Association of Taxation Technicians

Examination

May 2005

PAPER 2 – Business Taxation

Suggested Solutions

Parts I and II

PART I – SUGGESTED SOLUTIONS

Q1.

12 MONTHS TO 31 DECEMBER 2004

			POOL	ALLOWANCES
WDV B/FWD			15,000	
WDA @ 25%			(3,750)	3,750
			11,250	
28.02.04	Van	15,000		
	FYA@ 40%	(6,000)		6,000
			9,000	
30.06.04	Computer	3,000		
	FYA @50%	(1,500)		1,500
			1,500	
WDV C/FWD			21,750	
ALLOWANCES				11,250

Q2.

An accounting period of a company is deemed to begin when:

a) the company not previously being within the charge to Corporation Tax comes within it whether by the company becoming resident in the UK or acquiring a source of income or otherwise.

b) a previous accounting period of the company ending without the company ceasing to be within the charge to Corporation Tax.

Q3.

Profits Chargeable	18,000 @ 19%	3,420
Less: Marginal Relief		
(50,000 – 20,000) * (18,000/20,000) * (19/400)		(1,282)
		2,138

Effective Rate = 11.87%

Non- Corporate Distribution	5,000 @ 19%	950
Balance @ effective rate	13,000 @ 11.87%	1,543
Corporation Tax Liability		£2,493

Q4.

In order to be tax deductible the expenditure must be incurred in the seven years prior to the commencement of the trade and would have been tax deductible in computing taxable profits if it had been incurred after trading had commenced.

The qualifying expenditure is treated as incurred on the first day that trading commences and is deductible against trading income.

Q5.

Assessment for 2004/05 will be for the 12 months ended 31 July 2004

1/1/04 to 31/7/04	=	£14,000
1/8/03 to 31/12/03		
£36,000 * 5/12	=	<u>£15,000</u>
		<u>£29,000</u>

Overlap will be:

1/8/03 to 31/12/03 (as above)		£15,000
01/02/02 to 31/3/02		
£22,000 * 2/11	=	£4,000
01/01/03 to 31/1/03		
£36,000 *1/12	=	<u>£3,000</u>
		<u>£22,000</u>

Q6.

Penalty for late submission based on original return £100
The latest date by which an enquiry can be opened is 31 October 2005.

(The anniversary of the end of the quarter in which the amended return is submitted).
The enquiry period can be extended if the Revenue 'discover' that income has not been assessed or has been under assessed for an earlier period and raise an assessment.

Q7.

Claim for ABA's :

Land	No claim allowed	
Cattle Shed	4% * 10,000 =	400
Farmhouse	4% * 1/3 * 12,000 =	<u>160</u>
Maximum Claim		<u>560</u>

Q8.

A group for these purposes is defined as a company (the principal company) and its 75% subsidiaries except that any 75% subsidiary which is not an effective 51% of the principal company is excluded.

A 75% subsidiary is where not less than 75% of the ordinary share capital is beneficially owned. A 51% subsidiary is one in which parent is entitled to more than 50% of the profits/assets on winding up.

Q9.

Losses Group Relievable – Year Ended 30 September 2004
Common period 1 July 2004 to 30 September 2004

Juliet Ltd Losses	£10,000 * 3/12 =	£2,500	
Romeo Ltd Profits	£20,000 * 3/12 =	£5,000	
Maximum			£2,500

Losses Group Relievable – Year Ended 30 September 2005
Common period 1 October 2004 to 31 March 2005

Juliet Ltd Losses	£40,000 * 6/12 =	£20,000	
Romeo Ltd Profits	£20,000 * 6/12 =	£10,000	
Maximum			£10,000
Total Maximum Group Relief			£12,500

Q10.

The company will be due to pay s419 tax to the company based on the loan outstanding nine months after the end of the accounting period

Total loan	£30,000
Repaid pre 1/2/05	£10,000
O/S	£20,000 @ 25% = £5000

Further repayment 1/3/05 (i.e. during 30/04/05 accounting period

Repayable 10,000 @ 25% = £2,500 on 01/02/06

Further repayment 10/5/05 (i.e. during 30/04/06 accounting period

Repayable 10,000 @ 25% = £2,500 on 01/02/07

Q11.

1. Interest on the loan to acquire the van will be treated as a trading expense and be deductible against trading income or to enhance a trading loss.

2. Interest on the property loan will be treated as a non-trade deficit and can be relieved as follows:
   a. set against other non-trade credits
   b. surplus can be set against total profits or c/fwd against future non-trade income or be c/back against previous period non-trade credits.

Q12
A company is a consortium company if three-quarters or more of its ordinary share capital is beneficially owned by companies resident in the UK. Each company must own at least one twentieth and be entitled to one twentieth of any profits/assets on winding up.
The losses of a consortium company can be group relieved to members of the consortium.

Q13.
Rent paid in period:

```
1 Aug    £6000
1 Nov     £6000
1 Feb     £6000
          ---------
         £18,000
Less:     (2,000)  being paid in advance
          ---------
           £16,000
          ------------
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No tax relief for legal fees

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Lease Premium                        10,000
Less: ((10 – 1) /50) * 10,000       (1,800)
                                     --------
                                      8,200 over term of lease - 120 months
                                     ---------
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£8,200 * 8/120 = £547 treated as additional rent.

Q14

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2004/05  - 6 April 2004 to 30 June 2004  15,000 * 3/9  =                          5,000
           Overlap relief                                                         5,000
                                                                                 --------
                                                                                 10,000
2003/04 – 1 July 2003 to 5 April 2004
           1 October 2003 to 5 April 2004         15,000 * 6/9  =  10,000
            1 July 2003 to 30 September 2003    (24,000)*3/12=  (6,000)
                                                                --------
                                                                                  4,000
                                                                                  -------
                                                                                 14,000
                                                                                 --------
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Q15

a) If trade not being carried on on a commercial basis with a view to realisation of a profit.
b) Loss arising in a trade of farming or market gardening if loss (before capital allowances) also arose in each of previous five tax years.

Q16

Profits		280,000
Less: group relief		(100,000)

		180,000
Chargeable Gains	30,000	
Less: capital loss	(20,000)	
Less: notional trf to Orange/Banana	(10,000)	
	-----------	
		nil

PCTCT		190,000

Tax thereon:	
180,000 * 30%	54,000
less: Marginal Relief	
(500,000 – 180,000) * 11/400	(8,800)

	45,200

Q17

For goods the conditions are:

1. The goods were supplied to the person now registered
2. The goods were supplied not more than three years before registration
3. The goods are still owned or used to make goods still owned

For services the conditions are:

1. The services were provided to the person now registered
2. The services were received not more than six months before registration
3. The services were not related to goods disposed of before registration
4. The services related to the taxable activities of the business now registered

Q18

Standard rated supplies 10,000 * 117.5%	= 11,750
Exempt supplies	1,000
	12,750
Flat Rate @ 6%	= £765

Q19

The conditions to be satisfied are:

1. The debt must have remained unpaid for a period of six months after the later of the time payment was due and the date of the supply.
2. Must have already accounted for VAT on the supply and paid it to Customs
3. Must have written off debt in day to day VAT account
4. Debt must not have been paid, sold or factored under a valid legal assignment.

Q20

APRIL, MAY, JUNE AND JULY

£395 @ 0%	=	0
£2249@11%	=	247.39
£356 @ 1%	=	3.56
		250.95

* FOUR MONTHS £1003.80 (£1004 TO NEAREST £)

Question 1 - Rhodes Partnership

Part a)

		£
Profit before tax		335,851
Add:		
	Depreciation on non-finance leased assets (57,000-5,750)	51,250
	Client entertaining (3,760-1250)	2,510
	Hire of the box (not allowable as dual purpose)	3,483
	Legal fees for acquisition of new lease	1,250
Less:		
	Profit on disposal of fixed assets	(125,000)
	Decrease in general stock provision	(5,000)
	Interest income	(13,471)
		250,873
Less: capital allowances (W1)		(33,742)
Total profits		217,131

Working 1

	£	£	WDAS
Tax written Down Value		137,560	
WDAs at 25% *9/12		(25,792)	(25,792)
First Year Allowances			
Additions pre-April 2004	8,000		
Capital allowances at 40%	(3,200)		(3,200)
Additions post March 2004 (7,000 + 2,500)	9,500		
Capital allowances at 50%	(4,750)		(4,750)
		9,550	
		121,318	(33,742)

Part b)

	£
Schedule D Case I profit for the period	217,131
Schedule D Case I profit for the previous 12 month	

period (£175,680 * 3/12)	43,920
Schedule D Case I profits	261,051
Profits divided by 3	87,017

Overlap relief

Overlap relief b/fwd	34,200
Overlap relief created (3 months of profits in the year ended 31 October 2003 taxed twice)	14,640
Overlap relief carried forward.	48,840

Part c)

	Non-savings	Savings	Total
Individual profit (from part b)	87,017		
Net interest (W1)		8,114	
Less: personal allowances	(4,745)		
	82,272	8,114	90,386
Capital gain (W2)			1,350
£2,020 at 10%			202
£31,400-2,020 at 22%			6,464
£82,272-£31,400 at 40%			20,349
£8,114 at 40% on interest			3,246
Capital Gains Tax at 40%			540
Total tax payable			30,800
Less:			
Tax deducted at source			(1,623)
Total income and capital gains tax			29,177

W1	**Partnership**	**Individual**
Net interest	19,473	6,491
Multiply by 20/80 to calculate gross interest	4,868	1,623
Gross interest	24,341	8,114

W2

Proceeds				620,000
Less:	Cost		(495,000)	
	Indexation (162.6-159.3)/159.3	3 DP	(10,395)	
				(505,395)
				114,605
Less: taper relief at 75%				(85,954)
				28,651
Less: 3 annual exemptions				(24,600)
				4,051
Divided by 3				1,350

Part d)

Profits	87,017
Charge at 8%	2,158
At 1% in excess of £31,720	553
Class 4 liability	2,711

Part e)

Income Tax liability	30,260
Tax suffered on interest	(1,623)
National insurance	2,711
Total payments on account required	31,348

Payment of £15,674 on 31 January 2006, and a further payment of 31 July 2006.

Question 2 – Joanna Pasher

Advisers address

Ms J Pasher
Address

Date

Dear Joanna

NEW BUSINESS VENTURE

Further to our recent discussions, I have set out my advice in relation to the questions you raised about the your planned new business venture.

1. Incorporation or sole trader
The key tax implications of establishing you business as a company or a sole trader business are outlined below.

Incorporation

You could be the sole shareholder in a newly incorporated company or acquire an 'off the shelf' company. The company is regarded as a separate legal person and as such it is the company that will be required to pay corporation tax.
The company's taxable profits will be calculated for its accounting period ended 30 June 2006.
The expenses of the business, such as the payments to the machinists, designer and any salary you are paid by the company will be deducted in arriving at the profits chargeable to corporation tax.
The payment of any corporation tax will be due 9 months and 1 day after the accounting period end (i.e. 1 April 2007) as the company will not be regarded as a large company.

Also if you incorporate, you can extract your return from the business either through the company paying you a salary (which will be taxed under the PAYE scheme similar to your current basis of remuneration from your current employer) or you could take dividends from the company. By taking dividends you and the company will not be subject to NI.

Sole trader

If you do not incorporate your business, you will be regarded as a sole trader. As such, the profits will be regarded as your profits to be taxed according to the assessment rules for sole traders. Similar to a company, you will need to prepare a set of business accounts for your chosen accounting period end.
Any drawings you take out of the business will not be deductible in arriving at the business profits, although the costs of the machinists, designer etc will be allowable as business expenses.

Your tax liability in relation to tax years will be calculated as follows;

1st Tax year of business:
2005/06: Basis Period is 8 months to 31 March 2006 [5 April 2006]

2nd tax year:
2006/07: Basis period is first 12 months to 31 July 2006

3rd tax year:
2007/08: Basis Period is Accounting period ended 30 June 2007

As you will note from the above basis of assessment, the 8 months of the profits of the period end 30 June 2006 will effectively be taxed twice. These are called overlap profits and there are rules which will allow you to obtain relief for this 'double taxation' when the your sole tradership ultimately ceases or can be relieved if you subsequently change your accounting period.

Income tax will be payable based on your profits at the same rates that you are subject to as an employee of your existing employer.

2. Self employment versus employed

The reason why it is important to consider whether the machinists you use will be regarded as self employed or your employees is because if they are employees this will place greater obligations on you as employer, from a tax perspective.
Basically, the key requirement is that if they are employees of your business, there will be a requirement to operate a PAYE payroll scheme and also pay employer NICs as well as withhold tax and the employee's NICs on payments to the employees.

The Inland Revenue have guidance to be followed and will apply these to your circumstances.

Self Employment

Self employment is usually indicated by the following;

- Control Test

The individual has the final say in how the business is run, e.g. they can refuse work, set their own time limits for completion of work, decide on payment terms. You must therefore consider whether your sub-contractors set the terms under which they operate (i.e. indicating they are self employed) or whether they must accept your terms (i.e. employed), i.e. who is it who has control over their business

- Risks

Your subcontractors risk their own money in their business (e.g. buy materials etc)

They are responsible for meeting losses as well as taking profits, for example, if they set a price for a job and it takes longer to complete they cannot pass the loss on to you.

They must correct unsatisfactory work in their own time at their own expense

- Own Tools

They provide their own items of equipment they need to do their job (not just small tools which many employees provide themselves)

- Non-exclusive

They are free to hire other people on terms of their own choice to do the work you sub-contract to them, and they pay them out of their pockets

Employment
This is usually indicated by the following;

- Exclusivity

They must do the work themselves, rather than hire someone else to do it for them

- Control/Integration

You tell them what you want them to do, when and how to do it
You pay them on an hourly, weekly or monthly basis and may pay overtime or holiday pay
They work an agreed number of set hours, or given number of hours per week/month
They work at your premises or at a place you decide

The Inland Revenue will also consider whether the individual is registered with their local tax office as self-employed and pay class 2 NIC. They may also look to see if the sub-contractor has other customers apart from you.

With regard to the machinist that you propose to use which may end up working full time on your business requirements on balance they may well be viewed by the Revenue as an employee, although the other ones who will just be used from time to time are unlikely to be so.

To be certain, you can get a written decision on their employment status from the Inland Revenue and/or Contribution Agency. I would recommend this approach, otherwise you could be subject to penalties for not operating PAYE properly if ultimately they decide you should have.

3. VAT registration requirements

You will need to register the business for VAT. Registration is compulsory if, either;

1. At the end of any month, taxable supplies in the year then ended exceed £58,000, or
2. At any time there are reasonable grounds for assuming that the taxable supplies in the next thirty days will exceed £58,000.

Notification is required to C&E within thirty days after the end of the relevant month under the first test, with registration being effective from thirty days after the end of the relevant month, or earlier, if agreed.
If the second test applies then notification is required by the end of the thirty day period and registration will be effective from the beginning of the period.

Yours sincerely

A N Adviser

Question 3 - Henno

ABC Accountants
3 The Street
Guildford
GU1 3SY
14 May 2005

Mr Henno
14 London Rise
Ashford
Kent

Dear Mr Henno,

Further to our recent engagement, we have reviewed the two offers that you have received in respect of Garvie Limited and have evaluated these to determine which would yield the most proceeds in your own hands.

We have included our calculations in Appendices 1 to 3 for your perusal, and have commented on these herein.

Disposal of shares

The disposal of the shares in Garvie Limited will give rise to a chargeable gain in your own hands. Since your company is a trading company, your chargeable gain will be reduced by business asset taper relief at a rate of 75%.

As a higher rate taxpayer, you will pay tax at 40% on the gain after taper relief. On proceeds of £1.4 million, you will pay a total tax liability of £135,667. Consequently, after tax, you will have £1,264,433 in your own hands.

Sale of business

As the company will cease trading at the date that the business is sold, a corporation tax computation will need to be prepared for this nine month period.

Since the company is disposing of all of its assets, it will have a substantial taxable gain in the final period of trading, which will be added to the profits of the final nine months of trading to determine the taxable profits for the period.

Based on the information that we have obtained from our research, the corporation tax liability for this final period will be £401,243. This will leave funds of £1,423,757 to distribute to the company's shareholder.

Extraction of funds

The extraction of funds from the company will be treated as a capital distribution and accordingly will be taxed in the same way as if you were selling the shares to a third party.

Based on our calculations, extracting funds of £1,423,757 would give rise to a capital gains tax liability of £138,043, and would result in post tax funds in your own hands of £1,285,714.

Consequently, on the basis of our calculations, the sale of the business and winding up of the company would leave more funds in your own hands.

VAT Treatment of the sale of the business & property

Assuming that you decide to sell the business and assets of the company, it should be possible to transfer the property without charging VAT by treating the transaction as a transfer of a going concern.

In order for this transaction to be treated as a transfer of going concern, the following conditions must be met.

The transfer must be of a whole business, not just the assets. The assets transferred must be intended for use by Dempsey Limited in a similar trade.

In addition to Garvie Limited being a VAT registered trader, Dempsey Limited must either already be VAT registered, or it must immediately become VAT registered.

Garvie Limited must have opted to tax in respect of the property during its period of ownership, and prior to the date of supply Dempsey Limited must opt to tax and notify HM Customs and Excise.

I trust that this will provide you with sufficient information to enable you to choose the appropriate route. Please contact me if you require any further assistance.

Yours sincerely

A N Adviser

Appendix 1 - Disposal of shares

	£	£
Proceeds		1,400,000
Cost	10,000	
Indexation ((162.6-154.4)/154.4)	531	
		(10,531)
Indexed gain		1,389,469
Taper relief at 75%		(1,042,102)
Tapered gain		347,367
Annual exemption		(8,200)
Taxable gain		339,167
Tax payable		135,667

Appendix 2 - Disposal of business

		£	£
Profit per accounts		46,750	
Add:	PAYE penalty	100	
	PAYE interest	135	
	Depreciation	5,750	
Less: balancing allowance (W1)		(25,750)	
			26,985
Add: capital gain (W2)			1,310,490
			1,337,475

Corporation tax limits (1,500,000 * 9/12 = £1,125,000)

Corporation Tax at 30%	401,243

W1

Tax written down value brought forward	225,750	
Proceeds received	(200,000)	
Balancing allowance	25,750	

W2

Sale of goodwill		1,250,000
Sale of freehold	300,000	
Less: cost	(215,000)	
Less: indexation (187.6-168.4)/168.4	(24,510)	
		60,490
Total capital gain		1,310,490

Appendix 3 - Distribution of funds

Funds received into company	1,750,000
Add: funds in bank account	75,000
Less: corporation tax payable	(401,243)
	1,423,757
Less: indexed cost	(10,531)
Indexed gain	1,413,225
Taper relief at 75%	(1,059,919)
Tapered gain	353,306
Less: Annual exemption	(8,200)
Taxable gain	345,106
Capital Gains Tax at 40%	138,043

Answer 4 - Glassworks

a) **Crystal Limited**

	General Pool	Expensive Car	Total
B/f	72,000	0	
Additions	37,000	17,000	
Disposals	(5,000)		
	104,000	17,000	
WDAs @ 25%	(26,000)		(26,000)
		(3,000)	(3,000)
	78,000	14,000	(29,000)

Revised tax computation		£
	Draft computation - Sch D Case I	145,000
	Capital allowances	(29,000)
	Final Sch D Case I	116,000

Tumbler Limited

There is no adjustment to make to Tumbler Ltd's tax computation as the transfer of the asset will take place so as no gain/ no loss arises. This is because the companies are within the same group

Vase Limited

	Proceeds		129,000
	Original cost		(75,000)
			54,000
	Indexation		
186 Dec 04		0	(6,450)
171 Jan 01			47,550

Group rollover available

Amount reinvested by Tumbler in Land and buildings was			100,000
Proceeds received by Vase Ltd	129,000		
Amount not reinvested	29,000		
Gain arising is lower of:			
amount not reinvested	29,000		
actual gain	47,550		
Therefore, Vase Ltd will have a gain of		29,000	
Gain rolled over is 18,550			

Schedule D Case I	(54,000)
Schedule A	36,000
Schedule D Case III	
Capital gain	29,000

b) Group relief allocation

	Taylor Glassworks PLC	Flute Ltd	Tumbler Ltd	Crystal Ltd	Vase Ltd		
Schedule D Case I	320,000	140,000	0	116,000	0		
Schedule A					36,000		
Schedule D Case III	15,000		22,000				
Chargeable gain					29,000		
Notional trf S171A			28,000		(28,000)		
	335,000	140,000	50,000	116,000	37,000		
Group relief from Vase				(54,000)		54,000	total
From tumbler	(86,333)	(81,667)		(12,000)		180,000	total
	248,667	58,333	50,000	50,000	37,000		

Capital gain (after rollover relief) has been reallocated in part to Tumbler Ltd, where it will be taxed at 19% instead of 32.75%. Alternative allocations between these companies could achieve the same result.
Optimum group relief surrender is done by surrendering to companies with the highest marginal rate of corporation tax. For the group this will be to companies with profits falling in the range of £50,000 to £250,000. (Working 1)
Hence, Tumbler's losses should be surrendered to Crystal down to the £50,000 level.
Due to the corresponding accounting period rules restricting the set off of losses to Flute Ltd it is not possible to surrender sufficient losses to get down to the small companies rate of 19%, but the maximum should be surrendered.
The remainder should then be surrendered to Taylor Glassworks PLC having the next highest marginal CT rate of 30%.

Working 1

Profit limits

No. of associated companies			6	include all active companies including non UK
Upper limit	1,500,000	/6 =	250,000	)
				)
Lower Limit	300,000	/6 =	50,000	)

Loss memorandum

Companies with losses	Vase Limited	(54,000)
	Tumbler Limited	(180,000)
	Crystal Ltd	66,000
	Flute Ltd	81,667
	Taylor Glassworks	86,333
		0

Loss available to surrender to Flute Ltd is restricted to lower of;

7/12 of	Flute Ltd's profit of	140,000 =	81,667
7/12 of	Tumbler's Loss	(180,000) =	(105,000)

Group VAT Registration and implications

Eligibility

Companies must be corporate bodies
Companies must be established or have an established place of business in the UK
The companies must be under common control, meaning that one controls the other or the same person controls all of them.
Control is based on S736 Companies Act 1985.
Basically means have voting control by a simple majority of the share capital, but can include other forms of control such as being a member of the company and having contractual rights to appoint a majority of the directors.

Implications

Group is treated as one taxable person.
One Representative member responsible for filing and paying VAT
Joint and severable liability for each company for the group VAT liability
Intra-group transactions are ignored for VAT purposes

Question 5
Mr T Brown
Address

Dear Trevor

TAX IMPLICATIONS OF OPTIONS OF STRUCTURING BUSINESS

Further to our recent meeting, I set out below the answers to the queries you raised.

1. Income tax liability of starting partnership

If you decide to introduce Sandra as a partner into your business, then effectively your basis of assessment will be calculated in a similar manner, albeit that an element of the business profits would be allocated to Sandra for her partner's salary.

I have detailed out the workings of your taxable income in Appendix 1, but summarise them below.

Tax year	£
2001/02	32,083
2002/03	55,000
2003/04	85,000
2004/05	105,000
2005/06	130,000

As you will note, you have overlap profits from when you first started your business of £32,083 which are effectively profits that have been taxed twice. You will not get relief for these overlap profits when you cease being a sole trader and become a partnership.
You will not be taxed on the profits for the year ended 31 December 2005 in the 2005/06 year end, as these will just form part of your assessment for the year ended 31 August 2006 which are taxed in the tax year 2006/07.

2. Income tax liability if incorporate business

The main point to note of you incorporating your business is that you will cease to operate as a sole trader.
The key income tax implication of this is that you will be regarded as ceasing to trade and therefore the cessation rules will apply.
You will be regarded as ceasing to operate your business as a sole trader on the date of incorporation which is intended to be 31 December 2005 and your tax liability on the business profits will be assessed in the tax year of cessation (ie 2005/06). You will however get relief for the overlap profits that arose when you started your business.

Your assessable profits in relation to the business for 2005/06 will therefore be:

	£
Profits for period ending 31 August 2005	130,000
Profits for period ending 31 December 2005	45,000
	175,000
Less: Overlap profits	(32,083)
Taxable profits	142,917

As a director and employee of the company, you will also be subject to income tax on your salary.
Assuming you take an annual salary of £60,000, this will mean that in the tax year 2005/06 you will also have taxable income from employment of £15,000.

3. NIC implications on Sandra's income

As a partner of the business, Sandra will be self employed and so she will be subject to Class 2 and Class 4 NICs, compared to Class 1 which she will currently be subject to as an employee and which she will continue to be subject to as a director of the company if the incorporation route is adopted.

Class 2 NI contributions are a weekly flat rate amount of £2.05 pw (Note based on 04/05 rates)

Class 4 NI contributions will be based on Sandra's profit for the tax year.
The rate applied is 8% to the profits that fall between the Upper and Lower earnings limit, which for 2004/05 are £31,720 and £4,745, respectively. (Again based on 2004/05 rates/limits)
As she will be given a 'fixed' profit through her partners salary, her profits for 2005/06 will be

However, for the 2005/06 tax year Sandra will also have paid Class 1 NICs which will be taken into account in determining the overall NICs due for this tax year as there is a maximum limit.

If incorporation occurs and Sandra is made a director, although her NI liability will still be Class 1, as a director her Class 1 NI liability will be calculated on a cumulative annual basis, rather than just by looking at each earnings period in isolation. The main implication of this is that if bonuses are paid from time to time they will be taken into account in looking at the cumulative NI earnings for the tax year. In practical terms, since Sandra's annual salary will exceed the upper earnings limit for Class 1 NI, this will only really have a timing implication for the payment of Class 1 NI

4. VAT requirements

As you are currently the VAT registered person of the business, when you cease to trade you have an obligation to inform Customs and Excise of the cessation and need to deregister for VAT.

There should be no VAT payable on the transfer of the business to the new company on incorporation as long as the following conditions are met;

a) the business is transferred as a going concern
b) the purchaser (ie the new company) is or will become VAT registered
c) there is no undue 'gaps' in the trade
d) the business is carried on by the new company as before.

Based on our discussions I believe all these conditions should be satisfied.

You can also request that your current VAT number can be transferred to the company.

In order to deregister, you must notify Customs and Excise within 30 days of ceasing to make taxable supplies and so based on incorporation on 31 December 2005, you will need to notify by 30 January 2006.

Yours sincerely

A N Adviser