The Chartered Tax Adviser Examination

May 2019

Taxation of Owner Managed Businesses

Suggested solutions

ANSWER 1

Mr M Goss
Peters Ltd
Unit 5
Albion Business Park
Worcester
W1 5BL

7 May 2019

Dear Martin

Proposed gift of shares in Peters Ltd to Helen – tax consequences

You have asked me to advise on the tax consequences of your proposal to gift 49% of the shares in Peters Ltd to your daughter Helen.

For Capital Gains Tax ('CGT') purposes, disposals otherwise than at arm's length are regarded as being for a consideration equal to their open market value, albeit that in the case of a gift no actual consideration is received. Moreover, you and your daughter are 'connected persons' for CGT purposes and transactions between connected persons are automatically treated as not being at arm's length.

However, provided that the shares in Peters Ltd qualify as 'business assets' you and Helen will be able to make a joint election for CGT 'gift relief', whereby the gain will be held-over (i.e. deferred). Normally the gain will come back into charge when Helen disposes of the shares but it would also become chargeable if she becomes non-resident within six years. The joint gift relief election would normally be filed with your self-assessment tax return for the current tax year ending 5 April 2020 but the time limit for the claim is actually four years after the end of the tax year in which the gift occurs.

'Business assets' for gift relief includes shares in a 'trading company' which is the individual's 'personal company' or which is an unquoted company. A company is an individual's 'personal company' if they are able to exercise at least 5% of the voting rights in the company. This test is clearly met.

The definition of 'trading company' is a company carrying on trading activities whose activities do not 'to a substantial extent' include non-trading activities. Peters Ltd clearly carries on trading activities but the question arises whether it carries on any non-trading activities 'to a substantial extent'. This term is not defined in the legislation but HMRC apply a 20% test by reference to a number of indicators:

- Income or profits from non-trading activities;
- Asset base of the company;
- Expenses incurred or time spent by employees and officers of the company; and
- Company's history.

The HMRC guidance however stresses that no one indicator is conclusive and that the situation must be viewed ‘in the round’ based on the balance of indicators.

Dalton Mill was retained as an investment and its rental is not an activity carried on in the course of the company’s trade, and so the question arises whether that activity is ‘substantial’.

If we apply the above indicators:

1. The rental income is only £25,000 and is therefore less than 1% of the company’s income.

2. The value of Dalton Mill is considered to be £400,000, which is approximately 23% of the company’s asset base, by reference to the balance sheet at 31 December 2018.

3. As Dalton Mill is let on a full repairing and insuring lease the expenses incurred and time spent by Helen as administrator would appear to be negligible.

4. Dalton Mill was originally the company’s trading premises and was retained as an investment since the company had surplus funds which it used to buy Unit 5. It was not acquired as an investment and so its retention may be regarded as an organic development of the company’s business rather than an end in itself.

While the value of Dalton Mill slightly exceeds 20% of the company’s assets based upon the balance sheet at 31 December 2018, no single indicator is conclusive and my view is that ‘in the round’ the balance of indicators points to trading status.

It is possible to apply to HMRC for an informal clearance to confirm that the company is accepted as a trading company at the time of the clearance, however I do not think this is necessary.

There is however a further issue, which is that if a company holds ‘chargeable assets’ which are not ‘business assets’ (i.e. not used for the purposes of the trade) hold-over relief is restricted in the ratio of business assets to total chargeable assets. Chargeable assets are assets on the disposal of which a chargeable gain or allowable loss may arise. Stock, debtors and cash are usually exempt from CGT and so do not affect the calculation.

The total value of chargeable assets is £1,050,000, of which £650,000 are business assets. Based upon my firm’s valuation of the shares to be transferred, the restricted relief and chargeable gain would be as follows:

	£
Value of gift	700,000
Cost (200,000 x 700,000/(700,000 + 800,000))	(93,333)
Gain	606,667
Held-over gain (650,000/1,050,000 x 606,667)	(375,556)

Chargeable gain	231,111
Annual exempt amount	(11,700)
Taxable	219,411
CGT payable @ 10%	£21,941

The gain is taxable at 10% instead of the general rate of 20% because you qualify for CGT ‘entrepreneurs’ relief’. Relief is available for a disposal of shares in a trading company, which is the individual’s ‘personal company’ (through holding at least 5% of the ordinary share capital and voting rights), of which he is an officer or employee and has held the shares for at least one year. These tests are clearly met.

The CGT payable of £21,941 as above would be due for payment on 31 January 2021.

Please let me know if I may be of further assistance.

Yours sincerely

A Tax Manager

MARKING GUIDE

TOPIC	**MARKS**
Connected persons / MV rule	1
Hold-over relief explanation / joint election	1½
Shares as business assets	½
Personal company test/unquoted shares	½
Trading company definition	1
HMRC 20% test	½
Identifying Dalton Mill as a non-business asset	½
Application of 4 indicators	2
Conclusion of trading company status	½
Explanation of restriction of holdover relief by reference to chargeable assets	1½
Availability of ER	2
Calculation of gain / tax due	2
Date for payment	½
Presentation	1
TOTAL	**15**

ANSWER 2

Far Sight Partnership LLP
Capital Allowances period ended 31 March 2019

	R&D FYA	FYA	General pool	Special rate pool	Short life asset	Electric car	**Notes**
		£	£	£	£	£	
WDV b/f			108,000	92,000	0		
Additions:							
Removal and relocation of machinery			34,000				**1**
machinery			24,000				**2**
laboratory	120,000						**3**
Solar panels				29,000			**4**
Air conditioning				26,000			**5**
lighting		2,200		5,800			**6**
IT equipment					16,000		**7**
Computers	3,000				4,000		**8**
Shelving etc			44,000				
vans			54,000				**9**
Electric car						69,000	**10**
Disposals:							
Scrap			(14,000)				**11**
Van			(0)				**12**
Container			(5,500)				**13**
TOTAL	123,000	2,200	244,500	152,800	20,000	69,000	
Allowances:							
FYA	(123,000)	(2,200)					
AIA (not applicable)							**14**
WDA 18% x 9/12			(33,008)		(2,700)	(9,315)	**15**
8% x 9/12				(9,168)			
Private use 55%						5,123	**16**

Notes:

1) The cost of removal and relocation of existing equipment will qualify for capital allowances where the expenditure fails to meet the normal trading deduction (see HMRC manual BIM42530) (1 mark)
2) As the commitment to make payment is more than four months after taking delivery then only those instalments falling in the accounting period will qualify. (1 mark)
3) The laboratory qualifies for 100% R&D relief. (1 mark)
4) Solar panels treated as special rate pool assets under s.104A(g) CAA 2001 (1 mark)
5) Air conditioning treated as integral assets (1/2 mark)

6) Lighting will be treated as integral assets (1/2 mark) with the exception of the energy efficient bulbs which will qualify for FYA (1/2 mark)
7) As the useful life is less than 8 years then the LLP should elect to treat these as short life assets (1 mark)
8) The computer dedicated to the research laboratory would qualify for R&D FYA (1/2 mark)
9) As acquired under HP then no allowances can be claimed on the van not brought into use at the end of the accounting period. (1 mark)
10) Although this is an electric vehicle it will not qualify for FYA as is was not purchased new (1 mark). It is placed in a separate pool as there is an element of private use. (1/2 mark)
11) The scrap value is treated as disposal proceeds (1/2 mark)
12) There is no market value imputation as the transfer of the vehicle will fall within ITEPA 2003. (1 mark)
13) The disposal proceeds brought into the pool cannot exceed original cost (1/2)
14) AIA's are not available as the LLP includes companies as well as individuals. (I mark)
15) The WDA are time apportioned as this is a short accounting period (1 mark)
16) The private use proportion is not allowable (1/2 mark)

Capital Allowances on the property purchase

The vendor of the property has indicated that they are willing to cooperate to allow the LLP to maximise their capital allowances entitlement In order to secure capital allowances on a proportion of the purchase cost of the property it is necessary for the vendor to meet two tests.

Firstly, they should satisfy the "pooling requirement" (1/2 mark). This requires that the vendor must bring into their own capital allowances computation the cost of fixtures incorporated into the building. As the vendor has indicated that they have not previously claimed allowances on fixed plant and machinery then they should be asked to include such a claim in their tax computation covering the sale of the property (1 mark)

Secondly, they must satisfy the "fixed value requirement" (1/2 mark). This requires that within two years of the sale of the property the vendor and purchaser must enter into an election to fix the value of fixtures incorporated in the building. (1 mark) The elected sum must be between £1 and the "pooled" cost established above. (1/2 mark). As the vendor has indicated that they are happy to maximise the claim available to the LLP then they should be asked to sign a joint election under s.198 CAA 2001 fixing the value at "pooled " cost figure (1/2 mark).

Integral assets were introduced in April 2008 and as the vendor would not have been eligible for allowances on expenditure incurred prior to this date then the above requirements are not applicable. (1 mark) In this case the purchaser may make a claim for capital allowances on pre- April 2008 integral assets based on an apportionment of the purchase price. (1 mark)

MARKING GUIDE

TOPIC	MARKS
Removal and relocation cost qualify for c/a's (N.B. mark to be given if candidate makes reasoned case for simple trading deduction)	1
Payment made more than four months after commitment will not qualify in 18-19	1
Laboratory will qualify for R&D allowances at 100%	1
Solar panels are integral assets	1
Air conditioning is an integral asset	½
Lighting will be treated as integral assets	½
Energy efficient bulbs will qualify for FYA	½
Should elect for short life asset on IT equipment	1
The computer will qualify for 100% R&D allowances	½
The van not brought into use at year end will not qualify	1
No FYA on the Tesla as not purchased new	1
Placed in separate pool as private use element	½
Scrap value included as disposal proceeds	½
Van treated as sold at nil proceeds. market value overridden by ITEPA 2003	1
Disposal proceed limited to original cost	½
No AIA as LLP includes companies	1
Allowances time apportioned as short period	1
Private use add back	½
Must satisfy pooling requirement	½
Explanation of pooling requirement	1
Must satisfy fixed value requirement	½
Explanation of fixed value requirement	1
Elected sum between £1 and original cost	½
Suggest s.198 election fixed at pooled value	½
Pre 2008 integral assets will be eligible for relief	1
Allowance on pre 2008 integral assets based on apportionment	1
TOTAL	**20**

ANSWER 3

1) *Solid wall insulation*

The essence of R&D tax relief is that the project must be seeking a recognisable advance in science or technology, through the resolution of a scientific or technological uncertainty.

If the company was able to successfully develop a cost effective and technologically successful method of insulating solid walls, this would advance the field of construction through being able to successfully insulate solid walls with a method which was more efficient and cost effective than the current method – a recognisable advancement.

The technological uncertainties to be overcome were whether any existing products existed in the market which could be applied in a way which would resolve the dampness issue. This involved the testing of various existing materials and the application of these materials in new ways. At the outset of the project, the company did not know whether it would be possible to apply any existing products to this issue with successful results.

The fact that the project did not succeed is not a barrier to claiming enhanced R&D tax relief.

It appears that the project would therefore qualify for enhanced tax relief for R&D.

Plant-based foam insulation

Whilst the work does appear to meet the qualifying conditions to be eligible for enhanced R&D tax relief, in that the company is seeking an advance in science or technology through the resolution of a scientific or technological uncertainty, the company is acting as sub-contractor for another SME. This therefore precludes MK from making a claim for R&D tax relief. This claim would rest with the company who had contracted the work to MK.

2) *Staff costs*

Staff member	Qualifying months	Total months	Qualifying %	Scaled down for admin time (10%) (Note 6)	Note
Paul Hartley	7	12	58.3	52.5	1
Bill Martin	0	12	0	0	2
Dave Graham	7	12	58.3	52.5	3
Alice Swan	5	12	41.7	37.5	4
Marie Gilfillan	0	12	0	0	5

Notes:

1) Paul's work on researching existing products' suitability (2 months) and testing and development (5 months) should qualify as work undertaken directly on the R&D.
2) Bill has not taken part in any R&D.
3) As above for Paul.
4) Alice's work on the development should qualify as work undertaken directly on the R&D.
5) Market research is not work undertaken to resolve the technological uncertainties and is therefore excluded from the claim.
6) The percentage of qualifying time has been reduced by 10% to account for general admin time undertaken across the year. General administration work is not work undertaken in pursuit of the resolution of the technological uncertainties.

Externally provided worker

Colin Campbell has been provided to the company by Centre Street Limited. As he is under the control of MK, he is an externally provided worker. He has been involved in qualifying R&D work for the entirety of his time with MK, other than the 10% of time spent doing general admin tasks, and therefore 90% of his time will qualify. As he is provided by an unconnected supplier, only 65% of the payment made to Centre Street will be qualifying expenditure.

Qualifying costs

Staff costs	Qualifying above	%	Staff expenditure	Qualifying cost
			£	£
Paul Hartley		52.5	11,000	5,775
Dave Graham		52.5	68,250	35,831
Alice Swan		37.5	63,100	23,663
				65,269
Material costs	Solid wall insulation project			125,945
Heat, light and power	30%			3,000
Externally provided workers	Restricted to 65% of amount paid and reduced by 10% for non-qualifying time			11,700
Total qualifying expenditure				205,914

Notes:

1) Private medical insurance is not a qualifying staff cost, as it is a benefit in kind.
2) Rent and rates are not qualifying costs, as they do not fall within one of the permitted heads of expenditure.

3) The additional tax deduction for an SME is 130% of the qualifying expenditure, so £267,688. This is treated as an additional deductible expense in the company's tax computation and would therefore increase the losses which are carried forward.

However, as the company is loss-making and will continue to be so for a number of years, such that it is unlikely to be able to utilise the enhanced deduction at any point in the near future, it should surrender the losses which relate to the R&D expenditure for a cash repayment.

The surrenderable amount is the lower of:

- 230% of the qualifying expenditure (230% x £205,914) - £473,602; and
- Unrelieved trading loss (£211,617 + £267,688) - £479,305.

The amount of tax credit is 14.5% of surrenderable loss for that period. The company can therefore surrender the full £473,602 for a tax credit of £68,672. This should be repaid to them in cash if the company has no other outstanding liabilities with HMRC.

MARKING GUIDE

TOPIC	MARKS
Part 1 – Qualification status	
Project 1	
General conditions	1
Advance in project	1
Uncertainties in project	1
Failure not a restriction	½
Qualification status	½
Project 2	
Meets conditions	½
Subcontractor status and implication	1
Entitlement of other party to claim	½
Part 2 – Quantum of expenditure	
Staff costs	
Qualifying percentages	½
Scaling down for admin time	½
Comments on qualifying work undertaken	1
Comments on market research and admin	1
EPW	
Definition of EPW	1
Applying restriction for admin time	½
Restriction to 65% as unconnected	1
Calculation of qualifying staff costs	1
PMI not qualifying staff cost as benefit in kind	½
Rent and rates not qualifying cost	½
Material costs	½
Inclusion of H, L & P at appropriate %	1
Part 3 – Financial benefit	
130% additional deduction	1
Benefit of loss surrender	1
Surrenderable amount	1½
Calculation of tax credit	1
Repayment in cash after offset	½
TOTAL	**20**

ANSWER 4

Accountants LLP
Westminster Road
Southend

Mr E Smith
Softies Ltd
IT Road
Cambridge

Xx May 2019

Dear Ethan

Loans to directors and employees

Thank you for appointing us as the company's tax advisers.

I have reviewed the position on the company loans made to you and Damien, together with the loan finance provided by Jeff. The tax issues are detailed below.

Corporation tax - Loans to participators

General position

You may be aware that loans made to individuals who are "participators" in a "close company" may incur a one-off tax liability.

Softies Ltd is a close company, as it is controlled by five or fewer shareholders.

A participator in a company is any person who has, or is entitled to acquire, share capital or voting rights. You and Jeff are participators by virtue of being current shareholders in the company. However, Damien's entitlement to purchase a 6% share interest under the unapproved scheme means that he is also a participator and loans made to him will therefore also be caught by the above legislation.

A tax charge equivalent to 32.5% of the loan ("s.455 tax") arises when a loan made to a participator remains outstanding nine months after the end of an accounting period in which the loan was originally made and the debt does not arise from the company's ordinary business.

The company can seek repayment of the s.455 tax when the loan is repaid to or released by the company. Any repayment of the s.455 tax will be made nine months after the end of the accounting period in which loan repayment or release occurs.

Outstanding loans at 30 June 2018

The loan made to you of £60,000 on 31 May 2018 was *prima facie* repaid within nine months of the end of the year ended 30 June 2018. However a further cash advance of £20,000 was made to you on 20 April 2019.

Where further advances are made within 30 days of the repayment being made ("bed and breakfasting"), the repayment is matched with the later loan and not the original loan of £60,000. This rule automatically applies if the original debt is £5,000 or more and the new loan exceeds £5,000, which is the case here. As a result, £20,000 of the original £60,000 loan remains outstanding at 30 April 2019.

Where a repayment of a loan is itself subject to an income tax charge then subsequent draw-downs are not treated as bed and breakfasting. Although you have funded the repayment of the original loan using taxable dividend income from another company, this is not sufficient to avoid a s.455 charge because the repayment itself did not attract a tax charge, i.e. was not a dividend from Softies Ltd.

The £15,000 loan to Damien also potentially attracts a charge to s.455 tax, however as the debt has been repaid with nine months of the accounting period in which the loan was made and no further loans have been made, no tax liability will arise.

Based on the above, a s.455 liability of £6,581 (£20,250 @ 32.5%) was due to be paid by the company on 1 April 2019. You should make this payment to HMRC as soon as possible to prevent further late payment interest accruing.

Corporation tax – Loan interest

The company will be taxable on interest receivable on an accruals basis under the loan relationship rules i.e. following the recognition in the accounts. Interest due on your loan will be taxable in the year ended 30 June 2019.

Interest payable accrued by the company on the loan from Jeff will be deductible only if it is paid within twelve months of the company's accounting year end i.e. 30 June 2020. Where interest is not paid by this date, a corporation tax deduction will only be given when it is paid.

As the interest on Jeff's loan falls within the category of "yearly interest" the company will need to deduct and account for basic rate income tax at 20% through the quarterly accounting procedure (known as CT61 accounting). This should only be done when the interest is actually paid (or treated as paid). Jeff will receive interest net of the 20% deduction and will pay tax at his marginal rate (or recover the tax) through his own SA return.

Income tax – benefit in kind

A taxable benefit in kind arises on loans provided to employees or directors where interest is charged at less than the official rate of interest and the total of all loans exceeds £10,000 at any time in the tax year. The official rate for 2018/19 was 2.5%.

The original loan to you carried a 5% interest rate, and interest sufficient to cover the interest charge at 2.5% should have been paid in order to avoid a taxable benefit arising on you for 2018/19; otherwise the shortfall should be included on your Form P11D. Payment of interest can be made now to relate back to 2018/19. Any taxable benefit in kind will be subject to income tax at your marginal tax rate for the year.

Damien has entered into a salary sacrifice agreement and agreed to reduce his salary by £500 p.a. to compensate the company for interest on his loan. This amount exceeds the beneficial loan interest at the official rate of £375 (2.5% x £15,000). This type of benefit is taxed under the "optional remuneration rules", under which the value of the benefit is based on the higher amount of salary foregone or interest at the official rate. In this case £500 should have been included as taxable income as part of gross pay for income tax purposes through the monthly payroll process.

It should be noted that, whilst dealt with differently for income tax purposes, Class 1A NIC at 13.8% will still be accounted for by the company on both amounts above via a P11D(b). No primary Class 1 NIC is payable on Damien's benefit in kind, despite being taxed through payroll.

Proposed loan waiver

As you are a participator in the company, the waiver of your loan will have the following tax implications:

- No corporation tax deduction will be available to the company on the debt write off, as the loan relationship rules prohibit a deduction in these circumstances for loans made to participators;
- The s.455 tax of £6,581, referred to above, should be refunded to the company on 1 April 2020 (if the waiver is made before 30 June 2019);
- The company may need to account for employee's and employer's Class 1 NIC (only the latter is deductible for corporation tax) subject to the terms of the loan; and

- You will be treated as receiving an income distribution (dividend) and will be taxed at your marginal dividend rate.

You may wish to consider declaring a dividend (subject to available legally distributable reserves) to clear your loan account, as this will avoid the NIC costs. Alternatively, the debt could be settled by payment of a bonus. The level of the gross bonus would need to be sufficient to leave a net sum after deduction of PAYE and NIC to clear the balance of the loan. This would be processed via the payroll in the normal way and should be a deductible as a salary expense for the company, along with the employer's Class 1 NIC which would be payable by the company.

Please let me know if you would like me to calculate the best option.

Yours sincerely

A Tax Advis**er**

MARKING GUIDE

TOPIC	**MARKS**
Loans to participators - general principles	**3**
Close company and participators	1½
s.455 charge	1
Repayment of s.455 tax	½
Loans to participators – outstanding loans	**5**
Apparent repayment	½
"Bed and breakfasting" rules	2
Damien's loan	1
s.455 liability	1½
Corporation tax – loan interest	**3**
Treatment of interest receivable/payable	1½
Withholding tax/tax position	1½
Income tax – benefit in kind	**5**
Definition	½
Ethan's loan	2
Damien's loan	1½
NIC implications	1
Proposed loan waiver	**3½**
Tax implications	2
Dividend/bonus	1½
Format	½
TOTAL	**20**

ANSWER 5

Accountants LLP
Westminster Road
Southend

Angela Dudley
Dudley Antiques Ltd
Southwold
Suffolk

Xx May 2019

Dear Angela

Dudley Antiques Ltd: Sale of business

Further to our recent conversation, I attach illustrative calculations of the overall tax liabilities on the sale of your business. Three scenarios have been considered:

1. Sale of the shares (Appendix A)

2. Sale of business assets, followed by a liquidation of the company (Appendix B)

3. Sale of business assets, followed by a staged distribution of the proceeds as a dividend (Appendix B)

The purchaser has offered £500,000 for a purchase of shares as opposed to £600,000 to acquire the company's trading assets

The calculations assume that you are entitled to claim the capital gains tax (CGT) entrepreneurs' relief rate of 10% on the gain on the share sale or liquidation of the company.

The overall tax liabilities of a business assets sale followed by a full liquidation results in post-tax proceeds of approximately £388,000 (see Appendix B), as compared to £455,000, on a share sale (Appendix A). Therefore while the overall consideration on a share sale is lower, your proceeds after tax are higher. This is due mainly to avoiding a "double tax charge" that arises on the sale of the business; i.e. corporation tax on the profits arising on the assets sold by the company and a CGT liability on the share sale on liquidation. The after tax proceeds for both calculations do not include legal costs (share sale) or legal costs and liquidation expenses (sale of business).

Instead of liquidating the company (Appendix B) you could distribute the funds as income dividends over a number of tax years (possibly 10 years or more depending on future basic rate tax bands). If these amounts fall within your basic rate band and the dividend rate remains at 7.5%, after tax sale proceeds will be increased by 2.5% and result in proceeds after tax of approximately £398,000 (see Appendix B).

Consultancy and internet trading following liquidation
A capital distribution on a formal liquidation may be reclassified as an income distribution if you commence a new sole trader activity within two years after the commencement of the winding up under a targeted anti-avoidance rule (TAAR).

In your circumstances the TAAR may apply if:

i) the nature of your new activities as a consultant and online antiques dealer are the same or similar to the trade of Dudley Antiques Ltd; and if so

ii) the purpose or one of the main purposes of the liquidation is to avoid or reduce a payment of income tax.

The motive for the liquidation is therefore a critical factor. In view of your intended retirement the presumption is that the liquidation will not be “tax-motivated” however this will need to be reviewed in more detail. The TAAR legislation is difficult to interpret and if there is any uncertainty on the motive for the liquidation, a share sale may be the preferred route as the TAAR does not apply in these circumstances.

Kind regards

Yours sincerely

A Tax Adviser

Dudley Antiques Ltd Total for calculations 8

Illustrative calculations

Appendix A

1. Sale of shares

Proceeds	500,000	A		
Cost	(50,000)			
Chargeable gain	450,000			
CGT @ 10%*	45,000	B		`1/2
After tax proceeds A-B	455,000			`1/2
				1

Dudley Antiques Ltd

Illustrative calculations

Appendix B

Comparison of tax liabilities

Corporation tax		Income/gain	
		(deduction)	
Assignment of lease	£	£	
Proceeds	10,000		
Less Cost	0		
Chargeable gain	10,000		
Less capital losses	(5,000)		
	5,000	5,000	`1/2
Capital allowances			
Tax WDV	0		
Proceeds	7,000		
	7,000	7,000	`1/2
Trade stock			

Value	180,000				
	(60,000)				
	120,000		120,000	`1/2	
Debtors	4,000				
	(3,000)				
Loss sale of debtors	1,000		(1,000)	`1/2	
Goodwill	400,000		400,000	`1/2	
Profits subject to corporation tax			**531,000**	`1/2	
Corporation tax at 19%		A	**100,890**		
Proceeds			600,000		
Less corporation tax			(100,890)		
Less settlement of other liabilities			(80,000)		
Plus cash balance			7,000		
Less base cost of shares			(50,000)		
Gain on distribution			376,110	`1/2	
Capital gains tax at 10%*		B	**37,611**	`1/2	
Total tax liabilities on sale of business		A+B	**138,501**	`1/2	
			Capital receipt		Income distribution
Proceeds inc. share capital			426,110		426,110
CGT liability/ Income tax			(37,611)		(28,208)
After tax proceeds			**388,499**	`1/2	397,902
				5	**2**

*Annual exemption ignored.

MARKING GUIDE

TOPIC	**MARKS**
Letter format and sign off	1
Explanation of tax liabilities on sale of assets vs. sale of shares: inc. access to funds/drip feed dividends?	3
Workings showing tax liabilities of two options (see mark allocation on workings)	8
Conditions for s.396B to apply – liquidation and reclassification of distribution	2
Starting new trade: risk/uncertainties	1
TOTAL	**15**

ANSWER 6

To: Hayley Mills
From: Bob Moore
Date: 6 May 2019
Subject: Re: Ollie Johnston tax return

Hayley

I have set out below details of the tax treatment of each of the expenses.

Property repairs
The construction of a new extension is a capital expense, and will therefore be added back in Ollie's tax computation. There will be no capital allowances available on the structure of the extension, but some allowances may be available in respect of any fixtures (lighting, wiring, air conditioning etc.). A scope of work should be obtained to determine whether any elements are likely to qualify for allowances.

No deduction is given for the cost of repairs which might have been, but were not, carried out.

Services for own use
Whilst goods taken for own use should be accounted for at selling price, there is no similar rule for services. As such, no adjustment needs to be made to the tax computation to increase the £100 charged to the market price of £2,500.

However, no tax deduction will be given for the costs incurred in constructing the website, as this expenditure is not incurred "wholly and exclusively" for the purposes of Ollie's own business. An 'add-back' of £875 (25 x £35) would therefore be required to remove the cost of the web designer's time from the tax computation.

Training costs
Where costs are incurred by the 'proprietor' in acquiring "new expertise, knowledge or skills", as opposed to updating existing knowledge, then these costs will be capital expenditure and will need to be adjusted for in the tax computation. As such, the £2,000 incurred on Ollie's new qualification will need to be added back.

However, a tax deduction is allowed for work-related training for employees, relating to the trade, paid for by the employer. As Ollie intends to commence this new business of digital marketing in the near future, a tax deduction will be given for the cost of the employee's new qualification, on the basis that it relates to a trade to be carried on and will undoubtedly be useful to the employee in the performance of his duties. This will not be a taxable benefit on the employee, as it is specifically exempted by s.250 ITEPA 2003.

The cost of the monthly update seminars will be allowed for both Ollie and the employees, as this is training to maintain existing knowledge and skills.

Gift to employee
The cost of the gift will be tax deductible for Ollie, as it is specifically allowed by s.47(4) ITTOIA 2005 as a gift to an employee.

As long as the gift is not given in return for services in her employment, the employee will not suffer any income tax on the gift, as it is within the statutory exemption for "trivial benefits" up to £50 provided in a non-cash form.

If you need any further assistance, please let me know.

Thanks

Bob

MARKING GUIDE

TOPIC	MARKS
Repairs	
Extension as capital cost	½
No allowances on structure	½
Potential allowances available with examples	1
Review scope of work to determine nature of spend	½
No deduction for repairs ‘foregone’	½
Services for own use	
No adjustment required	1
No deduction for costs	½
Quantification of add back	½
Training costs	
Capital expenditure for Ollie acquiring new skills	1
Employee cost allowable	1
No taxable benefit	½
Update courses deductible for all	½
Gift to staff member	
Deductible for business	½
Trivial benefit to employee	1
Format	½
TOTAL	**10**