

# THE CHARTERED INSTITUTE OF TAXATION

## APPLICATION AND PROFESSIONAL SKILLS

### Taxation of Owner-Managed Businesses

**November 2022**

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TIME ALLOWED

3 HOURS 30 MINUTES

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- In order to secure a pass in this exam, you will be required to demonstrate competence in each of three skills.

You will be assessed across your answer as a whole for Structure. A pass or fail grade will be awarded.

You will be assessed for competence in a number of broad topics for the following skills:

- Identification and Application
- Relevant Advice and Substantiated Conclusions

For each topic for each of these two skills, a grade will be awarded. The grades for those topics will be weighted and averaged to produce a final grade for each skill of 0, 1, 2, 3 or 4. A grade of 3 or 4 is required to demonstrate competence.

- 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.

You are a tax manager in SPD Accountants LLP, a firm of accountants and Chartered Tax Advisers.

Your clients are Pinnacle Architects and its two partners, Teresa Ryan and Rohat Saj.

Your tax partner, Andy Jayze, has received an email from Teresa (**EXHIBIT A**).

The following exhibits are provided to assist you:

**EXHIBIT A:** Email from Teresa Ryan to Andy Jayze

**EXHIBIT B:** Extract from valuation report

**EXHIBIT C:** Budget projections for three years to 31 March 2025

**EXHIBIT D:** Pre-seen information

**Requirement:**

**Prepare a report to Teresa and Rohat, for review by Andy Jayze, providing advice and recommendations regarding the issues raised in Teresa's email.**

Continued

**EXHIBIT A**

Email from Teresa Ryan to Andy Jayze

From: T.Ryan@PA.co.uk  
To: A.Jayze@SPDaccounts.com  
Date: 24 October 2022

Hi Andy

As you know our practice has grown significantly over the last three years. In recent months we have been asked to quote for a number of substantial and high-profile commissions. Rohat and I have become increasingly concerned over our personal risk exposure in the event that one of these projects were to fail and could not be covered by our professional indemnity insurance. We should therefore like to know what actions we can take to mitigate this exposure.

As you know we have recently changed banks and as part of the re-financing we were required to undertake a valuation of the business and premises. I have attached an extract from the valuation report we have received (**EXHIBIT B**).

Neither Rohat nor I have any wish to sell the business, not least as we will both need to continue withdrawing the full annual profits of the business to maintain our current and anticipated lifestyles. This is likely to be the case for at least the next 10 years even if the profit levels do increase.

We believe that our current business premises could be sold to a third party for conversion into a residential development in the next three to five years and this will result in a substantial uplift in value. It is likely that we will sell the property if a suitable offer were made for the premises at that time.

We continue to be concerned about the high marginal tax rates that we are paying and this is likely to get worse if profits continue to increase as anticipated. I have attached our three-year budget forecasts covering the period to 31 March 2025 (**EXHIBIT C**).

We would therefore like your advice regarding our options for protecting ourselves against personal risk and also whether this can be achieved in a tax efficient manner?

Yours sincerely

Teresa Ryan  
Partner, Pinnacle Architects

Continued

**EXHIBIT B**Extract from Valuation report

“.....based on the above assumptions and the information that you have provided we propose the following current market valuations for the goodwill, freehold premises and other net assets:

	£
Goodwill	900,000
Freehold premises	400,000
Other net assets	50,000

The above valuations are given on the assumption of a disposal of the business and premises as a going concern. We believe that the freehold property would command a rental income of £28,000 per annum if let”.

**EXHIBIT C**Budget projections years ended 31 March 2023 to 31 March 2025

	<u>31 March 2023</u>		<u>31 March 2024</u>		<u>31 March 2025</u>	
	£	%	£	%	£	%
Fees	740,000		796,000		860,000	
Cost of sale	<u>(138,000)</u>		<u>(141,000)</u>		<u>(148,000)</u>	
Gross profit	602,000	81.4	655,000	82.3	712,000	82.8
Administration costs	<u>(302,000)</u>		<u>(307,000)</u>		<u>(328,000)</u>	
Net profit	<u>300,000</u>	40.5	<u>348,000</u>	43.7	<u>384,000</u>	44.7
Tax adjusted profit	247,000		300,000		331,000	

Continued

## **EXHIBIT D**

### Pre-seen Information

#### Clients

Pinnacle Architects, Teresa Ryan and Rohat Saj.

#### Client details

Pinnacle Architects is a firm of architectural consultants operated as a partnership.

It was formed on 1 June 2001 by Teresa Ryan and Rohat Saj. Each partner draws a fixed salary of £9,500 and the balance of profits are shared 60% to Teresa and 40% to Rohat. Capital assets and profits are shared 60% to Teresa and 40% to Rohat.

#### Partner details

Teresa Ryan is 54 years old, divorced with three adult children.  
Rohat Saj is 48 years old, single and has no children.

Neither partner has used any of their Business Asset Disposal Relief allowance.

Both partners are resident and domiciled in the UK and have no other income sources.

Teresa has personal capital losses brought forward of £260,000. Rohat has personal capital losses brought forward of £195,000.

Both partners are close to their pension lifetime allowance limits.

#### Tax Information

VAT Registration number: 194456543  
Registration date: 1 September 2001

All supplies are standard rated.

There is no election to waive VAT exemption on the business premises.

The tax written down value of the fixed assets at 1 April 2022 was zero.

Continued

Continuation

Accounts of Pinnacle Architects for the year to 31 March 2022

Profit and loss account for the year ended 31 March 2022

	£	£
Fees		587,500
Opening work in progress	48,000	
Cost of sales	112,000	
Less: Closing work in progress	<u>(50,500)</u>	
		<u>(109,500)</u>
Gross Profit		478,000
Expenditure		
Wages	182,500	
Premises cost	16,400	
Repairs & renewals	8,280	
Telephone	2,420	
Print & stationery	4,170	
Advertising	10,350	
Accountancy	4,200	
Vehicle cost	7,200	
Interest payable	8,180	
Amortisation	12,000	
Depreciation	<u>7,600</u>	
		<u>(263,300)</u>
Net Profit for the year		<u><u>214,700</u></u>

Balance Sheet as at 31 March 2022

	£	£
Intangible fixed assets		36,000
Fixed Assets		
Freehold premises		180,000
Equipment		129,000
Vehicles		40,200
Current Assets		
Work in progress	50,500	
Debtors	98,000	
Cash at bank and in hand	<u>84,000</u>	
	<u>232,500</u>	
Current Liabilities		
Trade creditors	(73,180)	
Bank and loans < 1 year	(18,000)	
Net Current Assets	<u>                    </u>	141,320
Long term loans		<u>(262,000)</u>
		<u><u>264,520</u></u>
Capital Account		
Opening balance	264,820	
Profit/(loss) in year	214,700	
Capital introduced	0	
Drawings	(215,000)	
Closing balance		<u><u>264,520</u></u>

Continued

Partners' Capital Account as at 31 March 2022

<u>Partner</u>	<u>Opening balance</u> <u>1 April 2021</u> £	<u>Capital introduced</u> £	<u>Partners' Salary</u> £	<u>Share of profit/(loss)</u> £	<u>Drawings</u> £	<u>Closing balance</u> <u>31 March 2022</u> £
Teresa Ryan	160,400	0	9,500	117,420	(129,000)	158,320
Rohat Saj	<u>104,420</u>	<u>0</u>	<u>9,500</u>	<u>78,280</u>	<u>(86,000)</u>	<u>106,200</u>
	<u>264,820</u>	<u>0</u>	<u>19,000</u>	<u>195,700</u>	<u>(215,000)</u>	<u>264,520</u>

Intangible fixed assets as at 31 March 2022

	<u>Goodwill</u> £
Cost	120,000
Amortisation at 1 April 2021	72,000
Charged in the year	12,000
Opening carrying value	48,000
Closing carrying value	36,000

The goodwill was acquired in June 2007 from an unconnected third party.

Tangible fixed assets

	<u>Freehold land &amp; buildings</u> £	<u>Fixtures, fittings &amp; equipment</u> £	<u>Motor vehicles</u> £	<u>Total</u> £
Cost				
At 1 April 2021	180,000	262,600	64,500	507,100
Additions	<u>0</u>	<u>19,400</u>	<u>0</u>	<u>19,400</u>
At 31 March 2022	<u>180,000</u>	<u>282,000</u>	<u>64,500</u>	<u>526,500</u>
Depreciation				
At 1 April 2021	0	147,360	22,340	169,700
Charged in the year	<u>0</u>	<u>5,640</u>	<u>1,960</u>	<u>7,600</u>
At 31 March 2022	<u>0</u>	<u>153,000</u>	<u>24,300</u>	<u>177,300</u>
Net book value				
At 31 March 2021	180,000	115,240	42,160	337,400
At 31 March 2022	180,000	129,000	40,200	349,200

The freehold property was acquired in June 2015 at a total cost of £180,000. Integral features were minimal.

The net book value of the fixtures, fittings and equipment is equivalent to the market value. None of these have a value greater than their original cost.

The motor vehicles are vans used exclusively for business purposes.