The Chartered Institute of Taxation

Advanced Technical

Taxation of Owner-Managed Businesses

May 2024

Suggested answers

Question 1

1) Assessable trading profit 2023/24

Adjustment to profit	Notes		£	£
Profit for the year				90,300
Less:				
Rental income	(a)			(17,200)
Add back:				
Cost of sailing course	(b)		200	
Depreciation	(c)		19,000	
Employer pension contributions	(e)		675	
Wages for Stefan's son	(d)		10,000	
Leasing payments	(f)	6,000 – (6,000 x 85% x 40%)	2,940	
Maintenance and other costs	(g)	40% x (1800 + 3,400)	2,080	
Premises costs	(h)	15% x 32,500 + 25% x 9,900	7,350	
Training costs	(i)		2,400	
				44,645
Capital allowances:				
AIA on sailing equipment			34,000	
WDA:				
General pool		18% x 15,000	2,700	
Special rate pool		6% x 6,500	390	
				(37,090)
Tax adjusted profit				80,655

Notes:
- (a) Rental income is not taxable as trading income.
- (b) The cost of the service provided to Stefan's friends is disallowed, as this was not incurred for trading purposes.
- (c) Depreciation is not an allowable expense (s33 ITTOIA 2005).
- (d) As the wages were paid within nine months, they are allowed (s35 ITTOIA 2005). The wages for Stefan's son are disallowed as they will not be paid until March.
- (e) The employer pension contributions are only deductible in the period they are paid (s196(2)(b) FA 2004).
- (f) The lease payments are restricted by 15% for a high emission car (s48 ITTOIA 2005) and also by 40% for private purposes. This does not include the maintenance part of the payment.
- (g) The maintenance and other motor expenses are restricted for 40% private use. There is no disallowance for the van used by the employee.
- (h) The costs related to the café are disallowed as they will be deducted from rental income.
- (i) The cost of the training course is disallowed as it is the cost of acquiring new knowledge and therefore capital expenditure.

Assessable trading profits:

			£	£
Standard part	y/e 30 April 2023			65,000
Profit of transitional part	p/e 5 April 2024	11/12 x 80,655	73,934	
Less overlap profit			(6,000)	
			67,934	
Spread over 5 years				13,587
Assessable trading profit for 2023/24				78,587
Transitional profits carried forward		4/5 x 67,934		54,347

Stefan's taxable income for 2023/24 will be made up of his rental profits and trading profits, which are less than £100,000. His income for 2024/25 may be more than £100,000 which means his personal allowances are restricted. He may want to elect for more of the transitional profits to be taxed in 2023/24. This will reduce the transitional profits spread over the remaining years. The due date for the election is 31 January 2026.

2) Taxation from 2024/25 onwards

From 2024/25, Stefan will be taxed on the profits for the tax year. He will have to apportion the tax adjusted profits for the years ended 30 April 2024 and 2025. He will then be taxed on 1 month worth profit for the year ended 30 April 2024 and 11 months' profit from the year ended 30 April 2025.

From having 21 months to finalise his accounts and tax return and make any balancing payment, he will now only have nine. This may cause increased administrative burdens and cashflow issues. He may have to estimate the profit for the year ended 30 April 2025 if the accounts for this year are not finalised before the filing date for the 2024/25 return on 31 January 2026. The final figures can then be amended when the next return is completed. If the final figures are more than the estimates, then there will be interest charges on the extra tax due.

He will also be taxed on one quarter of the remaining transitional profits each year for the next four years.

The effect of the changes is to accelerate the tax on his profits. As a seasonal business, earning most of his income in the summer months, he will also be paying tax on more profits than he has earned in the month of April each year.

He can decide to change his year end to 31 March to make administration easier. If Stefan decides to cease trading in September 2026, then the remaining transitional profits will be assessed in 2026/27.

3) National Insurance

Stefan will pay Class 2 National Insurance contributions for the weeks up to his birthday in January 2024:

39 weeks at £3.45 = £135.

He will pay Class 4 National Insurance contributions on all his profits for 2023/24 (including transitional profits):

(50,270 – 12,570) x 9% + (78,587 – 50,270) x 2% = £3,959

MARKING GUIDE

TOPIC	MARKS
Part 1 - Assessable profit 2023/24	
Deduction of non-trading income	0.5
Disallow cost of course for Stefan's friends and reason	1
Disallow depreciation	0.5
Disallow employer pension accrual	0.5
Disallow wages not paid within 9 months including reason	1
Restriction of lease payments for private use and high emissions	1
Private use restriction for maintenance and other car costs	1
No disallowance for employee van	0.5
Disallow of café costs	1
Disallow training costs including reason	1
AIA on second hand equipment	0.5
Writing down allowances	1
Identification of profits of standard part	0.5
Identification of profits of transitional part	0.5
Deduction of overlap from transitional part	0.5
Calculation of assessable profit	0.5
Calculation of transitional profits carried forward	0.5
Election for spreading transitional profits	1
SUB TOTAL	**13**
Part 2 - Tax year basis going forward	
Apportionment of profits for each year	1
Possibility of estimation of profits	0.5
Procedure for amendment	0.5
Possible interest charges	0.5
Inclusion of transitional year profits	0.5
Effective acceleration of profits	0.5
Effect on a seasonal business	0.5
Possibility of changing year end	0.5
Effect of retirement	0.5
SUB TOTAL	**5**
Part 3 - National Insurance	
Class 2 NIC due weekly until birthday	1
Class 4 NIC due for the whole tax year	1
SUB TOTAL	**2**
TOTAL	**20**

Question 2

1) Capital Gains Tax Reliefs

Business asset disposal relief (BADR)

For BADR to be available, Sally needs to have made a 'material disposal' of 'business assets'. The sale of the store qualifies as a 'material disposal' as she has owned the business for more than two years. However, the sale does not qualify as a disposal of 'business assets'. There are two categories of business assets for a sole trader: the whole or part of the business, or assets used by the business at the date of cessation. Sally has not ceased trading so the second category doesn't apply. The sale of one store where the business continues does not count as the disposal of the whole or part of a business, but rather the disposal of a single asset. The relevant case law is found in *McGregor v Adcock (1977) (Chancery Division)*, amongst others.

Other reliefs

Replacement of business assets relief (rollover relief)

Sally qualifies for rollover relief as she has disposed of a 'qualifying asset' and will be reinvesting the proceeds in another 'qualifying asset' within three years. The qualifying asset is a building under s155. TGCA 1992. However, as the lease is only for 55 years, it is a depreciating asset. This means that the gain will be held over until she sells the lease, or, if earlier, 10 years from the date of acquisition. However, if, within 10 years, Sally reinvests in a freehold property, then she will be able to rollover the deferred gain and deduct it from the base cost of the freehold property.

		£
Proceeds (market value)	(Note 1)	275,000
Cost		(85,000)
Gain		190,000
Deferred gain		90,000
Chargeable gain	(275,000 – 175,000)	£100,000
Cost of freehold property		250,000
Less deferred gain now rolled over		90,000
Base cost		£160,000

Note 1: As the sale was to a connected person the market value is used.

Gift relief (independent claim)

As there is a sale at undervalue to Sally's sister, they can make a joint claim for gift relief.

		£
Gain (as above)		190,000
Gift relief		(125,000)
	(150,000 – 85,000)	£65,000

It is possible to make a claim for both reliefs, in which case rollover relief takes priority. In this case Sally's chargeable gain would be reduced from £100,000 to £65,000 and the gift relief would be £35,000.

Tax Payments Due

	£	£
Trading profits		85,000
Dividend income		5,000
Total income		90,000
Less personal allowance		(12,570)
Taxable income		£77,430

Basic rate band		37,700	
Pension contributions	360 x 12 x 100/80	5,400	
Donations	40 x 12 x 100/80	600	
Taxed at 20%		43,700	8,740
Taxed at 40%	(85,000 - 12,570 - 43,700)	28,730	11,492
Taxed at 0%		1,000	-
Taxed at 33.75%		4000	1,350
		77,430	
			21,582
Capital Gains Tax	(65,000 – 6,000) x 20%		11,800
Tax			33,382
Class 2 NIC	3.45 x 52		179
Class 4 NIC	9% x 37,700	3,393	
	2% x (85,000 – 50,270)	695	4,088
			£37,649
Tax payments due			
31 July 2024 2nd payment on account			£13,000
31 January 2025			
- Balancing payment	37,649 – 26,000		11,649
- Payment on account 2024/25	(21,582 + 4,088)/2		12,835
			£24,484

Sally can reduce the payment on account due in July 2024 to £12,670 (21,582 + 4088 – 13,000). She can also reduce the payments on account for 2024/25, if she estimates profits will be lower. However, if the estimate is too low, then interest will be charged and possibly penalties.

MARKING GUIDE

TOPIC	Marks
Part 1 – Capital Gains Tax Reliefs	
Conditions for BADR relevant to Sally	0.5
Discussion of non-eligibility	1
Reference to case law	0.5
Identification of rollover relief (depreciating asset)	1
Potential for 'parking' the gain	1
Calculation of deferred gain including market value	1
Calculation of revised base cost	0.5
Identification of gift relief	1
Calculation of gift relief	0.5
Potential for both claims	1
SUB TOTAL	**8**
Part 2 – Tax and National Insurance Payments	
Calculation of taxable income	0.5
Calculation of basic rate band	1
Calculation of Income Tax – trading income	0.5
Calculation of Income Tax – dividend income	0.5
Calculation of Capital Gains Tax	0.5
Calculation of NIC	
- Class 2	0.5
- Class 4	0.5
Tax payments	
- July 2024 payment	0.5
- Balancing payment	0.5
- Payment on account (exclusion of Class 2 and CGT)	1
Potential reduction of payment on account	1
SUB TOTAL	**7**
TOTAL	**15**

Question 3

Capital allowances on plant and machinery:

	General pool £	Special rate pool £	Allowances £	Notes
Balances b/f at 1 October 2022	42,400 (W1)	27,368 (W1)		
Additions qualifying for FYA - Electric car, 28,500			28,500	1
Additions qualifying for super deduction: - Computer equipment, £3,000 - Electric charging points, £2,800			6,670 (W2)	2
Disposals		(10,800)		
	42,400	16,568		
WDA 18%/6%	(7,632)	(994)	8,626	3
Super deduction balancing charge			(17,250) (W4)	4
Total allowances for year ended 30 September 2023			26,546	
Balances b/f at 1 October 2023	34,768	15,574		
Disposals	(363,000) (W5)			5
Total	(328,232)	15,574		
Balancing charge	328,232		(328,232)	
Balancing allowance		(15,574)	15,574	
Super deduction balancing charge			(4,700) (W6)	6
Total balancing charge for period ended 31/12/2023	0	0	(317,358)	7

Capital allowances on structures and buildings:

Structures and buildings allowance (SBA) is available on a straight-line basis at 3%. As the building was brought into use on 1 May 2020, the applicable rate of relief throughout its period of ownership is 3%.

As the structure was bought unused from the developer, the structures and buildings allowance is available on the price paid for the structure. The construction costs of the developer are not relevant. Structures and buildings allowance are only available on the cost of the structure itself, the land is excluded.

In the year ended 30 September 2023, the allowance will be £3,864 (£128,800*3%).

In the period ended 31 December 2023, the allowance will be £966 (£3,864*3/12).

There are no balancing adjustments on structures and buildings. The allowances stop at the date of sale to the third party and the allowances statement must be passed to the new owner so that they can claim allowances for the remaining SBA period.

W1) TWDV brought forward

The car acquired on 18 January 2021 with emissions of 190g/km is a special rate asset.

Its tax written down value is:

	£
Cost (18 January 2021)	30,973
WDA @ 6%	(1,858)
TWDV at 30 September 2021	29,115
WDA @ 6%	(1,747)
TWDV at 30 September 2022	27,368

The car acquired on 8 August 2021 with emissions of 30g/km will be included in the general pool.
Its tax written down value is:

	£
Cost (8 August 2021)	63,057
WDA @ 18%	(11,350)
TWDV at 30 September 2021	51,707
WDA @ 6%	(9,307)
TWDV at 30 September 2022	42,400

W2) Super-deduction

	£
Computer equipment	3,000
Electric charging point	2,800
	5,800
Pro-rated super deduction (5,800x 115% (W3))	£6,670

W3) Super deduction percentage

Number of months prior to 31 March	6
Number of months in accounting period	12
Super deduction percentage (6/12 x 30)+100	115%

W4) Super deduction charge – year ended 30 September 2023

	£
Proceeds	15,000
Super deduction percentage (W3)	115%
Super deduction charge (15,000*115%)	£17,250

W5) Disposals from the general pool

	£
Plant and machinery	300,000
Computer equipment	22,000
Car – CO2 emissions 30g/km	19,000
Electric car	22,000
	£363,000

W6) Super deduction charge – period ended 31 December 2023

	£
Computer equipment	2,200
Electric charging point	2,500
	4,700
Super deduction relevant factor	1
Super deduction charge	£4,700

Notes:

1) While electric charging points are also eligible for FYA, as Harble Ltd wish to claim maximum allowances, the super deduction should be claimed instead.
2) As the accounting period ends after 31 March 2023, the super deduction is only available for the proportion of the accounting period up to 31 March 2023 (182 days).
3) While the car is the only asset in the special rate pool, its disposal does not trigger a balancing adjustment and instead writing down allowances continue.
4) As the super deduction disposal takes place in a year which straddles 1 April 2023, the relevant factor must be calculated for the proportion of the accounting period (182 days).
5) All disposals apart from the assets which qualified for the super deduction are deducted from the general pool.
6) As the disposal takes place in a period which begins after 1 April 2023, the relevant factor is one.
7) No writing down allowances available in period of cessation.

MARKING GUIDE

TOPIC	**MARKS**
Plant and machinery - year ended 30 September 2023	
TWDVs brought forward	1
FYA additions	1
Super deduction additions	1
Super deduction calculation	2.5
Car disposal	1
Writing down allowances	2
Super deduction balancing charge	1.5
Cary forward/total allowances	0.5
Plant and machinery - period ended 31 December 2023	
Main pool disposals	1
Balancing adjustments	2
Super deduction balancing charge	1
Total for period end 31 December 2023	0.5
Structures and buildings allowance	
Identification of eligible amount	2
Year end 30 September 2023	1
Period end 31 December 2023	1
No balancing adjustment	1
TOTAL	**20**

Question 4

1) PAYE and NIC on termination package

As the bonus payment of £10,000 and £7,500 of the payment in lieu of notice are included within Jack's employment contract, they are contractual and are therefore taxable under s.62 ITEPA 2003 and subject to PAYE and both classes of Class 1 NIC.

Although the pension payment of £5,000 is contractual, it is a tax-exempt benefit and therefore is not subject to PAYE or NIC.

The part of the payment in lieu of notice that is not contractual is £37,500. Both this and the value of the car (£25,000) - a total of £62,500 - are "ex-gratia" payments. As these are not contractual, they benefit from the £30,000 exemption afforded by s.401 ITEPA 2003. The above amounts cannot be included within this exemption, due to being contractual.

However, as Jack's contract includes a three-month notice period, which is not being worked, some of the ex-gratia payment in lieu of notice may be post-employment notice pay (PENP) and will not therefore be eligible for the £30,000 exemption, as it will also be treated as earnings.

PENP is calculated as below:

BP = £12,500 (£150,000/12 - this does not include the value of any benefits in kind)
D = 3 months
P = 1 month
T = £7,500 (the contractual PILON of £7,500, which is taxable under s.62, would fall within s.401 were it not for s.401(3) and it therefore forms part of T. The bonus payment is specifically excluded from T by s.402D(1)(d))

$\frac{£12,500 \times 3}{1}$ - £7,500 = £30,000, which is treated as general earnings subject to PAYE and both classes of Class 1 NIC

Therefore, of the £62,500 'ex-gratia' payment, £30,000 is treated as being PENP, leaving £32,500 which is subject to the £30,000 exemption. The balance of £2,500 will be subject to PAYE.

Ex-gratia payments that are not PENP, are not subject to NIC for the employee, regardless of whether they exceed the £30,000 exemption. However, the company will have a Class 1A NIC charge on the amount of the payment which is not PENP and exceeds the £30,000 exemption – in this case the £2,500 balance which is subject to PAYE above.

Summary:

	PAYE	NIC
Contractual:		
Bonus payment (£10,000)	Yes, s.62	Yes
PILON (£7,500)	Yes, s.62	Yes
Pension contribution (£5,000)	No, exempt	No
Ex-gratia:		
PENP (£30,000)	Yes, s.62	Yes
Exemption under s.401 (£30,000)	No, exempt	No
Balance (£2,500)	Yes, s.403	Class 1A

As the payments will be made after employment has ceased and a P45 has been issued, a 0T tax code on a week 1/month 1 basis will be used to calculate PAYE.

The monthly PAYE thresholds will therefore be:

Higher	3,142
Additional	10,428

Total subject to PAYE	50,000	
Tax at 20%	(3,142)	628
Tax at 40%	(7,286)	2,914
Tax at 45%	(39,572)	17,807
Total PAYE		21,349

2) CT treatment of termination package

The various elements of the termination package should generally be deductible for corporation tax purposes for the company, as staff costs which are wholly and exclusively incurred for the benefit of the continuing trade.

Normally there is no disposal value for capital allowances purposes where the asset is gifted to an employee and is chargeable to tax under ITEPA 2003. However, if a revenue deduction is claimed, the transfer cannot be a gift and therefore the disposal value of the car would be £25,000.

Where the payment has a direct link to the sale of the shares, there will be a duality of purpose and the payment will not be deductible. There is a risk that (following the decision in *James Snook & Co Ltd v Blasdale)* the termination payment is unable to be shown as not being linked to the sale of Jack's 10% shareholding. If this is the case, no deduction will be allowed for the termination payment, and the disposal value of the car would be nil. In order to reduce the risk of challenge, it should be able to be demonstrated that the same value is being paid to each of the shareholders for their shares and that the termination package for Jack is in addition to the share disposal, rather than a part of the disposal.

MARKING GUIDE

TOPIC	**MARKS**
Part 1 – PAYE and NIC	
Bonus and PILON	1.5
Pension contribution	1
Ex-gratia payment explanation	1.5
PENP – explanations	2
PENP – calculations	1,5
Ex-gratia payment PAYE	1
Ex-gratia payment NIC	1.5
Calculation of PAYE	2
SUB TOTAL	**12**
Part 2 – Corporation tax	
General deductibility	0.5
Capital allowances	1
Potential link to sale of shares	1.5
SUB TOTAL	**3**
TOTAL	**15**

Question 5

In order to for a repurchase of shares to be lawful:

- The shares must be fully paid up
- The shares must (with one exception relating to employees' share schemes) be paid for on purchase, which HMRC interpret as being in cash on completion and not through the creation of a loan balance
- The purchase must be made out of:
    - Distributable reserves;
    - The proceeds of a fresh issue of shares;
    - Capital (subject to specific conditions being met); or
    - Cash (up to the lesser of £15,000 and 5% of the value of the company's share capital)
- The purchase must be authorised by an ordinary resolution of the company.

Where shares are redeemed or purchased wholly out of the company's profits, the company must transfer, to a "capital redemption reserve", a sum equivalent to the amount by which the company's share capital is diminished on cancellation of the shares. This transfer is required to maintain the company's capital and to protect creditors. It will therefore reduce the profits available for distribution.

Provided there is no restriction in the company's articles preventing a repurchase, Dorothea will enter into a contract to sell her shares back to the company, but with legal completion of the repurchase taking place in tranches, on different dates. Dorothea will dispose of her beneficial interest in the shares at the date of the contract, and so there is only one capital gains tax event, but she will retain legal title to the unpurchased shares, as nominee for the company.

Provided certain condition are met, the repurchase will automatically be treated as giving rise to a capital payment to Dorothea, rather than any part being treated as a distribution. The rules begin from s.1033 CTA 2010.

The company must be an unquoted trading company. In addition, the transaction must:

- Be wholly or mainly for the purposes of benefitting a trade carried on by the company;
- Not be part of a scheme, the main purposes of which is the avoidance of tax;

Dorothea must:

- Be resident in the UK at the time of the purchase;
- Have owned the shares for at least five years (three years if they were inherited), including any holding periods of spouses or civil partners;
- Have a 'substantial reduction' (>25%) in her shareholding; and
- Not be connected (>30%) with the company immediately after the repurchase.

Dream Suites Ltd is an unquoted, trading company. The repurchase is being undertaken to effect the retirement of one of the shareholders without the need to introduce a third party, which could potentially disrupt the management of the trade. This should be seen as benefitting the trade of the company. There is no indication that the transaction is being undertaken for a tax avoidance purpose.

Dorothea is resident in the UK and has owned the shares since 2010.

Dorothea's shareholding is reducing from 50% to 0% as a result of the contract. Although the shareholdings of associates are aggregated together, as Dorothea's children are over 18, they are not associates for these purposes. As she has no beneficial ownership of the shares or any other entitlements once the contract is signed, she will have a "substantial reduction" in her shareholding under both the nominal and distributable profits tests.

Although Dorothea will still hold 28.6% of the company's shares after the first completion, as she will not possess, or be entitled to acquire, more than 30% of the share or loan capital of the company, she is not connected with the company.

As such, the disposal should meet the requirements for capital treatment. The only computation required in this case would be a capital gains computation. The capital disposal should also qualify for BADR, as Dorothea has held more than 10% of the company's share capital for more than two years and has been a director over that period.

Dorothea's CGT liability would therefore be:

Proceeds	1,250,000
Cost	50
Gain	1,249,950
Annual exemption	(3,000)
Taxable gain	1,246,950
CGT at 10% on £1,000,000	100,000
CGT at 20% on £246,950	49,390
Total CGT	£149,390

MARKING GUIDE

TOPIC	**MARKS**
Legal requirements	2.5
Accounting requirements	1.5
Multiple completion buyback implications	1.5
Capital payment or distribution	0.5
Unquoted trading company	0.5
Trade benefit	1
Tax avoidance motive	0.5
Residence	0.5
Ownership period	1
Substantial reduction	0.5
Associates' interests	1
Connection	1
Conclusion on capital treatment	0.5
BADR	0.5
CGT calculation	2
TOTAL	**15**

Question 6

Part 1 - Qualifying expenditure and enhanced deduction

Staff costs

Staff costs of those directly involved in the technological development of the project will qualify for R&D tax relief.

Ramanpreet and Daniel are contributing to the technological development. However, the qualifying costs are restricted by time not spent on qualifying activities. Time spent assisting Karen with sales activities is not time spent resolving the technological uncertainties of the R&D project, so will not qualify. Therefore, the cost will be restricted to 80% for Ramanpreet and Daniel.

The staff costs which qualify for relief are restricted to salary, employer's NICs and employer's pension costs. Benefits in kind do not qualify for relief.

Karen's time on sales and general administrative tasks will not qualify for R&D activities.

The qualifying staff costs will therefore be:

Employee	Salary	Employer's NIC	Employer pension contribution	Qualifying %	Qualifying cost
	£	£	£		£
Ramanpreet	125,000	11,500	10,000	80	117,200
Daniel	140,000	13,500	16,000	80	135,600
	265,000	25,000	26,000		
Total					252,800

The qualifying staff costs are £252,800.

Software costs

Software costs which are directly related to the technological developments on the project (such as the engine modelling software) are eligible for relief.

The costs of £1,000 unrelated to the R&D work will not qualify.

The qualifying software costs are therefore £14,000.

Property costs

Water, gas and electricity costs qualify as "consumables", but only to the extent that they relate to the R&D activities. Therefore, 80% of these costs will qualify for relief.

Rent and rates, insurance and cleaning do not fall within any of the categories of qualifying expenditure.

The consumables consist of water, gas and electricity (limited to 80%), being (£1,000 + £1,250 + £2,500) = £4,750 x 80% = £3,800.

Subcontractor costs

The subcontractor costs qualify for R&D tax relief. As Raan Ltd is a connected company (because Miracle Ltd owns 100% of the shares of Raan Ltd), the qualifying expenditure is limited to the staffing cost of Raan Ltd of £40,000 and excludes the £3,000 of capital expenditure.

The enhanced qualifying deduction available for the year ending 31 March 2024 is therefore:

	£
Staff costs	252,800
Software costs	14,000
Consumables	3,800
Subcontractor costs	40,000
	310,600
Enhanced tax deduction at 86%	£267,116

Part 2 - Benefit

The enhanced tax deduction of £267,116 will be treated as an additional tax deduction in calculating the company's trading profits and these will therefore be:

	£
Profit/(loss) before tax	(478,000)
Deduct:	
Non-trading income	(80,000)
Enhanced R&D tax deduction	(267,116)
Tax-adjusted trading loss	£ (825,116)

As Miracle Ltd has made a trading loss for the year in question, it can surrender the lower of:

i. Unrelieved trading loss: £825,116 less the £80,000 potential current year loss claim against other income = £745,116; and
ii. 186% of its qualifying expenditure of £310,600 = £577,716

Therefore, it can surrender £577,716.

The payable tax credit is therefore 10% of £577,716 = £57,772

Miracle Ltd's claim will be uncapped if its employees are creating, or planning to create, IP and the expenditure to a related party is less than 15% of overall expenditure. As less than 15% of Miracle Ltd's qualifying R&D expenditure (£40,000 out of £310,600) is incurred on R&D contracted out to a connected company and the employees work on the creation of IP, the claim will be uncapped.

Miracle Ltd can therefore surrender a loss of £577,716 for a tax credit of £57,772.

Carrying the loss back is not a possibility as Miracle Ltd has never generated a taxable profit.

However, the loss could be carried forward. The tax rate for future periods will be impacted by the fact that Miracle Ltd has one associated company - Raan Ltd. As there are two associated companies overall (i.e. Miracle Ltd and Raan Ltd), the corporation tax rate thresholds will be £25,000 and £125,000, rather than £50,000 and £250,000. If it was to carry forward the loss, subject to the profit in the following year, it would be able to relieve the loss at rates from 19% to 25% based on the taxable profits.

Carrying the additional losses forward would generate a tax saving of up to 25%, whereas the cash credit when the loss is surrendered is only 10%.

MARKING GUIDE

TOPIC	MARKS
Employee calculations	1
Explanations	1
Software Costs	½
Explanations	½
Property and Business Costs	1
Explanations	1
Subcontractor Costs	1
Explanations	1
Enhanced tax deduction at 86%	1
Tax-adjusted loss	1
Surrenderable loss calculation	1
Payable Tax Credit	1
Consideration of PAYE Cap	1
Loss carry forward	1
Associated company implications	1
Loss carry forward as higher deduction	1
TOTAL	**15**