Association of Taxation Technicians

Examination

May 2006

PAPER 2
BUSINESS TAXATION

SUGGESTED SOLUTIONS

PAPER 2 ATT MAY 2006
PART I – SUGGESTED SOLUTIONS

Q1.

		POOL	ALLOWANCES
WDV B/FWD		6,000	
ADDITIONS - FYA DISCLAIMED		2,000	
SALE PROCEEDS – 30.04.05		(8,000)	

ADDITION - 28.02.05 Van	10,000		
FYA DISCLAIMED	(2,000)		

	8,000		
FYA@ 50%	(4,000)		4,000
		4,000	
WDV C/FWD		4,000	

ALLOWANCES			4,000

Q2.

(A)
A company is close if: -
It is under the control of five or fewer participators
Or
It is under the control of participators who are directors

(B)
Control means the possession of or right to acquire: -
The greater part of share capital, right to greater part of income or greater part of assets on a winding up.

A participator means a person having a share or interest in the capital or income of the company.

Q3

Basis periods: -

2004/05 - 1/12/04 to 5/4/05 Loss £18,000 * 4/6 = loss £12,000
Assessment £Nil

2005/06 – First twelve months - 1/12/04 to 30/11/05

1/12/04 to 31/5/05	**loss (18,000)**
less: loss in 2004/05	**12,000**

	(6,000)
1/6/05 to 30/11/05	
£108,000 * 6/12	**54,000**

2005/06 ASSESSMENT	**£48,000**

Overlap Period	**1/12/04 to 5/4/05**	**NIL**
	1/6/05 to 30/11/05	**54,000**

	OVERLAP TO CARRY FORWARD	**£54,000**

Q4.

Companies are members of a group for group relief purposes if one is a '75% subsidiary' of the other or both are '75% subsidiaries' of another company.

'75% subsidiary' means a company not less than 75% of the ordinary share capital of which is beneficially owned directly or indirectly by another company.

Q5.

Calculate effective rate

Profits chargeable to corporation tax	**40,000**
Corporation Tax thereon @ 19%	**7,600**
Less: Marginal relief	
(50,000 – 40,000) * 19/400	**(475)**

	7125

Effective Rate 7125/40000 =	**17.81%**

NCD'S 15,000 + UNMATCHED B/FWD 5,000 = 20,000

Corporation Tax Liability: -

20,000 * 19% (MATCHED NCD'S)	**3,800**
20,000 * 17.81% (REMAINDER)	**3,562**

	7362

Q6.

In order to be a qualifying issuing company: -

The company must be unquoted.

The company must carry on a qualifying trade.

The company must not have gross assets of more than £15m before the investment and £16m after the investment.

At least 20% of the issued ordinary share capital must be beneficially owned by one or more independent individuals.

The company must not be a 51% subsidiary of another company or otherwise be under the control of another company or persons connected with it.

Q7.
Loss for 18 month period £21,600
2004/05 21,600 * 6/18 = £7,200
2005/06 21,600 * 12/18 = £14,400

s381 Loss relief

	2001/2002	2002/03	2003/04	2004/05
Taxable before loss relief	6,000	20,000	18,000	Nil
2004/05 loss	(6,000)	(1,200)	--	--
2005/06 loss	--	(14,400)	--	--
	----------	----------	---------	---------
After loss relief	--	£4,400	£18,000	--
	----------	----------	----------	---------

Q8.
<u>Sparrow Ltd</u>

Large in 31/3/05 accounting period and estimated to be large in 31/3/05 therefore Tax for 31/3/06 due by four equal instalments on 14 Oct 05, 14 Jan 06, 14 Apr 06 and 14 July 06

<u>Finch Ltd</u>

Estimated large in 31/3/06 accounting period but not large in 31/3/05 and in addition 31/03/06 not greater than 10m /2. Therefore payable in one payment due on 1 January 2007

Q9.

1. **Where any part of the expenditure is not required to be paid until a date more than four months after the date of an unconditional contract to pay, it is treated as incurred on that later date.**
2. **Where an obligation to pay becomes unconditional earlier than in accordance with normal commercial usage, with the sole or main benefit likely to be bringing forward the chargeable period in which incurred.**
3. **Where the expenditure is incurred before the qualifying activity commences.**

Q10.

Allowable items

Collecting bad debts	750
In obtaining new business loan	1,500

	£2,250

Other items are capital in nature and not deductible for trading purposes.

Q11.

<u>31 May 2004 accounting period</u>

Due for submission 31/5/05
Submitted 16/12/05

Initial Penalty £200 (as over three months late)
Additional penalty 10%* 10,000 = £1,000 (as over six months late)

Total £1,200

Q12. Two associated companies therefore limits divided by two.
Upper 1,500,000 divided by 2 = 750,000
Lower 300,000 divided by 2 = 150,000

Basic profits £200,000
Profits £210,000

Corporation Tax Liability: -

200,000 * 30%	**60,000**
less: Marginal Relief	
(750,000 – 210,000) * 200,000/210,000 *11/400 =	**(14,143)**

	£45,857

Q13.

1. **If the overseas company is carrying on a trade in the UK through a permanent establishment here it will be liable to UK corporation tax on income arising there from.**
2. **If the overseas company owns a let property in the UK it will be liable to basic rate income tax on the net rents derived there from.**
3. **If the overseas company's central management and control is in the UK it will be deemed to be UK resident for UK corporation tax purposes.**

Q14
Relief for the loss can be claimed against income of:

a. **the tax year in which the loss is incurred (2005/06)**

or

b. **of the tax year preceding that in which the loss is incurred (2004/05)**

additionally the loss can be carried forward for relief against profits from the same trade.
Where a loss has been claimed against income an additional claim can be made to relieve against capital gains in the same year.

Additionally any loss arising in the final twelve months trading can be carried back and set against the taxable profits of the business for the three preceding years on a LIFO basis.

Q15

Rent allowable = 1 June payment 3000
1 September payment 3000
Less: Prepaid (2/3rd) (2000)

1000

4,000

Lease Premium £10,000 * ((50-9)/50) = 8,200 over ten years (120 months)
From 1/6/05 to 30/09/05 = 4 months
Therefore 4/120 * £8,200 = £273 (rounded)

Total relief for expenses = £273 + £4000 = £4,273.
Legal fees not allowable.

Q16.

HM Revenue & Customs can enquire into a company tax return if they give notice of their intention to do so within twelve months after the filing date or, if the return was delivered after that date, by the quarter day (31/01, 30/04, 31/07 and 31/10) next following the first anniversary of the day on which the return was delivered.

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.

Q17

Relevant threshold is £60,000 inclusive of standard and zero-rated supplies (ignoring exempt supplies)
June standard + zero = £19,000 (cumulative £19,000)
July standard + zero = £19,000 (cumulative £38,000)
August standard + zero = £19,000 (cumulative £57,000)
Therefore registration threshold will be exceeded in September.

Latest date for notification = 30 October 2005 (30 days after end of month)
Registration from 1 November 2005 (first day of following month)

Q18

In order to be eligible to join the annual accounting scheme must either:

If VAT registered for less than 12 months must be reasonable grounds for believing that annual taxable turnover will be less than £150,000
Or
There must be reasonable grounds for believing that value of annual taxable supplies will not exceed £660,000 and must have been registered for twelve months

Q19.

Standard rated supplies	**300,000**		
Less:capital items	**(30,000)**		

	270,000		

Exempt supplies	**60,000**		

Unallocated input tax	**13,000 * (270,000/330,000) =**		**10,636**
Add: Directly attributable	**to standard rated**		**12,000**

Recoverable Input VAT			**22,636**

VAT on standard rated supplies £300,000 *17.5%			**52,500**

VAT DUE			**£29,864**

Q20

NIC ON SALES ASSISTANT SALARY
14,000 – 4,895 * 11% = £1,001.55

NIC ON OFFICE ADMIN SALARY
15,000 * 11% = £1,650.00
(On basis of associated employments)

(can have the £4,895 set against other employment to give figures of £1,540 and £1111.55 respectively)

PART II – SUGGESTED SOLUTIONS

Question 1

1 November 2005

ABC Tax
High Street
Upton

The Partners
Glue & Co
North Street
Upton

Dear John, Amanda & Ivor,

Tax Issues

Following our recent conversation, I set out below my response regarding the outstanding tax issues.

Research & Development ("R&D") Tax Credits

If the partnership is incorporated, the following expenditure will qualify as expenditure against which R&D Tax Credits can be claimed:-

- Employee costs incurred directly on R&D work – for example, £58,750 in 2005.
- Payment to an agency for providing R&D staff
- The costs of the materials, water, fuel & power used in the R&D – an element of the premises costs would be claimable (total cost in 2005, £12,500).
- The cost of the software used directly in the R&D – for example, £11,750 in 2005.
- The cost of subcontracted R&D work – for example, £10,000 in 2005.

In order for the company to qualify, the following requirements need to be met:-

- At least £10,000 per annum is spent on qualifying R&D expenditure.
- Only revenue expenditure will qualify for R&D tax credits.
- The intellectual property developed from the R&D must belong to the company.

Capital Allowances & Industrial Buildings Allowance

I have set out below my detailed calculation of the above allowances for the year ended 31 December 2005.

Capital Allowances			Pool, £		Private use Car, £		Capital Allowances, £	
	B/fwd		123,857					
	Additions	- cars	8,750		12,500			
			132,607					
	WDA @25%		- 33,152		- 3,000		36,152	
							- 750	Private use adjustment
	FYA @ 40%							
	Additions							
	- laptop	5,300						
	FYA	- 2,120	3,180				2,120	
	C/fwd		102,635		9,500		37,522	

Industrial Buildings Allowance

Original cost of building	65,000		
Length of Industrial use on purchase	17	years	
Annual allowance	65,000 / (25-17) =	8,125	**IBA for the year**

Profit apportionment

Using the above calculated allowances and the taxable profit for the year of £125,000, I calculate the following profit apportionments:-

		£
Profit before capital allowances		125,000
Less:	Capital allowances	(37,522)
	Industrial buildings allowance	(8,125)
Sch DI profit		79,353

Split as follows:-

	Total	*John*	*Amanda*	*Ivor*
Y/e 31.12.05	£79,353			
First 2 months	13,226	6,613	6,613	
Last 10 months	66,127	26,451	26,451	13,225
	£79,353	33,064	33,064	13,225
Assessed	2005/06	2005/06		1/10th 2004/2005 10/10ths together with 2/12ths of the y/e 31/12/06

I trust the above information is useful and should you have any queries, please do not hesitate to contact me.

Yours sincerely
A Other

Question 2

Memo
From – A Other
To - B Body
Date – 01 November 2005

Subject – **Conor Group**

1. **Tax payble for the periods ended 31 March 2005**

   Conor Group Limited

   In the year ended 31 March 2005, company is not large as PCTCT < £750,000 (£1,500,000/2)

   Corporation tax payable 1 January 2006.

   Tax payable = 741,000*30%-Marginal Relief (750,000-741,000)*11/400 = £222,053

   Conor (Retail) Limited

   In the 7 month period ended 31 March 2005, the company is large as PCTCT > £750,000 pa

   Corporation tax payable = 451,000*30% = £135,300

   Tax payable by instalments – 3 instalments due – 14/3/05, 14/6/05 & 14/7/05

Amount of tax due:	14/3/05	£57,986
	14/6/05	£57,986
	14/7/05	£19,328

2. **Corporation Tax Returns**

   Both companies will need to file CT600's by 31 March 2006.

3. **Group Payment Arrangement**

   Firstly, it is necessary for the entities to apply to HM Revenue & Customs for a GPA & enter into a contract with them.

   A GPA can be applied for a group consisting of a parent & it's 51% UK subsidiaries. Not all companies in the group have to be part of the GPA and the presence of non-UK companies does not prevent a GPA for the UK companies.

   The advantage to the group of setting up a GPA would be that only one payment would be needed each instalment date. This could help to reduce late payment interest and penalties.

Form CT61

The new payments would have the following income tax treatment:-

Royalty payment – basic rate tax (22%) will be deducted from the payments and paid over on a quarterly basis with the completion of form CT61

Gift-Aid payments by companies are paid gross – not included on form CT61.

Interest payments between UK companies do not need to have tax deducted at source - not included in form CT61.

4. VAT treatment of Houses

The sale of new houses is a zero-rated supply.

The supply of construction services to the Conor Group in the building of the new houses would qualify as a zero-rated supply. This includes the supply of building materials but excludes the services of an architect or surveyor and the hire of goods.

Question 3

Mr & Mrs H Usher
Usher & Co
82 South Street
Upton

10 November 2005

Dear Harry & Doreen

Incorporation

Following our recent discussion, I set out below the tax issues regarding the incorporation of the business.

Capital Gains

Chargeable gains will arise on the transfer of chargeable assets from yourselves to the company. The transfers will be deemed to occur at market value. But there are two reliefs available known as “incorporation relief” and “gift relief” which can defer the gains.

Incorporation Relief

Incorporation relief automatically applies when:-

A business is transferred as a going concern, and
The whole of the assets, other than cash, are transferred to the company, and
The consideration for the transfer is wholly or partly in exchange for shares

The relief is given for the total of the indexed gains on each asset transferred to the company. Where the consideration is only partly for shares, the relief is reduced proportionately.

The impact is that the gain is deferred by reducing the base cost of the shares (by the untapered gain) that you are issued with by Usher & Co Limited in consideration for the assets, so that ultimately when you sell the shares the gain deferred will crystallise. As the calculations below indicate the gain deferred would be £259,600.

One planning point is to receive part of the consideration in cash to create a gain equal to your annual exemption from capital gains (2005/06 - £8,500 each). The consideration to achieve this is shown in the attached calculations to be £80,557.

Gift Relief

If you do not transfer all of the assets then incorporation relief will not apply. Instead, an election can be made for gift relief. You could just transfer the goodwill and retain the building under your ownership. This results in the gain on the goodwill being held over into the base cost of the goodwill for the company

It should be noted that by changing the ownership of the business from you to the company then taper relief does not transfer from the business to the shares. The taper relief relating to your shares in the company does not start until the company starts trading i.e. 1 January 2006. This will not be a problem if the company trades and you own the shares for at least two years as you will then be able to dispose of the shares at an effective tax rate of approximately 10%.

Capital gains calculations

I have set out below the calculation of the capital gains on incorporation and the impact of the above relief.

Chargeable assets - goodwill & the property

			£	£	Gain pre taper, £	Taper relief, £ 75%	Gain post taper, £
Goodwill							
Proceeds & gain before taper relief				110,000	110,000	82,500	27,500
Property							
Proceeds				192,500			
Less	Allowable cost		25,000				
	Indexation	0.716	17,900	42,900			
Indexed gain				149,600	149,600	112,200	37,400
					259,600		64,900

Indexation factor

RPI - April 1985	94.78
RPI - April 1998	162.6

Factor = (162.6-94.78)/94.78 = 0.716 (3sf)

Non-share consideration to crystallise gain of £8,500 per partner

Total consideration = (110,000+192,500+2,500+3,250+9,852-10,562) =	307,540
Total gain after taper relief =	64,900
Consideration to crystallise gain of 2x£8,500 = (17,000/64,900)*307,540 =	80,557

Income tax

For 2005/06, you will be assessed upon the business profits for the year ended 31 December 2005. But the profits for this period will be reduced by overlap profits in determining your taxable income.

The overlap profits relate to profits of periods assessed twice in the opening years of the business or on the transition to the current year basis of tax assessment.

Your expected taxable incomes for 2005/06 from the partnership are:-

	Salary	Profit share	Overlap relief	Total
Harry	£8,500	£16,912	£(4,300)	£21,112
Doreen	£Nil	£16,913	£(5,010)	£11,903
		£33,825		
Add: salary		£ 8,500		
Profit for the year		£42,325		

National Insurance

You will be liable to National Insurance contributions on both your self-employed income and employed income as directors. For Doreen, your total national insurance liability for 2005/06 will be £830 & the company's liability relating to your employment in that year is £218. The detailed calculation is set out in the attached appendix.

Corporation tax liability

Based upon the company having a taxable profit of £12,000, I estimate that the corporation tax liability for the first year's trading to 31 December 2006 will be £475, payable on 1 October 2007. I have set out the detailed calculation in the enclosed appendix.

If you have any queries regarding the above, please do not hesitate to contact me.

Kind regards

Yours sincerely

A Other

Appendix

National Insurance

			£
Class 2	39 weeks to 31/12/05 @ £2.10pweek		82
Class 4	= (11,903-4895)*8%		561
Class 1	Primary contributions	=(3*1,000-((53-39)/53)*4,895)*11%	188
NI payable by Doreen			830
NI payable by the company		=(3*1,000-((53-39)/53)*4,895)*12.8%	218

Note
Earnings period for director is the period 1/1/06 to 5/4/06 = 14 weeks

Corporation Tax

		£
PCTCT		12,000
Tax at 19%		2,280
Less	Marginal relief - 19/400*(50,000-12,000)	1,805
Tax payable for year		475

Question 4

PART 1

Rooster Limited

Disposal of Business Premises

Sale proceeds	31/01/06		400000
Less:			
Original Cost	31/10/96	100000	
Enhancement	31/12/98	40000	
			(140000)
			260000
Less:			
Indexation			
100000 @	24.70%	24700	
(Oct 96 to Jan 06)			
40000 @	16.70%	6680	
			(31380)
GAIN BEFORE ANY RELIEFS			228620
Less:Roll-over relief on re-investment by Tiger Holdings Ltd			
Maximum		228620	
less:Proceeds not reinvested			
proceeds	400000		
reinvested	(300000)		
		(100000)	
			(128620)
GAIN AFTER ROLL OVER			100000
Elect to treat gain as arising in Monkey Ltd to utilise capital losses b/fwd			
Monkey Ltd - Capital losses b/fwd			(80000)
GAIN CHARGEABLE TO CORPORATION TAX in MONKEY LTD			20000

BASE COST OF PROPERTY IN TIGER HOLDINGS LTD

COST OF ACQUISITION	300000
LESS: GAIN ROLLED OVER	(128620)
	171380

Boar Limited

Disposal of Business Premises

Sale proceeds	31/01/06		200000
Less:			
Original Cost	31/01/00	80000	
			(80000)
			120000
Less:			
Indexation			
80000 @	15.10%	12080	
(Jan 00 to Jan 06)			
			(12080)
GAIN BEFORE ANY RELIEFS			107920
less: Available Reliefs			0
GAIN CHARGEABLE TO CORPORATION TAX			107920

As the effective shareholding of Tiger Holdings Ltd is less than an effective 51% Boar Ltd is not a member of the chargeable gains group. (Effective shareholding is 75% times 65% = 48.75%

Rat Limited

Transfer of Business Premises To Monkey Ltd

Market Value	30/09/05		240000
Less:			
Original Cost	31/03/98	120000	
			(120000)
			120000
Less:			
Indexation			
120000 @	18.80%	22560	
(Mar 98 to Sept 05)			
			(22560)
GAIN BEFORE ANY RELIEFS			97440
Less: Gain held over as inter group transfer between members of a capital gains group			(97440)
GAIN CHARGEABLE TO CORPORATION TAX			0

BASE COST OF PROPERTY IN MONKEY LTD

Market Value	240000
Less: held over on transfer between group companies	(97440)
Being original cost + indexation	142560

PART 2

Corporation Tax Calculation

	Normal	# of associates	adjusted
Upper Limit	1500000	5	300000
Lower Limit	300000	5	60000
starting rate upper limit	50000	5	10000
starting rate lower limit	10000	5	2000

Monkey Limited

Taxable Profits excluding Gain			20000
Chargeable Gain as above			20000
PCCT			40000
Corporation Tax thereon @ 19%			**£7,600**

Boar Limited

Taxable profits excluding gain			80000
Chargeable Gain as above			107920
PCCT			187920
Corporation Tax thereon			
187920	@	30%	56376
Less:Marginal relief			
(300,000-187920) * (11/400)			(3082)
Corporation Tax Liability			**£53,294**
Examiners check			
60000	@	19%	11400
127920	@	32.75%	41894
			53294

PART 3

The acquistion will represent a further asset acquired within the group for roll over purposes and the chargeable gain deemed to arise in Monkey Ltd could be reduced by up to a further £80,000.

This would reduce the corporation tax due by £20,000 @ 19% = £3,800.

A leasehold property is however a depreciating asset and therefore the gain is not rolled over against the cost of acquisition but is merely postponed/deferred until the earlier of the following:

The disposal of the leasehold property

The leasehold property ceasing to be used for the purposes of the trade.

or

10 years after the acquisition of the leasehold property.

PART 4

As the shareholding in Dragon Limited is greater than 10% the substantial shareholding exemption for companies may be available to exempt any gain from corporation tax.

The other conditions that must be satisfied are:

The shareholding must have been held throughout a continuous period of twelve months beginning not more than two years prior to the disposal.

Dragon Ltd must have been a qualifying company throughout the period and immediately after the disposal primarily meaning that it is a trading company or the holding company of a trading group.
Monkey Ltd must, as would appear to be the case, be a trading company or a member of a trading group thoughout the period and immediately after the disposal.
The shares must be 10% of ordinary share capital and entitle to at least 10% of assets on a winding up or available for distribution.

Question 5

PART 1
Corporation Tax
Computations
Based on estimated management accounts

	NORMAL	ASSOCIATES	ADJUSTED
UPPER LIMIT	1500000	2	750000
LOWER LIMIT	300000	2	150000
UPPER STARTING LIMIT	50000	2	25000
LOWER STARTING LIMIT	10000	2	5000

TOWN BUILDERS LIMITED

Estimated Profits			15000
Corporation Tax thereon			
15000 @		19%	2850
Less: Marginal Relief			
(25,000-15,000)*19/400			-475
			2375

CITY DEMOLITION LIMITED

Estimated Profits			190000
Corporation Tax thereon			
190000 @		30%	57000
Less: Marginal Relief			
(750,000-190,000)*11/400			-15400
			41600

TIMOTHY & CO
MEMORANDUM

TO:	Alan Timothy
FROM:	A Tax Senior
DATE:	15 March 2006
REF:	10001/SM/770/08
SUBJECT:	Mr & Mrs Truro – Potential Client

I now write to advise on the letter dated 10 March 2006 from Mr Truro, which you gave to me yesterday.

Potential Corporation Tax Liabilities

Based on the estimates contained in the letter I now attach calculations of the corporation tax liabilities that will arise for each company. These can be summarised as: -

Town Builders Limited (TBL)- £2,375 due for payment on or before 1 January 2007
City Demolition Limited (CDL)-£41,600 due for payment on or before 1 January 2007
Total due £43,975.

One important point to note on these computations is that the relevant limits have been divided by 2 due to the fact that the two companies are deemed associated due to their being controlled by either Mr or Mrs Truro.

Mr and Mrs Truro may wish to consider amalgamating the two companies into one company to reduce the exposure to corporation tax. One company with profits of £15,000 plus £190,000 equal £205,000 would only pay £38,950 (all at 19%) a tax saving of £5,025 per annum assuming profits remain at similar levels. This is of course subject to other non-tax considerations. Great care would be needed as regards any amalgamation of the companies and specialist tax advice would be needed. Alternatively could consider planning as regards profit extraction to reduce profits below the relevant higher tax limits.

Extraction of monies from Companies

Mr and Mrs Truro have asked for comments on tax efficient extraction of monies from the companies and I would summarise the various methods and implications as follows: -

a) **Rent charge**

As the property currently used by TBL is currently owned by Mr & Mrs Truro, they may wish to consider charging the company a rent. Such a rent charge would be deductible for corporation tax purposes but would be liable to income tax in hands of Mr & Mrs Truro. As a higher rate taxpayer Mr Truro would suffer tax at 40% but Mrs Truro as a basic rate taxpayer at 22%. Ownership could be altered to Mrs Truro's sole name to minimise the tax. (No capital gains tax on inter spouse transfers)

National Insurance would not however be due and this is certainly an NIC efficient method.

Any rent charged must however be at no more than a commercial rate, £10,000 per annum per letter.

b) Interest Charge

Mrs Truro has loaned monies to CDL and could therefore charge the company a commercial rate of interest. Such an interest charge would be deductible for corporation tax purposes provided paid within 12 months of the year end and we could therefore accrue for such an interest charge and reduce the 31 March 2006 corporation tax liability. The company would be required to deduct 20% income tax at source and pay this direct to the Revenue under the CT61 procedures. Mrs Truro as a basic rate taxpayer would have no further tax to pay. Again interest does not give rise to any NIC liabilities.

c) Pension Contribution

Either company could pay a pension contribution on behalf of either Mr or Mrs Truro provided within the designated limits. Such contributions would be deductible for corporation tax purposes and would of course not be liable to either income tax or NIC. It must be noted that any pension contributions must be paid on or before 31 March 2006 to be deductible for corporation tax purposes in that period. Time is therefore of the essence if this is to be considered.

d) Dividends

Provided each company has sufficient distributable profits a dividend can be paid to Mr & Mrs Truro. Such dividends are free from NIC. As Mrs Truro is a basic rate taxpayer no income tax would be due unless the amount of the dividend takes her income above the basic rate threshold. For a higher rate taxpayer additional tax is due calculated at 32.5% of the gross dividend less the 10% notional credit. For TBL the non-corporate distribution legislation will affect the corporation tax due if the dividend is paid on or before the 31 March 2006. In simple terms an amount of profits equal to the dividend will suffer tax at 19% with the remainder paying tax at the effective rate.

Dividends are not however liable to NIC.

e) Bonus/Salary

Any bonuses or salaries paid will be tax deductible for the company and liable to income tax at the rate of tax payable by the recipient. PAYE will of course need to be operated. Such payments will also be liable to both employers NIC at 12.8% and employees NIC at 11%/1%. Provided we accrue for such payments in the 31 March 2006 accounts and that they are paid within nine months of the year end they are corporation tax deductible in that period.

As Mrs Truro has income in line with her personal allowance she would benefit by receiving dividends as opposed to salary to utilise her basic rate band. CDL the company in which she has the higher 75% shareholding would appear to be the best dividend route company.

Overdrawn Loan account

The overdrawn loan account that Mr Truro has in TBL will have two potential tax implications: -
As I assume he has not paid the company interest on the loan a benefit in kind will arise based on the official rate of interest (the de-minimus £5000 maximum balance has been exceeded) and entry will need to be made on form PIID.
In addition as Mr Truro is a shareholder in TBL a tax charge will arise under s419 ICTA 1988 (loans to participator legislation) if this is not cleared within 9 months of the year-end. The amount due will be £20,000 @ 25% = £5,000. This will only be repaid to the company after the loan is repaid. It is important therefore that the loan is repaid using whichever of the above methods deemed most appropriate or out of personal resources.

Purchase of new property

If the company (CDL) purchases the new property by way of loan the interest payable on such a loan would of course be deductible for corporation tax purposes as a trading expense.
If the property is purchased personally the interest on the loan will be allowable against any rental income charged to the company, such interest is not deductible against general income and a rent would therefore need to be charged. The letter would suggest that the property is to be purchased by the company. In such a situation it may be that Mr & Mrs Truro will be taking out a loan to lend monies to the company, I assume secured on private assets. Interest on such a loan is allowable against general income and as a higher rate taxpayer it is better that any loan and interest is paid by Mr Truro.

Additionally if the property is purchased by the company any gain arising on a future disposal would be liable to corporation tax at the company's effective rate, minimum 19% although could roll over gain on subsequent acquisition. If purchased personally any gain would be liable to capital gains tax with benefit of business asset taper relief and possible 10% tax rate.

I hope this memo is helpful but please let me know if you wish me to be available for the meting you have now arranged for Friday 17th March.

A Tax Senior