

The Chartered Institute of Taxation

Advanced Technical

Taxation of Owner-Managed Businesses

November 2021

Suggested answers

Question 1

Elite Yacht Services

Structures and buildings allowance (SBA) for period ended 31 March 2021

Costs eligible for SBA:

	<u>£</u>	<u>Notes</u>
Architect and designer fees	45,000	1
Site preparation	200,000	1
Construction of factory	600,000	1,3
Total available for SBA	<u>845,000</u>	2
SBA available 7/12 x845,000 x3%	<u>14,788</u>	4

An allowance statement will need to be completed by the partnership.

Notes:

- 1) SBA is available on building components only. Land, stamp duty and planning permission costs are not eligible for SBA. However, costs of preparation of land and all design fees in relation to the building are eligible (s.270 (BG) CAA 2001).
- 2) SBA is not available on assets qualifying for plant and machinery allowances.
- 3) SBA is not available on a building used purely for entertaining as this is not a qualifying activity.
- 4) SBA is available at 3% per annum from 1 September 2020. It can be claimed for 7 months.

Capital allowances on plant and machinery for the period ended 31 March 2021

	<u>FYA</u>	<u>Main pool</u>	<u>Special rate pool</u>	<u>Allowances</u>	<u>Notes</u>
	£	£	£	£	
Air conditioning- factory Production machinery including delivery and installation (£600,000+£50,000)		650,000	80,000		1, 2,6 3
Gurprit's machinery Equipment		200,000 130,000			4, 5 6
Electric vans	102,000			102,000	7
Electric vehicle charging point	1,200			1,200	8
Gurprit's car (80% business) (£86,000+£17,200)	103,200			82,560	9
Production Manager's Car (£24,500 + £4,900)		29,400			9
Total		<u>1,009,400</u>	<u>80,000</u>		
WDA: (£1,009,400 x18% x11/12)		(166,551)		166,551	10
(80,000 x 6% x 11/12)			(4,400)	4,400	10
TWDV c/f		<u>842,849</u>	<u>75,600</u>	<u>356,711</u>	

Notes:

- 1) s.33A CAA 2001 provides that air conditioning is an integral feature and, therefore, qualifies for plant and machinery allowances rather than the SBA. This should be included in the special rate pool (s.104(A) CAA 2001)
- 2) No AIA for mixed partnerships (s.38A CAA 2001).
- 3) As there is a gap of more than four months between the dates on which the obligation to pay becomes unconditional and the date on which payment is required to be made for the production machinery, the expenditure is not incurred until the date on which payment is required to be made. As 25% of the payments will not be made until August 2021, these will be treated as an addition in the y/e 31 March 2022.
- 4) s.264 CAA 2001 provides that capital allowances can be claimed by the partnership for assets personally owned by a partner.
- 5) s.13 CAA 2001 provides that where assets are used for private use prior to being used in the trade, the allowable expenditure is the market value when first used for the purposes of the trade.
- 6) No capital allowances available on assets used for client entertaining (s.269 CAA 2001).
- 7) s.45(DA) CAA 2001 provides that new and unused zero-emission vans qualify for 100% FYA.
- 8) Electric charging points eligible for 100% FYA (s.45(EA) CAA 2001)
- 9) New electric cars are eligible for 100% FYA (s.45(D) CAA 2001). A private use restriction will apply on Gurprit's car. The production Manager's car is second hand and so no FYA is available. No private use restriction applies, and it is included in the general pool. As the cars have some private use, they will need to be included at their VAT-inclusive price.
- 10) As the partnership has a short period of account, writing down allowances are pro-rated (11 months).

MARKING GUIDE

TOPIC	MARKS
Structures and buildings allowance:	
Identification of qualifying costs	1
No SBA on building for entertaining	0.5
No SBA on air conditioning	0.5
No SBA on land, stamp duty, planning	0.5
Calculation of SBA – 3% (0.5), 7 months (0.5)	1
Mention of allowance statement	0.5
Capital Allowances:	
Air conditioning - SRP	0.5
Production machinery – 75% with explanation	1
Installation/delivery	0.5
Claim for assets personally owned by Gurprit	1
Use of market value for Gurprit's machinery	0.5
Office equipment	0.5
Electric vans	0.5
Electric vehicle charging point	0.5
Gurprit's car -FYA	0.5
Gurprit's car – PU adjustment	0.5
PM's car – general pool	0.5
VAT inclusive on Gurprit's and PM's cars	1
WDA main pool	1
WDA SRP	1
Total allowances	0.5
Explanation that no allowances on entertainment	0.5
No AIA in mixed partnership	0.5
TOTAL	15

Question 2

Chailit Ltd Corporation tax computation Year ended 28 February 2021

	Note	£	£
Draft profit per accounts			675,000
Depreciation	1	45,000	
Less assets on finance leases	2	<u>(18,000)</u>	27,000
Employer pension contributions	3		13,770
Provision for structural work	4		12,000
Motor vehicle lease - employee	5	£3,600 x 15%	540
Entertaining costs	6		500
Hampers	7		300
Sponsorship costs	8		10,000
Theft by director	9		15,000
Interest on late paid PAYE	10		1,600
Legal fees for shareholder agreement	11		12,600
Loss on transfer of fixed assets	12		<u>16,000</u>
			784,310
Capital allowances	13		<u>(200,713)</u>
Taxable profit			<u>583,597</u>
Taxable at 19%			<u>110,883</u>

Notes:

- 1) Depreciation is an accounting adjustment.
- 2) Depreciation on assets held under finance leases is allowed.
- 3) Employer pension contributions are allowable when paid (FA 2004, s.196). Accrued wages are allowable provided paid within 9 months (ITTOIA 2005, s.36).
- 4) The expenditure on redecoration is allowable but the reinstatement of the internal walls is capital and therefore disallowed.
- 5) There is no disallowance for private use of a car: this is dealt with as a benefit. However, the employee's car has CO₂ emissions exceeding 110 g/km, therefore deductible costs are restricted by 15%.
- 6) Hotel and meals costs for the five customers are disallowed as entertaining.
- 7) The notebooks are allowed as the total cost in the year (excluding food gifts) does not exceed £50 per person. The hamper costs are disallowed as they include food.
- 8) The sponsorship costs are unlikely to satisfy the requirement of being wholly and exclusively for the purposes of the company's trade and are therefore disallowable. (Executive Network v O'Connor [1995] SpC56).
- 9) Theft by an employee is an allowable expense as a risk of doing business. This relief doesn't extend to theft by directors.
- 10) Interest on late paid PAYE is disallowable. Other costs are allowable.
- 11) Legal costs for the shareholder agreement are capital and therefore disallowable. Costs for the debt collection and renewal of the lease are allowable.

12) The loss on the transfer of the trucks to stock is an accounting adjustment.

13) Capital allowances:

		Main pool	Special rate pool	Allowances
		£	£	£
WDV b/f		116,000	125,000	
Disposal value (market value of tankers)		(100,000)		
Trucks for hire fleet				
September 2020	145,000			
AIA	<u>(145,000)</u>			145,000
January 2021	100,000			
AIA (restricted see below)	<u>(33,333)</u>	66,667		33,333
		<u>82,667</u>		
WDA at 18%/6%		(14,880)	(7,500)	22,380
WDV c/f		<u>67,787</u>	<u>117,500</u>	
				<u>200,713</u>

Maximum Annual Investment Allowance:

$$10/12 \times £1,000,000 + 2/12 \times £200,000 = £866,667$$

$$\text{Maximum } 1/1/21 - 28/2/21 \text{ } 2/12 \times £200,000 = £33,333$$

[Note AIA apportionment is based on the legislation examinable in this session, which established that the AIA would reduce to £200,000 per annum from 1 January 2021. Finance Act 2021 subsequently extended the £1m AIA limit for an extra year to 31 December 2021. Whilst Finance Act 2021 is not examinable in this session, candidates will be given credit equally if they apply it in their answer].

MARKING GUIDE

TOPIC	MARKS
Adjustment of profit (inclusion and amounts) - ½ mark each	6
Adjustment of profit (explanations) - ½ mark each	6
Correct deduction of capital allowances	½
Disposal value of tankers	½
Identification and calculation of restricted AIA	1
WDA at appropriate rate	1
Total	15

Question 3

1) Income and Corporation Tax consequences

(a) Loan to trading partnership

Where a close company makes a loan to a participator or their associate a tax charge can arise under s455 CTA 2010. The charge is calculated at 32.5% of the loan outstanding more than nine months after the end of the accounting period.

An associate for these purposes includes lineal descendants and in particular Clara, Alan's daughter. As she is a member of the partnership the loan will be treated as falling under these provisions. Even though the other two partners are not Alan's associates the s455 charge is based on the full amount of the loan and is not apportioned. The loan will need to be repaid prior to 1 January 2023 to avoid this charge.

In addition to the s455 charge a taxable benefit can arise where an interest free loan of greater than £10,000 is made by reason of employment. The benefit is calculated using the official rate of interest for the tax year. HMRC could argue that the loan was made by reason of Alan's employment. The company would then be required to include the benefit on a form P11D. Where however the loan is used for a qualifying purpose a benefit does not arise. The making of a loan to a trading partnership is a qualifying purpose and a benefit does not therefore arise in this case.

(b) Loan to Jones Cosmetics Ltd

Angela, Alan's wife, is an associate of Alan for the purposes of s455. However, as the loan is not being made to an individual the provisions of s455 do not apply.

Similarly, as the loan is not being made to Angela personally a benefit in kind does not arise as it is not a loan to an individual. In addition, the rate of interest being paid on the loan is significantly above the official rate.

The interest payable on the loan will be received by AJ Clear Ltd gross without deduction of tax and it will be treated as a non-trade credit in their corporation tax computations.

(c) Loan to Emily Hall

The interest free loan to Emily, by reason of her employment, potentially gives rise to a benefit in kind, as described above as the amount of the loan exceeds the £10,000 limit.

The release of the loan would be treated as earnings arising from the employment to be dealt with under PAYE. The company would also be liable to National Insurance at 13.8% although the total of the £9,000 released and the National Insurance would be allowable for Corporation Tax purposes.

There is however an exemption for the payment or reimbursement of removal expenses relating to an employee's qualifying relocation as in this case. The maximum exempt amount is £8,000 with any excess being taxed as a benefit in kind on form P11D.

The amount of the debt released is £9,000 and provided Emily can show that she has incurred qualifying costs of at least this amount the £8,000 exemption can be used. The excess of £1,000 plus the beneficial loan interest charge will be included on form P11D as benefits in kind. The company will be liable to pay Class 1A National Insurance on the £1,000 and the loan benefit but both the loan write off of £9,000 and the lower amount of class 1A National Insurance will remain to be allowable for Corporation Tax purposes.

2) Potential Capital Gains Tax issues

As Alan is considering selling the company it is important to minimise the future capital gains tax on disposal by ensuring that Business Asset Disposal Relief (BADR) is available. A key condition for BADR is that the company is a 'trading' company, a company which carries on trading activities and does not carry on other activities to a 'substantial' extent. Substantial is interpreted as more than 20%. The monies being accumulated to buy larger premises would clearly have qualified as for trading purposes.

The first two loans totalling £70,000 now made however are for a non-trade purpose and represent more than 20% of the net assets. Assets however are not the only test and on profitability, turnover and time spent or assets including any goodwill value they clearly represent less than 20%. Alan should be made aware of the risk should further loans be made.

MARKING GUIDE

TOPIC	MARKS
<u>PART 1 - Income Tax and Corporation Tax consequences</u>	
<u>Loan to Trading Partnership</u>	
Potential s455 Liability at 32.5%/timing	1
Associate definition	½
No apportionment – s455 in full	1
Benefit in kind – by reason of employment	1
Benefit in kind – qualifying purposes	1
<u>Loan to Jones Cosmetics Ltd</u>	
S455 does not apply	1
No loan benefit	1
Interest no deduction at source	½
Non-trade credit	½
<u>Loan to Emily</u>	
Relocation Allowance	1
Benefit in Kind	½
Loan release PAYE issues	1
PIID excess	½
Class 1A NIC	1
Corporation Tax deduction	½
SUB TOTAL	12
<u>Part 2 - Potential Capital Gains Tax issues</u>	
Business Asset Disposal relief	1
Definition trading company	½
Substantial issues	1
Assets/Turnover/Profits	½
SUB TOTAL	3
TOTAL	15

Question 4

1) **Summary**

	£	Taxable?	NIC?
Gross salary for December 2021	4,500	Earnings	Class 1
Contribution to personal pension scheme	3,000	No	No
Company car (market value)	6,750	s.401	See below
Statutory redundancy payment	9,350	s.401	See below
Payment to enforce restrictive covenant in contract	1,000	Earnings	Class 1
Ex-gratia redundancy payment	28,000	s.401	See below
Retraining course	1,500	No	No

PAYE treatment

The gross salary for December 2021 will be subject to PAYE as general earnings, as this is an amount payable under the contract of employment.

The company contribution to the pension scheme will be exempt from PAYE, under s.408 ITEPA 2003.

The payment to enforce the restrictive covenant will be subject to PAYE as general earnings from employment, under s.225 ITEPA 2003.

The retraining course will not be subject to PAYE, under s.311 ITEPA 2003, assuming it is related to skills relevant to the gaining of employment.

The transfer of the company car and the ex-gratia redundancy payment are both capable of being covered by s.401 ITEPA 2003, as these are outside of the employment contract and are voluntary. Statutory redundancy payments are always charged to tax by s.401. Where payments are taxed under s.401, there is a £30,000 exemption available.

However, as Les does not work a notice period, an element of the payment covered by s.401 will be post-employment notice pay ("PENP"). This will not be subject to the £30,000 exemption and therefore subject to PAYE as general earnings.

The amount which is not taxable as PENP will qualify for the £30,000 exemption.

NIC treatment

The gross salary for December 2021 and the payment in respect of the restrictive covenant will be subject to Class 1 NIC for both the employee and the employer, as these are taxable as general earnings arising under a contract. The PENP is also treated as earnings for Class 1 NIC purposes.

The pension contributions and retaining course will not be subject to any NIC, as these are exempt benefits.

Where the payment is not contractual and is not PENP, the payment will not be treated as earnings for Class 1 NIC purposes, even if this payment exceeds £30,000.

However, where the above payment exceeds £30,000, a Class 1A NIC charge at 13.8% will arise on the company on this excess over £30,000.

Reporting

PAYE and both classes of Class 1 NIC will need to be paid over to HMRC by 22 January 2022 (19 January 2022 if paying by post). An RTI submission must be made on or before 31 December 2021, being the date of payment. The Class 1A NIC which is due must be paid to HMRC as part of this RTI process.

As the termination payment exceeds £30,000 and includes non-cash benefits, a report must be filed with HMRC by 6 July 2022.

2) Calculation of PENP

Basic pay	£4,500
Months in post-employment notice period	3
Pay period in months	1
Amounts otherwise taxable as earnings under s.62	£4,500

$$\text{PENP} = \frac{\text{£4,500} \times 3}{1} - \text{£4,500} = \text{£9,000}$$

Amount taxable as general earnings = £4,500 + £1,000 + £9,000 = £14,500

Amount treated as specific employment income = £6,750 + £9,350 + £28,000 - £9,000 (PENP) - £30,000 (exemption) = £5,100

Total taxable income = £19,600

As the payment is made following the date of the P45, 1/12th of the basic and higher rate bands are available:

$$\begin{aligned} 1/12 \times \text{£37,500} &= \text{£3,125} \\ 1/12 \times \text{£112,500} &= \text{£9,375} \end{aligned}$$

		£
£3,125	@ 20%	625
£9,375	@ 40%	3,750
£7,100	@ 45%	3,195
<u>£19,600</u>		<u>7,570</u>

Total PAYE of **£7,570** should be deducted from the payment.

Class 1 NIC will only be due on the general earnings figure of £14,500 above:

		£
£792	@ 0%	0
£3,375	@ 12%	405
£10,333	@ 2%	206
<u>£14,500</u>		<u>611</u>

Total employee's Class 1 NIC of **£611** should be deducted from the payment.

Employer's Class 1 NIC of **£1,891** (13.8% x (£14,500 - £792)) should be paid to HMRC by the company.

Class 1A NIC of **£703** (13.8% x £5,100) should also be paid to HMRC by the company.

MARKING GUIDE

TOPIC	MARKS
Part 1 – Explain:	
PAYE:	
Salary	1
Pension	$\frac{1}{2}$
Restrictive covenant	$\frac{1}{2}$
Retraining course	$\frac{1}{2}$
s.401 and PENP	$1\frac{1}{2}$
NIC:	
Salary and covenant	$\frac{1}{2}$
PENP	$\frac{1}{2}$
Pension and retraining course	1
No Class 1 on s.401 payments even if >£30k	1
Class 1A charge	1
Reporting:	
Date of payment for PAYE/NIC	$\frac{1}{2}$
RTI submission	$\frac{1}{2}$
Form required by 6 July 2022	1
Part 2 – Calculate:	
Calculation of PENP	$1\frac{1}{2}$
Calculation of PAYE	$1\frac{1}{2}$
Calculation of employee's C1 NIC	1
Calculation of employer's C1 NIC	$\frac{1}{2}$
Calculation of Class 1A NIC	$\frac{1}{2}$
TOTAL	15

Question 5

Capital table at 1 May 2022

		%	Held by:	Base cost	Proceeds
Ordinary shares:					
A Ordinary shares of £1 each	750	71.8	Mr A	£750	£1,200,000
B Ordinary shares of £1 each	200	19.1	Mr B	£200	£320,000
C Ordinary shares of £1 each	50	4.8	Mrs C	£50	£80,000
D Ordinary shares of £1 each	45	4.3	Mrs D	£6,750	£72,000
Preference shares:					
5.5% cumulative non-redeemable preference shares of £1 each	250,000		Mr B	£125,000	£250,000
Total		100.0			£1,922,000

Mr A

Mr A will dispose of his A Ordinary shares, generating a gain of £1,199,250. As he has held more than 5% of the company's nominal share capital, voting rights and rights to assets distributable on a winding up for at least two years, been an employee for the same period, and the company is a trading company, he will be eligible to claim business asset disposal relief ("BADR") on the disposal of his shares. However, the lifetime limit of gains on which BADR can be claimed is only £1m. As a result, the remainder of the gain will be chargeable to CGT at Mr A's marginal rate of 20%.

Mr A also has an annual exempt amount (AEA) of £12,300 which should be allocated to the proportion of his gain chargeable at 20%.

Total CGT payable:

	Gain eligible for BADR (£)	Gains not eligible for BADR (£)
Loan notes	-	-
A Ordinary shares	1,000,000	199,250
Less: annual exempt amount		(12,300)
Taxable gains	<u>1,000,000</u>	<u>186,950</u>
CGT:		
1,000,000 @ 10%		100,000
186,950 @ 20%		<u>37,390</u>
CGT payable		<u>137,390</u>

Mr B

Mr B will dispose of his B Ordinary shares, generating a gain of £319,800.

Mr B will also dispose of his 250,000 preference shares, generating a gain of £125,000.

As Mr B does not hold at least 5% of the voting rights in the company, he will not qualify for BADR on either the gain on the disposal of his Ordinary or Preference shares.

As above, Mr B can make use of his annual CGT exempt amount of £12,300.

CGT payable: $(£319,800 + £125,000 - £12,300) \times 20\% = £86,500$.

Mrs C

Mrs C will dispose of her 50 C Ordinary shares, generating a gain of £79,950.

Although the C Ordinary shares carry full rights to vote etc., Mrs C's 50 shares will only constitute a holding of 4.4% of the company's nominal share capital at the date of disposal, because of the exercise of Mrs D's share options in December 2021. Because Mrs C does not hold 5% of the company's nominal share capital at the date of disposal, she will not be eligible to claim BADR on the disposal of her C Ordinary shares on 1 May 2022.

However, prior to the exercise of Mrs D's options, Mrs C's shares represent a 5% holding and she would meet the qualifying conditions for BADR to be available at this point. As the shares will be issued to Mrs D wholly for cash, and for commercial reasons, Mrs C can make an election for a deemed disposal and reacquisition, at market value, of the shares immediately before the dilution. This election will result in a notional gain on which BADR can be claimed.

As the directors have received an offer of £1,672,000 for the company's share capital, which takes into account the exercise of Mrs D's options, Mrs C's pro-rata allocation of £80,000 can reasonably be used as the market value of her shares at the date on which Mrs D exercises her options. Making this election will give rise to a gain of £79,950, but this will be deemed to arise in December 2021 – falling within tax year 2021/22. This election must be made by 31 January 2024.

Assuming that Mrs C will remain a director until the date of actual disposal, an additional election can be made to defer this gain until the shares are disposed of on 1 May 2022, within tax year 2022/23, delaying the payment of the CGT for 12 months. This election must be made by 5 April 2026 – four years from the end of the tax year of the notional disposal.

No gain should arise on the disposal of the actual shares on 1 May 2022, as the market values in December 2021 and May 2022 are the same.

As above, Mrs C can make use of her annual CGT exempt amount of £12,300.

Assuming both elections are made, CGT payable is: $(£79,950 - £12,300) \times 10\% = £6,765$.

Mrs D

Mrs D will acquire her shares through exercise of her qualifying EMI options in December 2021. As these are qualifying share options which have not been granted at a discount to market value, the base cost of the acquired shares will be the £6,750 which Mrs D will pay for her shares.

As such, when Mrs D disposes of her shares on 1 May 2022, a gain of £65,250 will arise.

Mrs D does not hold 5% of the company's nominal share capital. However, as the shares have been acquired by exercising a qualifying EMI option, any size of shareholding can potentially qualify for BADR. Furthermore, the two year holding requirement is extended to include the time during which the option has been held. As such, Mrs D will meet the two year holding requirement. She has also been a director of the company for at least the two years prior to disposal of the shares.

As a result of the above, the disposal of Mrs D's shares will qualify for BADR.

As above, Mrs D can make use of her annual CGT exempt amount of £12,300.

CGT payable: $(£65,250 - £12,300) \times 10\% = £5,295$.

MARKING GUIDE

TOPIC	MARKS
Pro-rata allocation of share proceeds to ordinary shares	1
Mr A:	
Calculation of gain on shares	$\frac{1}{2}$
BADR conditions	2
BADR limit and implications	1
AEA and allocation	1
Calculation of CGT	$\frac{1}{2}$
Mr B:	
Calculation of gain on shares	$\frac{1}{2}$
BADR qualification status	1
Calculation of CGT	$\frac{1}{2}$
Mrs C:	
Calculation of gain	$\frac{1}{2}$
BADR qualification status	1
Background to election 1	2
MV and effect of election	1
Date of election 1	$\frac{1}{2}$
Election 2	2
Date of election 2	$\frac{1}{2}$
Calculation of CGT	$\frac{1}{2}$
Mrs D:	
Base cost calculation	1
Calculation of gain	$\frac{1}{2}$
BADR qualification status	2
Calculation of CGT	$\frac{1}{2}$
TOTAL	20

Question 6

1) Assessable profits for Natasha and Anton

Profit allocation – year ended 30 April 2021

		Total	Anton	Nico	Natasha
1/5/20 – 30/9/20 (5m)					
Profit	380,000 x 5/12	158,333			
Interest	5% x 400,000 x 5/12	(8,333)		8,333	
Salary	25,000 x 5/12	(10,417)	10,417		
Balance	50:50	<u>139,583</u>	69,792	69,791	
1/10/20 – 31/12/20 (3m)					
Profit	380,000 x 3/12	95,000			
Interest	8% x 400,000 x 3/12	(8,000)		8,000	
Salary	45,000 x 3/12	(11,250)			11,250
Balance	45:30:25	<u>75,750</u>	34,088	22,725	18,937
1/1/21 – 30/4/21 (4m)					
Profits	380,000 x 4/12	126,667			
Interest	8% x 400,000 x 4/12	(10,667)		10,667	
Salary	45,000 x 4/12	(15,000)			15,000
Balance	60:40	<u>101,000</u>		60,600	40,400
Total allocation			<u>114,297</u>	<u>180,116</u>	<u>85,587</u>

Estimated profit allocation – year ended 30 April 2022

		Total	Nico	Natasha
Estimated profits		400,000		
Interest	8% x 400,000	(32,000)	32,000	
Salary		(45,000)		45,000
Balance	60:40	<u>323,000</u>	193,800	129,200
Total estimated allocation			<u>225,800</u>	<u>174,200</u>

Natasha – assessable profits

			£
2020/21			
Profit share (1/10/20 – 5/4/21)	85,587 x 6/7		<u>73,360</u>
2021/22			
Profit share (1/10/20 – 30/4/21)			85,587
Profit share (1/5/21 – 30/9/21)	174,200 x 5/12		<u>72,583</u>
Assessable profits			<u>158,170</u>
2022/23			
Year ended 30/4/2022			<u>174,200</u>
Overlap profits	1/10/20 – 5/4/21 6m		73,360
	1/5/21 – 30/9/21 5m		<u>72,583</u>
			<u>145,943</u>

Anton – assessable profits

		£
2020/21		
Profit share	y/e 30/4/20	126,000
Profit share	1/5/20 – 31/12/20	114,297
Less – overlap profits		<u>(64,000)</u>
Assessable profits		<u>176,297</u>

2) Taxation of partnership rental and dividend income

Taxation of rental income

The rental income is treated as a second deemed trade. Even though the income stopped in November 2020, there is no cessation of the trade. The net income will be allocated to all partners on the basis of their profit shares for the year ended 30 April 2021. The normal opening and closing year rules will apply to Natasha and Anton to allocate the income to tax years. Natasha will have overlap profits arise and amounts allocated to Anton will be reduced by any overlap profit brought forward.

Taxation of dividend income

The dividend income can either be allocated to each of the partners' tax returns, in line with their profit-sharing ratios, in the tax year in which they were actually received (both dividends would fall within the 2020/21 tax year). The alternative is that the dividends received in the accounts year to 30 April 2021 are time apportioned to the relevant tax years. In this case 11/12ths of the total dividends of £8,000 would be included in the partners' tax returns for 2020/21 and 1/12th in 2021/22.

3) Explanation of partners' National Insurance contributions

Nico will be liable to Class 2 and Class 4 contributions for the entire year as a continuing partner.

Anton reached state retirement age in 2020/21. He will therefore be subject to Class 2 National Insurance contributions for the period from 5 April 2020 to 1 January 2021, after which his contributions will cease. He will however be liable for Class 4 National Insurance contributions for the entire tax year, as had not yet reached retirement age at the beginning of the tax year.

Natasha will start to pay Class 2 contributions when she becomes a partner. She will also pay Class 4 contributions on profits exceeding the annual profits limit. As she will also pay Class 1 contributions on her employment income, she may exceed the annual maximum for contributions and be entitled to a refund.

Even though Peter will be given the title of partner, the normal considerations apply to determine his employment status. As he does not participate in the profits or losses of the business and has no financial risk, he is likely to continue to pay Class 1 contributions as an employee.

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