Calculate the Corporation Tax payable by Towering Media Ltd for the year ended 30 June 2023.** (6)

Total (20)

Continued

3. Pierre operated as a sole trader for many years, running a shop which sold bicycles and accessories. Accounts were prepared to 31 March each year. Profits declined in recent years, and Pierre closed the business on 31 December 2022.

The following draft profit and loss account has been drawn up for the nine months ended 31 December 2022:

	Notes	£
Sales		321,100
Cost of sales	1)	(228,000)
Gross profit		93,100
Staff costs	2)	(51,400)
Premises costs	3)	(35,000)
Repairs and consumables		(27,000)
Office costs		(11,000)
Travel costs	4)	(18,200)
Entertaining	5)	(2,400)
Sundry expenses	6)	(6,700)
Depreciation		(4,800)
Loss for the period		£(63,400)

Notes

1) Cost of sales

Cost of sales includes an adjustment for closing stock of £78,000, valued at cost. Pierre expects to dispose of the stock as follows:

	£
Sale to his brother's UK business	45,000
Gifts to friends and family	8,000
Sale at auction	25,000
	£78,000

Pierre applies a 50% mark-up on cost. The sale at auction is expected to realise £20,000 after selling costs.

2) Staff costs

Staff costs includes redundancy costs for all employees at the statutory redundancy rates.

3) Premises costs

Premises costs include a provision of £5,500 for the final 12 months of rent under the shop lease (which expires on 31 December 2023).

4) Travel costs

Travel costs include £6,600 leasing costs, and £4,800 running costs for Pierre's car. The car has CO_2 emissions of 120 g/km and 40% business use. Running costs of £2,400 for Pierre's motorbike, which is used 50% for business purposes, are also included.

5) Entertaining

Entertaining costs were for a meal for seven suppliers and 15 customers. Pierre hosted the event with one staff member also attending.

6) Sundry expenses

Sundry expenses include gifts to long standing customers. Pierre's top 20 customers were each given a leather wallet, which cost £40 each. The top 10 customers also received a leather notebook, which cost £50 each. All items included the business logo.

The fixed assets on the balance sheet at 31 December 2022 were as follows:

	Notes	Cost	Depreciation	Net book value
		£	£	£
Tenant's improvements	1)	15,000	12,000	3,000
Motor vehicles				
- Motorbike	2)	8,000	5,000	3,000
Workshop equipment	3)	9,000	2,000	7,000
		£32,000	£19,000	£13,000

All assets were bought before 1 April 2022 and there were no acquisitions or disposals in the period to 31 December 2022.

Notes

1) The tenant's improvements relate to an air-conditioning and heating system installed by Pierre in 2010. The landlord has agreed to pay £4,000 to Pierre for the value of the improvements.

2) Pierre will keep the motorbike, which had a market value of £4,600 on 31 December 2022.

3) The workshop equipment was sold at auction in February 2023 for £6,000, after costs.

There was no balance on either the general pool or the special rate pool as at 1 April 2022.

Continued

Pierre's tax adjusted profits and losses for prior years were as follows:

Year ended	Profit/(loss)
	£
31 March 2022	(14,000)
31 March 2021	7,000
31 March 2020	36,000

Pierre's only other taxable income was £15,000 of rental profits each year.

Pierre has unused transitional overlap relief of £16,000.

Requirement:

1) Calculate, with explanations, the tax adjusted loss for 2022/23 and the loss available for terminal loss relief. (10)

2) Explain how Pierre's losses can be relieved assuming he has not yet made any loss relief claims. Calculations are NOT required. (5)

Total (15)

4. Adam and Ellie have traded in partnership as yoga teachers for many years, preparing accounts to 31 March each year. They have decided to start providing online yoga sessions.

They have been in discussions with Kate, a yoga teacher who provides her services via a limited company; Yoga IT Ltd. Yoga IT Ltd prepares accounts to 31 December each year and has an issued share capital of 100 £1 ordinary shares, held equally by Kate and her husband Anil. Yoga IT Ltd has two distinct activities – the provision of online yoga classes and specialist computer advice. The yoga classes are wholly provided by Kate and the computer advice is wholly given by Anil.

It has been agreed that, on 1 December 2023, a Limited Liability Partnership will be formed by Adam, Ellie, Kate and Yoga IT Ltd. Yoga IT Ltd will charge the Limited Liability Partnership a fee for computer advice, set at twice the rate it charges other businesses. The remaining profits of the Limited Liability Partnership will be paid 35% to each of Adam and Ellie, 15% to Kate and 15% to Yoga IT Ltd.

The Limited Liability Partnership will prepare accounts to 31 March 2024 and annually thereafter. All of the capital required by the Limited Liability Partnership will be provided by Adam and Ellie.

Requirement:

Explain the tax and National Insurance implications of including Yoga IT Ltd in the Limited Liability Partnership and of the proposed profit allocation. (10)

You are NOT required to discuss basis periods for Income Tax purposes or VAT.

Continued

5. DE Designers Ltd was incorporated on 1 January 2022 and commenced trading on 1 February 2022. The two shareholders are Darren and his sister, Eve.

The initial working capital of DE Designers Ltd was provided by way of a five year, interest-free loan of £50,000 from ODE Investments Ltd.

Darren and Eve are also shareholders and directors in DES Developers Ltd, a property development company. It prepares accounts to 31 December each year and is operated and financed independently from DE Designers Ltd.

Each company's ordinary share capital is held as follows:

	DE Designers Ltd	ODE Investments Ltd	DES Developers Ltd
Darren	50	-	75
Eve	50	-	75
Olive (Darren and Eve's mother)	-	100	-
Suni (Darren and Eve's sister)	-	-	75
Sophie (Eve's civil partner)	-	-	75
Total number of £1 Ordinary shares	100	100	300

All shares carry the same rights and have been held since at least 1 January 2022.

A draft Corporation Tax computation for DE Designers Ltd for the period from commencement to 31 May 2023 shows tax adjusted profits, before capital allowances, of £60,000. The company also received a dividend of £500 from a quoted investment on 1 May 2023 and had the following fixed asset additions in the period:

Date	Item	Cost £
1 February 2022	Second hand office furniture	12,000
1 March 2022	Two new computers at £2,500 each	5,000
1 April 2022	New van	10,500
15 January 2023	Office electrical re-wiring (as below)	20,000
12 March 2023	New computer	3,000
22 May 2023	New office furniture	2,000

On 21 May 2023, the company sold a van for £2,400. The van was acquired new on 1 May 2022 for £8,000.

During the period, the whole of the business premises was re-wired for £20,000. In line with the contract, £5,000 was paid when the work was completed on 15 January 2023, £5,000 was paid on 15 April 2023 and £10,000 was paid on 15 July 2023.

Requirement:

1) **Explain whether ODE Investments Ltd and DES Developers Ltd are associated companies of DE Designers Ltd and the effect this could have on the rate of Corporation Tax applying to DE Designers Ltd.** (6)

2) **Calculate the Corporation Tax liabilities of DE Designers Ltd for the period ended 31 May 2023 stating the due dates for payment.** (14)

Total (20)

Continued

6. Selteck Ltd was incorporated on 1 January 2023 and will prepare its first accounts to 31 December 2023. The company provides on-site maintenance services. The two directors, James and Rashid, each own 50% of the share capital. The directors have not drawn any salaries. There are currently no other employees.

The company is recruiting two engineers, a supervisor and a sales manager.

The two engineers will be provided with vans with two front seats and storage in the rear for tools and spares. Both engineers will receive a fuel card to cover the cost of all fuel, and will pay a contribution of £10 per month towards the cost of private fuel. One engineer has asked if he can use the van to drop his son off at school on his way to work. The other has asked if he can use the van at weekends.

The supervisor will be provided with a van with a removable row of seats behind the driver so it can carry other staff. The van will also have a window next to these seats. The remainder of the van will be used for tools and storage. The supervisor will take the van home each night.

James has been offered three different methods to acquire these vans:

1) a contract hire agreement, under which the company will lease the vehicles for two years after which they can be returned to the motor dealer.

2) a hire purchase agreement over four years with a deposit paid in December 2023 and repayments starting in January 2024, when the vans will be delivered.

3) a deferred payments scheme, with half the amount due paid in December 2023 and the balance in May 2024.

The sales manager will be given an interest free loan of £20,000 on 1 December 2023. He will repay the loan monthly, with the first repayment due on 1 June 2024. He will use his own car for business purposes. James and Rashid have agreed to pay 45p per mile for all business miles. He is expected to cover 25,000 business miles annually.

The company has also bought an 18-year old sports car for Rashid to use for business and private purposes. The list price when new was £24,000 and the current market value is £40,000.

Requirement:

1) Explain any taxable benefits arising from the vehicles, loan and mileage payments and the Corporation Tax treatment of the different acquisition methods for the vans. (10)

2) Explain how Selteck Ltd will report the new employees and account for the benefits to HMRC. (5)

Total (15)