

THE CHARTERED INSTITUTE OF TAXATION

APPLICATION AND PROFESSIONAL SKILLS

Taxation of Owner-Managed Businesses

May 2024

TIME ALLOWED

3 HOURS 30 MINUTES

- 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 2023/24 legislation (including rates and allowances) continues to apply for 2024/25 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 employed by Carter Taxation, a firm of Chartered Tax Advisers, where you work for Paul Carter.

Paul has recently met with Adam Alfaro (**EXHIBIT A**) who owns all of the shares in Charlotte Ceramics Ltd, a successful company which manufactures high end ceramic products. Adam and his company have been clients of Carter Taxation for the last four years.

Adam wants to sell Charlotte Ceramics Ltd in the near future and requires advice on how a sale of the company might best be achieved.

It was agreed that Paul would draft a report to Adam advising on the sale of his company.

The following exhibits are provided to assist you:

EXHIBIT A: Notes of a meeting between Paul Carter and Adam Alfaro

EXHIBIT B: Assets and liabilities of Charlotte Ceramics Ltd

EXHIBIT C: Information relating to shares held by Charlotte Ceramics Ltd in other companies

EXHIBIT D: Pre-seen information

Requirement:

Prepare a draft report, for review by Paul Carter, providing advice and recommendations to Adam Alfaro on how the sale of Charlotte Ceramics Ltd could be structured, together with the associated tax liabilities.

Continued

EXHIBIT A

Notes of a meeting between Paul Carter and Adam Alfaro

Meeting Date: 1 May 2024
Present: Paul Carter, Adam Alfaro
Subject: Sale of Charlotte Ceramics Ltd

Adam explained that his late wife, Charlotte, had always been the primary driving force behind Charlotte Ceramics Ltd. Since her death in March 2021, Adam has managed to continue running the company. However, without his wife he has lost heart and does not have the energy to drive the company forward with the needed development of new product lines. As a result, he feels that the time is now right for the company to be sold.

Following Charlotte's death, a larger company, Superior Ceramics Ltd, expressed interest in buying Charlotte Ceramics Ltd. Several informal approaches were made to Adam to see whether this would be possible. Following the latest approach, a month ago, Adam said that he would now be interested in pursuing a sale of the company. As a result, it was agreed that a valuation of Charlotte Ceramics Ltd's trade and assets would be performed. This has recently been completed by a reputable valuation company. Adam has prepared a schedule detailing the values given in the valuation report together with other relevant information (**EXHIBIT B**).

The Board of Superior Ceramics Ltd have confirmed that the valuations are acceptable to them. They would like to proceed to drafting heads of agreement for the purchase of Charlotte Ceramics Ltd as quickly as possible. Their intention is that the purchase of the company is completed by 30 June 2024. Due to a previous share purchase of another company, which unwittingly led to acquiring some unforeseen liabilities, their firm preference would be for a purchase of the trade and assets of Charlotte Ceramics Ltd (with the exception of investments, cash at bank, debtors and creditors). Adam, however, wants to be fully aware of all his options for the sale, together with the associated tax liabilities, before proceeding. In the event that a trade and asset sale does occur, Adam confirmed that he would then like to wind up Charlotte Ceramics Ltd.

Adam provided details of some shares in other companies which have been held by Charlotte Ceramics Ltd for a number of years (**EXHIBIT C**).

We agreed that a report would be prepared detailing our advice and recommendations on how the sale of Charlotte Ceramics Ltd could be structured together with the associated tax liabilities. Because Adam felt that the values would not change significantly before any sale, the values from the valuation report dated 30 April 2024 and forecast balance sheet at 30 June 2024 (**EXHIBIT B**) are to be used for the purposes of our report. We should also assume that the company will have taxable profits of £50,000 (before any adjustments required for the sale to Superior Ceramics Ltd) from its trading activities for the accounting period ended 30 June 2024. Adam agreed that there was no need to consider any Inheritance Tax implications within the report.

P Carter

Continued

EXHIBIT BAssets and liabilities of Charlotte Ceramics LtdAssets subject to trade and asset sale to Superior Ceramics Ltd

The assets that Superior Ceramics Ltd would like to purchase have been professionally valued at 30 April 2024 as follows:

	<u>Notes</u>	<u>Market value</u>
		£
Goodwill	1)	200,000
Freehold property	2)	650,000
Vehicles	3)	75,000
Equipment	4)	50,000
Stock		<u>34,000</u>
		<u>1,009,000</u>

Notes

- 1) The goodwill was purchased for £10,000 on 15 July 1998. This goodwill was amortised in the accounts, in accordance with GAAP, at the rate of 10% per year on a straight-line basis.
- 2) The company operates from two freehold properties:

Office and warehouse

This property was acquired for £160,000 (which included £25,000 for land) on 1 January 2000. An extension costing £35,000 was added to the property in January 2010. Its market value at 30 April 2024 is £250,000 (which includes £80,000 for land).

The original acquisition price included £15,000 on fixtures qualifying for capital allowances included in the main pool. The extension cost included £8,000 for fixtures qualifying as integral features. The market value at 30 April 2024 includes a value of £10,000 and £5,000 respectively for these fixtures.

New factory

The land for this factory was acquired for £100,000 in September 2018. Construction started in March 2019 and the factory was completed in June 2020. The total construction expenditure was £225,000 (excluding any relevant VAT). The new factory's market value (including the value of the underlying land) at 30 April 2024 is £400,000. The factory was first brought into exclusive use by Charlotte Ceramics Ltd on 1 July 2020.

The construction cost of £225,000 included £45,000 for fixtures qualifying as integral features. The market value at 30 April 2024 includes a value of £35,000 for these.

- 3) Vehicles comprise a lorry, two vans and two cars (included within the capital allowances main pool). No vehicle has a value exceeding its original cost. No vehicles will be bought or sold (unless to Superior Ceramics Ltd under a trade and asset sale) during the year ended 30 June 2024.
- 4) This figure includes some equipment purchased on 15 April 2024 for £5,000. No other items of equipment will be either bought or sold (unless to Superior Ceramics Ltd under a trade and asset sale) during the year ended 30 June 2024. No individual item of equipment was bought or will be sold for more than £6,000.

Continued

Other assets and liabilities

The forecast balance sheet of Charlotte Ceramics Ltd at 30 June 2024 shows the value of the other assets and liabilities of the company at that date will be:

	<u>Notes</u>	£
Investments	1)	1,000
Bank		65,000
Debtors		70,000
Creditors	2)	<u>(85,000)</u>
		<u>51,000</u>

Notes

- 1) This relates to shareholdings held in Charlotte Retail Ltd and Crowley Glass Ltd (**EXHIBIT C**) after an appropriate write down of the latter.
- 2) Creditors includes all tax liabilities (i.e. including VAT and Corporation Tax liabilities) for periods up to and including 30 June 2024, with the exception of those relating to any adjustments arising from the proposed sale to Superior Ceramics Ltd. The Corporation Tax liability currently included in creditors is £9,500.

Continued

EXHIBIT C

Information relating to shares held by Charlotte Ceramics Ltd in other companies

Charlotte Retail Ltd

Charlotte Ceramics Ltd subscribed for 1,000 ordinary £1 shares (all of the issued share capital) in Charlotte Retail Ltd on 1 February 2021. The intention was to start selling the products of Charlotte Ceramics Ltd directly via a chain of retail outlets operated by Charlotte Retail Ltd. However, Charlotte's premature death on 31 March 2021 meant that this company has never traded. The company's only asset is £1,000 of cash held in a bank account.

Shareholding in Crowley Glass Ltd

Crowley Glass Ltd is a local company which specialised in the production and sale of ornamental glass products. Charlotte Ceramics Ltd purchased 500 ordinary £1 shares in this company (a 5% holding) on 1 April 2017 for £50,000. Whilst Crowley Glass Ltd was initially successful, following some disastrous investment decisions, the company's fortunes have dramatically declined. A full write down of this investment has been made in the accounts of Charlotte Ceramics Ltd. Charlotte Ceramics Ltd have been informed that Crowley Glass Ltd entered liquidation on 1 March 2024. The liquidators have stated that there is no prospect of any value being returned to shareholders.

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EXHIBIT D

Pre-seen information

Client Names

Adam Alfaro
Charlotte Ceramics Ltd

Client Background

Adam was born on 15 June 1964.
He married his wife Charlotte on 31 August 1990.
Charlotte died in a car accident on 31 March 2021 and Adam remains single.
The couple do not have any children.

Charlotte Ceramics Ltd

Charlotte Ceramics Ltd manufactures high end ceramics. The company was incorporated on 30 June 1998 by Charlotte Alfaro who subscribed for 20,000 fully paid up ordinary £1 shares. The share capital of £20,000 introduced was used to buy the trade and assets of a small unconnected ceramics company on 15 July 1998 (including £10,000 for goodwill).

Charlotte gifted 9,800 of her shares to Adam on 30 June 2002, on which date he also became a director in the company. These shares were worth £25,000 on that date.

Adam inherited the remaining shares in Charlotte Ceramics Ltd on 31 March 2021 upon the death of his wife. The probate value of the shares inherited on that date was £275,000.

The company accounts are made up to 30 June each year.

Tax information

Personal

Adam Alfaro

Adam is UK tax resident and domiciled.

Adam takes a salary and dividends of £25,000 and £35,000 respectively each year from Charlotte Ceramics Ltd.

Apart from a small amount of interest income he does not have any other sources of income.

With the exception of his shares in Charlotte Ceramics Ltd and his own house Adam does not have any other substantial capital assets.

Adam has previously used £650,000 of his lifetime allowance for business asset disposal relief purposes, following the disposal in 2021 of another business that he ran.

Corporate

The company tax return for the year ended 30 June 2023 shows:

	£
Taxable trading income (and taxable total profits)	<u>48,350</u>
Corporation Tax at 19%	<u><u>9,186</u></u>

The tax written down values for Charlotte Ceramics Ltd as at 30 June 2023 are as follows:

Main pool	£18,500
Special rate pool	nil

All capital allowances have been claimed to the maximum extent as early as possible.

Charlotte Ceramics Ltd has a capital loss of £25,000 brought forward from the accounting period ended 30 June 2019. This related to the disposal of a property which had previously been used by the company but which had become surplus and fallen into disrepair.

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VAT

Registered entity	Charlotte Ceramics Ltd
Registration number	987 6543 21
Effective registration date	15 July 1998

All of Charlotte Ceramics Ltd supplies are standard rated.

Most recent accounts for Charlotte Ceramics LtdProfit and Loss Account

	<u>30 June 2023</u>	<u>30 June 2022</u>
	£	£
Turnover	842,500	806,350
Cost of Sales	<u>(631,875)</u>	<u>(604,763)</u>
Gross Profit	210,625	201,587
Administrative Expenses	<u>(163,476)</u>	<u>(152,349)</u>
Profit before Taxation	47,149	49,238
Tax on profit	<u>(9,186)</u>	<u>(8,705)</u>
Profit after Taxation	<u><u>37,963</u></u>	<u><u>40,533</u></u>

Balance Sheet

	<u>30 June 2023</u>	<u>30 June 2022</u>
	£	£
Fixed assets:		
Tangible assets	590,050	587,642
Investments	<u>1,000</u>	<u>1,000</u>
	591,050	588,642
Current assets:		
Stock	33,400	35,600
Debtors	75,905	76,542
Cash at bank and in hand	<u>63,975</u>	<u>59,435</u>
	173,820	171,577
Creditors: Amounts falling due within one year	<u>(85,842)</u>	<u>(84,694)</u>
Net current assets	87,438	86,883
	<u><u>678,488</u></u>	<u><u>675,525</u></u>
Capital and reserves		
Called up Share Capital	20,000	20,000
Profit and Loss Account	<u>658,488</u>	<u>655,525</u>
	<u><u>678,488</u></u>	<u><u>675,525</u></u>