Chartered Institute of Taxation

Excellence in Taxation

The Chartered Tax Adviser Examination

November 2019

Taxation of Owner-Managed Businesses

Advanced Technical Paper

TIME ALLOWED – 3 ¼ HOURS

- The first 15 minutes is designated as reading time. During this time you may read your question paper and legislation, annotate your question paper and use your calculator. You are not permitted to write in the answer booklet. The Presiding Officer will inform you when you can start writing.
- You should answer all **SIX** questions.
- Start each answer on a fresh page and do not write in the margins.
- All workings should be shown and made to the nearest month and pound unless the question specifies otherwise.
- Marks are specifically allocated for presentation.
- Candidates who answer any law elements in this paper in accordance with Scots law or Northern Ireland law should tick the appropriate box on the front of each answer booklet.
- Unless otherwise indicated by the provision of additional information, you may assume that 2018/19 legislation (including rates and allowances) continues to apply for 2019/20 and future years. Candidates answering by reference to more recently enacted legislation or tax cases will not be penalised.

1. You are a tax manager working for a firm of Chartered Accountants.

Your client Re-Furb Ltd recycles golf balls. The company has two director-shareholders; Mr Cotton and Mr Banks who each own 50% of the issued ordinary share capital.

The company's accounts for the year ended 30 June 2019 show a trading loss of £250,000, as adjusted for Corporation Tax purposes but before capital allowances.

The company's Corporation Tax profits/losses (after capital allowances) for the three previous years were:

Year ended	Profit/(loss)
	£
30 June 2018	100,000
30 June 2017	(60,000)
30 June 2016	10,000

A claim under s.37(3)(b) CTA 2010 was made for £10,000 of the loss for the year ended 30 June 2017 to be set against the profit of the previous year and the balance of £50,000 was carried forward against the profit for the year ended 30 June 2018 under s.45(4) CTA 2010.

Contracts for the sale of the company's trading premises were exchanged on 15 October 2019 with completion expected on 30 November 2019 when Re-Furb Ltd will cease to trade. The company's Corporation Tax profit for the final period is estimated to be zero, before capital allowances and estimated closure costs of £35,000 for statutory redundancy payments and £45,000 for impaired trade debts.

During December 2019 the directors will continue to collect trade debts and pay creditors prior to the appointment of a liquidator after the Christmas/New Year holiday, to take effect on 7 January 2020. The liquidator's fees are expected to be £20,000 for a members' voluntary liquidation.

The sale price for the trading premises is £750,000 giving rise to a capital gain of £300,000 after the deduction of the indexation allowance. An election under s.198 CAA 2001 has been entered into with the purchaser of the building which places a value of £1 on all fixtures in the building.

The company remains solvent despite current losses and there will be a balance of funds to distribute to the shareholders. The company's assets include cash of £300,000 and a loan to Mr Cotton of £100,000 in respect of which the company paid tax under s.455 CTA 2010 of £32,500.

The company's capital allowances computation for the year ended 30 June 2018 shows only a balance of qualifying expenditure on the main pool of £250,000. Except for the disposal of the property, there have been no additions or disposals of plant and machinery since 30 June 2018. The company's fixed asset register includes two commercial vehicles, miscellaneous office equipment and specialist production plant which are expected to be sold (below the cost of each item) for a total of £100,000 during the course of liquidation.

Re-Furb Ltd also owns a flat which was let on short-assured tenancies but has been vacant since 1 July 2018. The property was purchased several years ago and is now valued at £200,000. A gain after indexation of £100,000 will arise on the disposal of the property. Mr Banks would however like to acquire the property from the company to retain as an investment.

Requirement:

Write a memo to your firm's tax partner, Angela Barton, advising on the Corporation Tax implications of the above information including any pro-active advice which may be given. (15)

2. Your client is Hyperion Ltd, a small consultancy company which was incorporated and commenced trading in 2016. Bella subscribed £1,000 for 1,000 ordinary shares of £1 each, being the entire share capital of the company. Bella funded the company by way of a personal loan to it of £100,000.

Trading has been modest with Bella carrying out the majority of the work herself, so as not to compromise on quality. However, she has acquired a good reputation within the industry and has been asked to undertake larger projects so that she has realised she can expand the business and diversify its range of services. Accordingly, Bella asked a former colleague of hers, Frank Thomas, to join the company.

It has been agreed that Bella will transfer 30% of her own shareholding to Frank Thomas when he joins the company next week and that he will receive an annual salary of £40,000. A 100% shareholding is valued at £50,000, a 70% holding is valued at £29,400 and a 30% holding is valued at £4,500. The shares in the company are not subject to restrictions.

Two other consultants, Fred Harman and John Cowles, will also join the company next week on salaries of £25,000 per annum.

All three new employees will be provided with private medical insurance at a cost of £500 each, as part of their contractual agreements. Each would be able to obtain coverage personally at a cost of £575.

As Bella has until now always withdrawn money from the company by way of repayments of her loan and has not had to deal with employment matters, she would like to learn more about how to comply with the company's obligations as an employer.

In order to service larger and more diverse jobs, Bella wants to acquire some additional office equipment and furniture, at a total cost of £65,000. As there is insufficient cash within the company to purchase these assets outright, she is looking to acquire them on either hire purchase or under a finance lease. She assumes that, as both are accounted for in similar ways, the tax treatment would be similar, but would like advice from you on this.

Requirement:

Draft an email to Bella advising on:

1) **Bella's gift of shares to Frank Thomas.** (8)

2) **The steps which the company must undertake as a new employer and its obligations with regards to PAYE and NIC.** (8)

3) **The acquisition of assets on hire purchase and finance lease, making recommendations where appropriate.** (4)

Total (20)

You are NOT required to consider Capital Gains Tax.

3. You are a tax manager in an accountancy firm and your client is Donald Graham.

Donald traded as a timber merchant from 1995 until his retirement on 30 September 2018.

Whilst in business, Donald owned two small warehouses from which he traded; both purchased many years previously. In anticipation of his retirement, he disposed of one of the warehouses and a small amount of the warehouse stock on 30 April 2018 to a competitor for use in their business, moving the remaining stock and the one staff member to his main warehouse. The capital gain arising on the disposal of the warehouse was £135,000. Donald continued to service his customers from his remaining warehouse.

When Donald ceased trading, his business held the following assets:

	Cost	Accounts Net Book Value
	£	£
Customer list	-	-
Warehouse	275,000	470,000
Delivery van	20,000	12,500
Timber saw	4,000	2,500
Stock	30,000	30,000
Debtors	12,750	12,750
Cash	10,000	10,000

The customer list, delivery van, timber saw and stock were sold to another competitor business on 30 September 2018 for consideration of £340,000, which was divided as follows:

	£
Customer list	300,000
Delivery van	20,000
Timber saw	4,000
Stock	16,000

Donald made his only employee redundant on the same date, after working her six month notice period. As a gesture of thanks, he paid her £25,000 on termination, despite only being obliged to pay her statutory redundancy pay of £4,000.

Donald retained the warehouse and rented it out from 31 October 2018 until he received an acceptable offer of £500,000 in early 2019. He exchanged contracts for the sale of the property on 12 March 2019, with completion taking place on 12 April 2019.

Donald is a higher-rate taxpayer, and the above are the only disposals that will be made until 2020/21. He has not previously made any disposals which qualified for Entrepreneurs' Relief.

Requirement:

1) **Explain the Capital Gains Tax implications of the disposals taking place, including calculations of any liabilities.** (12)

2) **Explain how the termination payment will be treated in Donald's Income Tax computation and the employer's National Insurance implications of making the payment.** (3)

Total (15)

4. You are a newly qualified Chartered Tax Adviser in a regional tax firm.

Your client is Foodles Ltd and its owner is Kate O'Connor. Due to concerns about personal liability Kate incorporated Foodles Ltd on 20 October 2017 and transferred her existing sole trade business of event catering to Foodles Ltd on 1 November 2017. The consideration was shares worth £260,000 and loan notes worth £50,000, with an interest rate of 6% per annum.

The sole-trade business had suffered from poor performance in the two years prior to incorporation, and trading losses carried forward at the date of incorporation were £26,450. To aid the recovery of the business, Kate has not yet drawn any interest on the loan note from the company, and doesn't plan to do so until June 2020.

Kate has provided the draft profit and loss account for the period from 1 November 2017 to 31 March 2019.

	Notes	£	£
Turnover			175,000
Cost of sales			
Opening stock		nil	
Purchases and direct costs		100,000	
Closing stock		(25,000)	
			(75,000)
Gross Profit			100,000
Overheads:			
Staff costs	1	48,000	
Premises costs	2	25,000	
Office costs		10,000	
Insurance		5,520	
Bad debts – specific		10,850	
Bank charges		1,500	
Advertising	3	2,750	
Computer running costs	4	3,000	
Travel and entertainment	5	9,750	
Legal and professional fees	6	17,500	
Interest payable	7	5,750	
Profit on sale of assets		(6,500)	
Depreciation		17,000	
			(150,120)
Net Profit/(Loss)			£(50,120)

Continued

4. Continuation

Notes

1) Staff costs

Staff costs includes a salary of £15,000 paid to Kate, plus the associated employer's Class 1 NIC.

2) Premises costs

	£
Rent and rates	15,000
Heat, light and power	3,500
Provision for dilapidations	5,000
New building sign – November 2017	1,500
Total	£25,000

The provision for dilapidations is to cover expected future work to remove internal offices created by Kate within the rented warehouse.

3) Advertising

Advertising includes £2,500 paid for sponsorship of a local rugby club in August 2018. Kate is a board member at the rugby club. In return for the sponsorship payment, the company is given complimentary tickets to each match. Kate normally attends the matches with a customer of the business.

4) Computer running costs

	£
Installation of new router, hard disks and cabling	575
Domain hosting costs	1,000
Website development	750
Annual support contract and internet hosting	675
Total	£3,000

The website development costs relate to the creation of the business's new website in November 2017, through which customers can make bookings.

5) Travel and entertainment

	£
Travel costs	5,000
Accommodation	2,000
Client entertainment	1,500
Client gifts (see below)	550
Staff entertainment	700
Total	£9,750

In December 2018, Kate gave 10 of her best customers Christmas gifts of a hamper and bottle of wine costing £40 and a company-branded diary costing £15.

Continued

4. Continuation

6) Legal and professional fees

	£
Company formation costs	250
Cost of transferring property lease to company name	500
Debt collection fees	3,500
Fees for defending action (see below)	10,000
General corporate legal work, tax compliance, accounts preparation etc.	3,250
Total	£17,500

A person fell ill at an event at which Foodles Ltd provided the catering and they made an unsuccessful claim against the company for damages. The legal costs were incurred in defending this action.

7) Interest payable

£4,250 of the interest relates to the loan note held by Kate. The remainder relates to bank overdraft interest and charges.

8) Fixed assets

Foodles Ltd made the following asset purchases and (disposals) during the period:

Date	Description	Cost	Disposal proceeds
		£	£
1 November 2017	All main pool plant and machinery transferred on incorporation	60,000	
15 November 2017	Flat top grill	1,000	
10 January 2018	Fridge	(250)	nil
15 January 2018	Office furniture	1,500	
31 May 2018	Fridge freezer	400	
30 September 2018	Dishes and bowls	275	
1 December 2018	Catering truck	(30,000)	40,000
4 January 2019	Food preparation unit	500	
21 February 2019	Two-ring burner	750	
Total		£34,175	£40,000

No elections were made on the transfer of the plant and machinery to Foodles Ltd on incorporation. This was transferred at its market value at the time.

Requirement:

1) **Prepare the Corporation Tax computation for Foodles Ltd for the period ended 31 March 2019, along with brief explanatory notes for any tax adjustments.** (18)

2) **Briefly explain the Income Tax implications of Kate's salary of £15,000.** (2)

Total (20)

5. You are a student in a national tax consultancy firm.

Your firm is part of a network of firms which provides *pro bono* business advice through the local Chamber of Commerce.

The next seminar is for people who are looking to start up in business and your firm's Tax Partner has asked you and a colleague to prepare a short presentation and accompanying notes to distribute to attendees of the event. The principal topic of the seminar will be the differences in taxation between carrying on business as a sole trader and as an owner-managed limited company.

You have been asked to prepare two elements of the handout notes:

1) An explanation of the "accruals basis" of accounts preparation for sole traders and limited companies and of any alternative basis of preparation which could be used.

2) Calculations to illustrate the Income Tax and National Insurance implications of an individual operating as a sole trader and as a limited company assuming profits of £65,000 in the year to 31 March 2019. You should assume that the individual receives no other income in the tax year and that all available profits of the company are extracted by 31 March 2019.

Requirement:

Draft the explanation and illustrative calculations detailed above for inclusion in the handout notes. (15)

6. GreenBuild LLP is a Limited Liability Partnership providing environmental design consultancy. Victoria Ho joined the LLP on 1 July 2018. She receives a fixed profit share of £6,000 per month plus a variable share of 10% of profits in excess of £300,000. The LLP's tax adjusted profit for the year to 31 March 2019 was £360,000.

The LLP has a small capital base and Victoria was required to contribute £10,000 on joining.

The operational and strategic management of the LLP is undertaken by the two founder members.

The LLP meets the purchase and running costs of a car for each member.

During the 2018/19 tax year Victoria also received a salary of £2,000 per month for acting as a non-executive director of a large environmental lobbying company.

Requirement:

1) **Explain the basis of taxation of Victoria's income from the LLP and the tax and NIC responsibilities of the LLP.** (10)

2) **Using a monthly period, calculate Victoria's primary Class 1 National Insurance liability for the 2018/19 tax year.** (5)

Total (15)