

# THE CHARTERED INSTITUTE OF TAXATION

## APPLICATION AND PROFESSIONAL SKILLS

### Taxation of Owner-Managed Businesses

**May 2023**

---

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 2022/23 legislation (including rates and allowances) continues to apply for 2023/24 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 Scilia Taxation, a firm of Chartered Tax Advisers, where you work primarily for Tamara Scilia.

Tamara has recently met with a new client, Sonya Style (**EXHIBIT A**). Sonya owns AA Construction Ltd, a company that has recently sold all of its trading assets to an unconnected company. Sonya, who has always been interested in art, is seeking advice about acquiring an existing art gallery business in a local town.

It was agreed that Tamara would draft a report to Sonya advising on how the purchase of the art gallery business should be structured.

The following exhibits are provided to assist you:

**EXHIBIT A:** Notes of meeting between Tamara Scilia and Sonya Style

**EXHIBIT B:** Assets and liabilities of AA Construction Ltd as at 31 March 2023

**EXHIBIT C:** Information relating to the purchase of the art gallery business

**EXHIBIT D:** Pre-seen information

**Requirement:**

**Prepare a draft report, for review by Tamara, advising Sonya on how the purchase of the art gallery business could be structured together with an overall recommendation on how the purchase should proceed.**

## EXHIBIT A

### Notes of meeting between Tamara Scilia and Sonya Style

Meeting Date: 24 April 2023

Present: Tamara Scilia and Sonya Style

Subject: Commencement of new art gallery business and related issues

Sonya explained that she had originally intended to find a job in the art sector following the completion of her fine art degree in the mid 2000's. However, this proved difficult. Her father's company, AA Construction Ltd, had experienced some financial difficulties at the time and he had asked her to help with the company's administration. She had felt obliged and being in need of employment decided to help.

Gradually AA Construction Ltd's position improved and, following the decision to become involved in the restoration of historic buildings, became reasonably successful. Following her father's death in 2012 Sonya inherited all of the shares in the company, and continued to create a specialist workforce and build the company's reputation in the restoration sector.

However, Sonya has become disillusioned in running AA Construction Ltd. Her first love has always been art, and throughout all this time she has built up her private collection. Her ambition has always been to start her own art gallery. When Bigger Restorations Ltd, a larger, unconnected restoration company approached her with an offer to purchase the trade and most of the assets of AA Construction Ltd, a deal was soon agreed with the selected assets sold at their market value on 31 March 2023. A schedule has been prepared providing details of the assets and liabilities of AA Construction Ltd as at 31 March 2023 (**EXHIBIT B**).

Sonya now wants to purchase "The Creative Touch", an existing art gallery business located in a local town. The business is owned by an unconnected individual who operates it as a sole trader. This purchase will be completed on 1 June 2023 and will involve acquiring the freehold property in which the gallery is located together with certain other assets. Whilst The Creative Touch is currently modestly profitable, Sonya feels that the contacts she has established in the local art world plus the rising affluence of the local area will lead to increased profitability after the purchase. A refurbishment of the gallery building and a marketing programme would, however, be required. It is anticipated that the refurbishment will last 3-4 weeks. Sonya would like to introduce some of her private art collection into her new business.

Sonya does not have any substantial private funds or other assets to dispose of and would like to avoid, or at least minimise, the amount she borrows. She will therefore need to use the funds generated from the AA Construction Ltd asset sale to fund the acquisition. If possible, Sonya would also prefer to avoid, or at least minimise, any initial tax charges that may arise.

We agreed that a report would be prepared detailing our advice and recommendations regarding how this new business could be structured together with an overall recommendation on how this should proceed. We discussed the possibility of a loan being made from AA Construction Ltd either to Sonya or any other party and it was decided that, to avoid ongoing complexities, this was not desirable and therefore did not need to be considered within the report.

A schedule has been prepared providing details of the business that Sonya will buy, her preliminary expenditure plans for this business, information regarding her private art collection, and summary forecast profit and loss accounts for the next three years (**EXHIBIT C**). Whilst the latter are just forecasts, following extensive market research, Sonya has a high level of confidence in her profit projections. Sonya expects that profitability of the new business will stabilise at year three levels for years after this. Once profits of the new business are stabilised, she will not necessarily require all of the post-tax profits to live on.

The meeting then ended.

T Scilia

## EXHIBIT B

### Assets and Liabilities of AA Construction Ltd as at 31 March 2023

	<u>Note</u>	<u>Cost</u> £	<u>Market value at 31/3/23</u> £
<u>Assets purchased by Bigger Restorations Ltd</u>			
Goodwill	1)	25,000	100,000
Freehold property	2)	100,000	250,000
Vehicles	3)	60,000	60,000
Equipment	4)	100,000	50,000
Stock	5)	30,000	25,000
<u>Assets &amp; Liabilities retained by AA Construction Ltd</u>			
Bank		N/A	30,000
Debtors		N/A	35,000
Creditors	6)	N/A	75,000

### Notes

- 1) The only goodwill purchased relates to that acquired for £25,000 from an unconnected construction company on 1 April 2008. This goodwill was amortised in the accounts, in accordance with GAAP, at the rate of 10% per year on a straight line basis. The value at 31 March 2023 relates to all goodwill owned by AA Construction Ltd at that date.
- 2) The company operated from freehold premises acquired for £100,000 on 1 April 2008.
- 3) Vehicles comprised two vans, each purchased for £15,000 on 1 January 2020 and a specialist lorry purchased for £30,000 on the same date. The vans were valued at £10,000 each and the lorry was valued at £40,000 on 31 March 2023.
- 4) No item of equipment was bought or sold for more than £6,000.
- 5) Stock included some older consumable items which have reduced in value.
- 6) Creditors includes all tax liabilities (i.e. including VAT and Corporation Tax liabilities) for periods up to and including 31 March 2023, with the exception of those relating to the disposal of any assets and any final capital allowances adjustments.

### General

In the year to 31 March 2023 no assets were purchased and the only asset sales were those to Bigger Restorations Ltd, as set out above under the heading "Assets purchased by Bigger Restorations Ltd".

## EXHIBIT C

### Information relating to the purchase of the art gallery business

#### Purchase of The Creative Touch

The business will be bought from the current owner, who is VAT registered, for £310,000 plus VAT (if relevant), to be allocated as follows:

	£
Freehold property	255,000
Goodwill	25,000
Display cases / sundry equipment	5,000
Stock	25,000
	<u>310,000</u>

The freehold property was bought by the current owner on 1 January 2008 and is not subject to a VAT option to tax. The figure of £255,000 above includes £55,000 allocated to fixtures. Capital allowances on fixtures have been claimed by the current owner based on their original cost of £37,300. Sonya and the current owner will elect, under s198 CAA2001, that the amount of sales proceeds allocated to the fixtures will be £37,300.

#### Preliminary Expenditure

Once Sonya has acquired the business, the freehold building will be extended and refurbished. This may mean that the gallery will have to temporarily close for 3-4 weeks. An initial marketing campaign will also be undertaken. Total costs are projected to be:

	£
Gallery refurbishment	58,000
New display units	10,000
Other new equipment	10,000
Decorating	3,000
Marketing campaign	<u>9,000</u>
	<u>90,000</u>

The refurbishment expenditure includes items eligible for capital allowances amounting to £15,000.

All figures exclude VAT.

#### Summary Forecast Profit and Loss Accounts

The profit and loss accounts for the business for the current period and next two years are forecast to be:

	<u>Period ended</u> <u>31/3/24</u> £	<u>Year ended</u> <u>31/3/25</u> £	<u>Year ended</u> <u>31/3/26</u> £
Sales	60,000	250,000	300,000
Cost of sales	<u>(30,000)</u>	<u>(125,000)</u>	<u>(150,000)</u>
Gross profit	30,000	125,000	150,000
Expenditure	<u>(39,840)</u>	<u>(60,000)</u>	<u>(60,000)</u>
Net profit / (loss)	<u>(9,840)</u>	<u>65,000</u>	<u>90,000</u>

These forecasts do not include any disallowable expenditure or the preliminary expenditure of £90,000 identified above. They are also before any pre-trading expenditure or capital allowance adjustments.

#### Private Art Collection

Sonya would also like to introduce paintings currently personally owned by her with an aggregate cost of £20,000 and a value of £30,000 to the business. No individual painting originally cost more than £6,000 and no painting will have a value exceeding £6,000.

## EXHIBIT D

### Pre-seen information

#### Client Names

Sonja Style  
AA Construction Ltd

#### Client Background

Sonya was born on 3 January 1981.

Sonya is not married nor in a civil partnership and has no children.

#### AA Construction Ltd

The company was incorporated on 1 April 2002 by Albert Style, Sonya's father who subscribed for 500 fully paid-up ordinary £1 shares, the entire share capital of the company.

On 1 April 2008 the company acquired the trade and some selected assets of an unconnected local construction company for £50,000. This included £25,000 for goodwill.

Albert died on 20 April 2012 and left all of his shares to Sonya. At that time the shares were worth £20,000.

The company accounts are made up to 31 March each year.

#### Tax Information

##### Personal

Sonya received a salary of £65,000 from AA Construction Ltd for the tax years 2020/21 to 2022/23 inclusive.

She does not have any other sources of income.

Sonya has not used any of her lifetime allowance for Business Asset Disposal Relief purposes.

##### Corporate

The tax written down value on the main pool for AA Construction Ltd, the only capital allowances pool, as at 1 April 2022 was nil.

##### VAT

Registered entity	AA Construction Ltd
Registration number	987 6543 21
Effective registration date	1 April 2004

All of AA Construction Ltd's supplies are either standard or zero rated.

Most recent statutory accounts for AAL

AA Construction Ltd

Profit and Loss Account

For the Year Ended 31 March 2022

	<u>31/03/2022</u>	<u>31/03/2021</u>
	£	£
Turnover	895,600	878,500
Cost of Sales	<u>(695,875)</u>	<u>(685,230)</u>
Gross Profit	199,725	193,270
Administrative Expenses	<u>(148,435)</u>	<u>(151,085)</u>
Profit Before Taxation	51,290	42,185
Tax on Profit	<u>(15,400)</u>	<u>(8,437)</u>
Profit After Taxation	<u><u>35,890</u></u>	<u><u>33,748</u></u>

AA Construction Ltd

Company Registration No 1234561

Balance Sheet at 31 March 2022

	<u>31/03/2022</u>		<u>31/03/2021</u>	
	£	£	£	£
Fixed assets				
Tangible assets		236,500		228,525
Intangible fixed assets				
Goodwill		<u>0</u>		<u>0</u>
		236,500		228,525
Current assets				
Stock	23,800		16,485	
Debtors	34,050		27,525	
Cash in bank and in hand	<u>28,755</u>		<u>21,500</u>	
	86,605		65,510	
Creditors: amounts falling due within one year		<u>(73,105)</u>		<u>(79,925)</u>
Net current assets / liabilities		<u>13,500</u>		<u>(14,415)</u>
Total assets less current liabilities		<u><u>250,000</u></u>		<u><u>214,110</u></u>
Capital and reserves				
Called up share capital		500		500
Profit and loss account		<u>249,500</u>		<u>213,610</u>
		<u><u>250,000</u></u>		<u><u>214,110</u></u>