

Answer-to-Question-_1_

1. Elite Yacht Services

Structure and buildings allowance (SBA) for period ended 31 March 2022

Costs eligible for SBA:

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

Notes:

N1) 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).

N2) SBA is not available on assets qualifying for plant & machinery allowances.

N3) SBA is available at 3% per annum for 1 September 2021. It can be claimed for 7 months.

CAs on P&M for the period ended 31 March 2022

CAs	N o t	FYA	AIA	Main pool	Specia l rate pool	Allowanc es

	es					
		£	£	£	£	£
Aircon factory	1,6		680,000			
Water & electrical systems	1		310,000			
			990,000			
AIA	2		(916,667)			916,667
					73,333	
Production machinery incl delivery and installation	3			650,000		
Gurprit's machinery	4,5			200,000		
Equipment	6			130,000		
Electric vans	7	102,000				102,000
Electric vehicle charging point	8	1,200				1,200
Gurprit's car (80% business)	9	103,200				82,560
Production manager's car	9			<u>29,400</u>		

(24,500 + 4,900)						
Total:				1,009,400	73,333	
WDA (1,009,400 x 18% x 11/12)	10			(166,551)		166,551
(73,333 x 6% x 11/12)	10				(4,033)	4,033
WDV c/f				842,849	69,300	1,273,011

Notes:

N1) S33A CAA 2001 provides that aircon and water and electrical systems are integral features and therefore qualify for P&M allowances rather than the SBA. This is special rate pool expenditure (s.104(A) CAA 2001) therefore the AIA (s.38A CAA 2001) should be allocated to this expenditure in priority.

N2) The AIA available for an 11 month accounting period is 11/12 x 1,000,000 = £916,667 (s.51A(6) CAA 2001)

N3) As there is a pay gap of more than 4m's 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 2022, these will be treated as an addition in the y/e 31 March 2023.

N4) S.264 CAA 2001 provides that CAs can be claimed by the partnership for assets personally owned by a partner.

N5) S.31 CAA 2001 provides that where assets are used for private use prior to being used in the trade, the allowable expenditure is the MV when first used for purposes of the trade.

N6) No CAs available on assets used for client entertaining (S.269 CAA 2001)

N7) S.45(DA) CAA 2001 provides that new and unused zero-emission vans qualify for 100% FYA.

N8) Electric charging points eligible for 100% FYA (S.45(EA) CAA 2001).

N9) New electric cars are eligible for 100% FYAs (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.

N10) As the partnership has a short period of accounting, WDA's are pro-rated (11 months).

-----ANSWER-1-ABOVE-----

 -----ANSWER-2-BELOW-----

Chailit Ltd

Corporation tax computation

Year ended 28 February 2022

	Note	£	£
Draft profit per accounts			675,000
Depreciation	1	45,000	
Less assets on finance leases	2	(18,000)	27,000
Employer pension contributions	3		13,770
Provision for structural work	4		12,000
Motor vehicle lease - employee - 3,600 x 15%	5		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			<u>(255,380)</u>
Taxable profit			<u>528,930</u>

Taxable @ 19%			100,497

Notes

- N1) Depreciation is an accounting adjustment.
- N2) Depreciation on assets held under finance leases is allowed.
- N3) Employer pension contributions are allowable when paid (FA 2004, s.196). Accrued wages are allowable provided paid within 9 months (ITTOIA 2005, s.36).
- N4) The expenditure on redecoration is allowable but the reinstatement of the internal walls is capital and therefore disallowed.
- N5) There is no disallowance for private use of a car: this is dealt with as a taxable benefit. However, the employee's car has CO2 emissions exceeding 50 g/km (110g/km if lease taken out pre April 2021), therefore deductible costs are restricted by 15%.
- N6) Hotel and meals costs for the five customers are disallowed as entertaining.
- N7) 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.
- N8) 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).
- N9) Theft by an employee is an allowable expense as a risk of doing business. This relief doesn't extend to theft by directors.
- N10) Interest on late paid PAYE is disallowable. Other costs are allowable.

N11) Legal costs for the shareholder agreement are capital and therefore disallowable. Costs for the debt collection and renewal of the lease are allowable.

N12) The loss on the transfer of the trucks to stock is an accounting adjustment.

N13) Capital allowances:

		Main pool	Special rate pool	Allowances
	£	£	£	£
WDV b/f		116,000	125,000	
Disposal value (market value of trucks)		<u>(100,000)</u>		
Trucks for hire fleet:				
September 2021	145,000			
January 2022	<u>100,000</u>			
	245,000			
AIA	(245,000)			245,000
		16,000		
WDA @ 18% / 6%		<u>(2,880)</u>	<u>(7,500)</u>	<u>10,380</u>
WDV c/f		13,120	117,500	255,380

 -----ANSWER-2-ABOVE-----

-----ANSWER-3-BELOW-----

Answer-to-Question-_3_

1) Tax consequences for the company

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 2024 to avoid this charge.

In addition to the s455 charge, an income tax charge on 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 and pay Class 1A NIC. 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 taxable benefit does not arise as it is not a loan to an employee. 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 a taxable benefit reported 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 taxable benefits. The company will be liable to pay Class 1A National Insurance on the £1,000 and the loan benefit. The loan write off of £9,000 and the amount of Class 1A National Insurance paid will 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.

-----ANSWER-3-ABOVE-----

 -----ANSWER-4-BELOW-----

Answer-to-Question- _4_

1) Summary:

	£	Taxable?	NIC?
Gross salary for December 2022	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 2022 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 2022 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 retraining 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 2023 if paid electronically (19 January 2023 otherwise). An RTI submission must be made on or before 31 December 2022, 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 2023.

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		

$PENP = 4,500 \times 3/1 - 4,500 = \pounds 9,000$

Amount taxable as general earnings = $4,500 + 1,000 + 9,000 = \pounds 14,500$

Amount treated as specific employment income = $6,750 + 9,350 + 28,000 - 9,000 \text{ (PENP)} - 30,000 \text{ (exemption)} = \pounds 5,100$

Total taxable income = $\pounds 19,600$

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

$1/12 \times 37,700 = \pounds 3,142$
 $1/12 \times 112,300 = \pounds 9,358$

£			£
3,142	@ 20%		628
9,358	@ 40%		3,743
<u>7,100</u>	@ 45%		<u>3,195</u>
19,600			7,566

Total PAYE of £7,566 should be deducted from the payment.

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

£			£

797	@ 0%	0
3,392	@ 12%	407
<u>10,311</u>	@ 2%	<u>206</u>
14,500		613

Total employee's Class 1 NIC of £613 should be deducted from the payment.

Employer's Class 1 NIC of £1,899 (13.8% x (£14,500 - £737)) should be paid to HMRC by the company.

Class 1A NIC of £704 (13.8% x £5,100) should also be paid to HMRC by the company.

-----ANSWER-4-ABOVE-----

 -----ANSWER-5-BELOW-----

Answer-to-Question- _5_

MATTERHORN LTD

Capital table at 1 May 2023

		%	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			Mr B	125,000	<u>250,000</u>
Total					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	Gain not eligible for BADR
	£	£
Loan notes	Nil	Nil
A Ordinary shares	1,000,000	199,250
		<u>(12,300)</u>
Taxable gains	1,000,000	186,950
CGT:		
1,000,000 @ 10%		100,000
186,950 @ 20%		<u>37,390</u>
CGT payable		137,390

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 4.8% of the company's nominal share capital at the date of disposal, because of the exercise of Mrs D's share options in December 2022. 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 2023.

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 ordinary 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 2022 - falling within tax year 2022/23. This election must be made by 31 January 2025.

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 2023, within tax year 2023/24, delaying the payment of the CGT for 12 months. This election must be made by 5 April 2027 - 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 2023, as the market values in December 2022 and May 2023 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) x 10% = £6,765.

Mrs D

Mrs D will acquire her shares through exercise of her qualifying EMI options in December 2022. 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 2023, 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) x 10% = £5,295.

-----ANSWER-5-ABOVE-----

 -----ANSWER-6-BELOW-----

Answer-to-Question- _6_

1) Assessable profits - Natasha and Anton

Profit allocation - y/e 30 April 2022

	Total	Anton	Nico	Natasha
	£	£	£	£
1/5/21 - 30/9/21 (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	<u>(10,417)</u>	10,417		
Balance 50:50	139,583	69,792	69,791	
1/10/21 - 31/12/21 (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	<u>(11,250)</u>			11,250
Balance 50:50	75,750	34,088	22,725	18,937
1/11/22 - 30/4/22 (4m)				
Profit 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	<u>(15,000)</u>			15,000
Balance 60:40	<u>101,000</u>		<u>60,600</u>	<u>40,400</u>

Total allocation		<u>114,297</u>	<u>180,116</u>	<u>85,587</u>

Estimated profit allocation - y/e 30 April 2023

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

Natasha - assessable profits

<u>2021/22</u>		£	
Profit share (1/10/21 - 4/5/22)	85,587 x 6/7	<u>73,360</u>	
<u>2022/23</u>			
Profit share (1/10/21 - 30/4/22)		85,587	
Profit share (1/5/22 - 30/9/22)	174,200 x 5/12	<u>72,583</u>	
Assessable profits		<u>158,170</u>	
<u>2023/24</u>			
Y/e 30/4/2023		<u>174,200</u>	

		£	
Overlap profits:	1/10/21 - 5/4/22 (6m)	73,360	
	1/5/22 - 30/9/22 (5m)	<u>72,583</u>	
		<u>145,943</u>	

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Anton - assessable profits

		£	
2021/22			
Profit share	y/e 30/4/21	126,000	
Profit share	1/5/21 - 31/12/21	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 2021, 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 2022. 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 2021/22 tax year). The alternative is that the dividends received in the accounts year to 30 April 2022 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 2021/22 and 1/12th in 2022/23.

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 2021/22. He will therefore be subject to Class 2 National Insurance contributions for the period from 5 April 2021 to 1 January 2022, after which his contributions will cease. He will however be liable for Class 4 National Insurance contributions for the entire tax year, as he 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.