Association of Taxation Technicians

Examination

November 2006

PAPER 2

BUSINESS TAXATION

SOLUTIONS
(without marking guide)

PAPER 2 ATT NOVEMBER 2006
SHORT FORM ANSWERS

Q1.
Period exceeds 18 months in length, 19 months, and therefore is split into 12 month and 7-month periods for capital allowances purposes.

12 months to 31 MAY 2005

		POOL	ALLOWANCES
ADDITION 31/7/04	2,400		
FYA@ 50%	(1,200)		1,200
		1,200	
7 months to 31 DECMBER 2005			
WDA @ 25% * 7/12		(175)	175
ADDITION 31/8/05	2,500		
FYA @ 40%	(1,000)		1,000
		1,500	

WDV C/FWD		2,525	

MAXIMUM ALLOWANCES			2,375

Q2.

A group comprises:

A company 'the principal company of the group'
And
That company's '75 per cent subsidiaries' (i.e where not less than 75% of the ordinary share capital is beneficially owned directly or indirectly by the principal company) and those subsidiaries 75% subsidiaries except that any subsidiary which is not an effective 51% subsidiary of the principal company is excluded.

Q3

Calculate effective rate

Profits chargeable to corporation tax	**20,000**
Corporation Tax thereon @ 19%	**3,800**
Less: Marginal relief	
(50,000 – 20,000) * 19/400	**(1,425)**

	2,375

Effective Rate 2375/20000 =	**11.88%**

Corporation Tax Liability

9000*80% =	**7,200* 19% =**	**1,368.00**
Reminder	**12,800* 11.88% =**	**1,520.64**
	--------	**----------**
	20,000	**2,888.64**
	---------	**---------**

Q4.

The first accounting period ending with the new date must not exceed 18 months
And either
No accounting change in previous five years of assessment
Or
Change must be made for bona fide commercial reasons

Q5.

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	**£500,000**
Profits	**£520,000**

Corporation Tax Liability: -

500,000 * 30%	**150,000.00**
less: Marginal Relief	
(750,000 – 520,000) * 500,000/520,000 *11/400 =	**(6,081.73)**

	£143,918.27

Q6.

The goodwill is acquired from Tony and Cleo who are connected persons is not tax deductible as post 1 April 2002. (Confirm why not deductible as post April 02)

Goodwill purchased from unconnected business £60,000
Amortisation period 5 years = £12,000 per annum
Period 1/2/05 to 31/12/05 = 11 months
Therefore allowable amortisation = £11,000.

Q7. A company's corporation tax return must be submitted within twelve months after the end of the period to which it relates.

If the return is submitted late the following penalties arise:

£200 (£100 if submitted within three months of due date)
The above penalties are increased to £1000 and £500 respectively if penalty incurred in respect of two preceding accounting periods.

Additional penalties arise if return still outstanding 18 months after the end of the return period. 10% of tax unpaid if delivered within two years, 20% otherwise.

Q8.
Basis periods will be:
2003/04 - Actual 1/1/04 to 5/4/04
2004/05 - Actual 6/4/04 to 5/4/05
2005/06 – 12 mths to 31/12/05 (being future accounting date)
Overlap period 1/1/05 to 31/12/05

Calculations:
Assessable 2005/06 = £48,000 * 4/16 + £24,000 = £36,000
Overlap £48,000 *3/16 = £9,000

Q9.

An Industrial Building is a building used for the purposes of a trade or part of a trade consisting of: -

The manufacture or processing of goods or materials
Or
The maintaining or repairing of goods or materials
Or
The storage of:

a. **raw materials for manufacture**
b. **goods to be processed**
c. **goods manufactured or processed but not yet delivered**
d. **goods on arrival in UK from place outside the UK**

Q10.
Mike can claim:
Terminal loss relief for last 12 months against profits from same trade in three preceding years.

Period to 31/12/05	**18,000**
1/1/05 to 31/5/05	**10,000**
Overlap	**10,000**

Maximum	**38,000**

Against other income of 2005/06 and/or 2004/05

Period to 31/12/05	**18,000**
Year ended 31/5/05	**24,000**
Overlap	**10,000**

Maximum	**52,000**

Q11.
Three companies in group and as a result the small company limit is reduced to £300000 / 3 = £100,000. Therefore most tax efficient to reduce as far as possible companies to this figure.

1. **Capital loss can only be set against chargeable gains and therefore elect to treat gain as arising in loss making company, Harmy Limited. Remaining capital loss to carry forward £20,000.**
2. **Losses of Monty Limited brought forward must be set against profits pre group relief**
3. **After 1 and 2 Monty Limited and Freddy Limited have profits of £150,000 each**
4. **Trade losses and Non-trade deficit should be group relieved leaving rental income taxable. Max claim £80,000 + £20,000 = £100,000 therefore group relieve £50,000 to each company leaving:**

Monty Limited PCTCT = £100,000
Freddy Limited PCTCT = £100,000
Harmy Limited PCTCT = £10,000

Q12. Air conditioning unit will qualify for capital allowances. 40% first year allowance and WDA's in future. Add back in adjusted profit computation and claim capital allowances.

Double glazed units will qualify for deduction as repair expenditure on basis replacement of windows with modern day equivalent. No adjustment needed.

Land remediation relief will be available to give 150% deduction for costs incurred. Further 50% deduction therefore available.

Fencing costs will be capital and must therefore be added back in adjusted profit computation. Capital Allowances not available but include as capital gains tax cost of property.

Q13 The gain on disposal of business premises can be deferred by the acquisition of other qualifying assets under the roll-over relief provisions.
Qualifying assets include purchase of land and property used for purposes of trade or the purchase of goodwill.
Any new qualifying assets must be purchased in the period 12 months before the disposal and 3 years after the disposal i.e. 25/1/05 to 25/1/09

Q14
Gain arising on incorporation £50,000 - £20,000 = £30,000
Immediately chargeable £30,000 *30,000/120,000 = £7,500
Taper Relief at 75% leaves £1,875 chargeable.

Q15
Any item of plant and machinery can be treated as a short-life asset provided it is not an excluded asset. The excluded assets include amongst others the following:

A car
A ship
A long life asset
A leased asset

An asset on which short life asset treatment has been claimed is allocated to its own pool for capital allowance purposes with the effect that a disposal will give rise to a balancing event. If however the asset has not been disposed of in any of the chargeable periods ending on or before the fourth anniversary of acquisition the asset is transferred back into the general pool at the commencement of the next chargeable period.

Q16.
2004/05 = 44,000
2005/06 = Nil (loss treated as nil)
44,000 + 0 = 44,000/2 = 22,000
2004/05 fixed at £22,000

2005/06 22,000
2006/07 30,000 => 2005/06 > 70% but < 75% of 2006/07
(30,000 – 22,000)= 8,000 * 3 = 24,000
75% *30,000 = 22,500
24,000 – 22,500 = 1,500
Therefore 2005/06 becomes 22,000 + 1,500 = 23,500.

Q17. Two or more bodies corporate are eligible to be treated as members of a group if:

1. **one of them controls each of the others, or**
2. **one person controls all of them, or**
3. **two or more individuals carrying on a business in partnership control all of them**

AND each is established or has a fixed establishment in the UK

Group treatment creates a single taxable person and the VAT group is treated in the same way as a single company registered for VAT on its own.

Q18.
Gary must notify HM Revenue & Customs of his requirement to be registered by 30 July 2005.

If he is late in notifying HM Revenue & Customs of his requirement to be registered he will be liable to a penalty of the following percentage of the net VAT due for the period between the above and the date actually notified
:
5% of any unpaid VAT if less than 9 months late
10% between 9 and 18 months late
15% if more than 18 months late

Q19.
The late submission of the return for the quarter to 31 October 2005 will result in the issue of a surcharge liability notice (for a 12 month period)but no penalty will be charged.

The second late return to 31 January 2006 will result in a penalty if also the VAT due is paid late. A penalty will not arise if the VAT is paid on time or a repayment is due or a nil return arises. The surcharge liability notice period will however be extended in any event.

Q20.

Trading Profit 30 June 2005	**40,000**
Less: unused loss b/fwd	**(3,000)**
Less:Loss used against non-trade Income in 2004/05	**(17,000)**

	20,000

Class 4 NIC thereon

4895 @ 0%	**=**	**nil**
15105 @ 8%	**=**	**1,208.40**

		1,208.40

Answer 1.

Adam & Co
High Street
Newtown

1 November 2006

Mr J Thompson
Sweet Success
Fore Street
Newtown

Dear Jim

Business Start-Up

Thank you for your letter of 20 October 2006, I have set out my advice below.

Registration with HM Revenue & Customs

You are required to register a new start-up of a self-employed business within three months of the start of trading. Failure to do so results in a £100 penalty.

Badges of Trade

Tax case law has developed definitions of what constitutes trading known as the "badges of trade".

The badges of trade are:-

- The subject matter of the realisation;
- The length of the period of ownership;
- The frequency or number of similar transactions by the same person;
- Supplementary work on or in connection with the property realised;
- The circumstances that were responsible for the realisation; and
- Motive.

I can provide further clarification of some of the badges below:-

Frequency or number of similar transactions by the same person

Although a one-off transaction is capable of being a trading transaction, a lack of repetition will indicate the lack of existence of a trade.

The subject matter of the realisation

In Rutledge v CIR 1929 14 TC 490, the court held that one million rolls of toilet paper, purchased for no other purpose than for resale at a profit, was an adventure in the nature of trade because of the nature of asset involved.

Supplementary work on or in connection with the property realised

Work carried out on an asset prior to sale is a factor in determining the existence of a trade.

In Cape Brandy Syndicate v CIR [1921] 12 TC 358, three individuals who acquired a quantity of Cape brandy and blended it with French brandy before re-casking and selling it were deemed to have made a profit from a trade or business.

Motive

An intention to re-sell in the short term indicates a trading transaction.

Based upon the information in your letter, I would consider you commenced to trade in August 2005 when you started trading from the stall with a profit motive.

Capital Allowances

You will receive tax allowances called Capital Allowances against the purchase of Plant & Machinery (equipment with a continued use in the business).

The allowances are calculated as per the following example:-

Equipment purchased or introduced	£1,000
Tax allowance in year of purchase (40% First Year Allowance)	£400
Tax allowance in 2nd year = 25% of balance (25%x(1,000-400))	£150
Tax allowance in 3rd year = 25% of balance (25%x(1,000-400-150))	£113

For equipment introduced, the expenditure value used is the market value on the date introduced into the business not the original purchase price.

National Insurance

You will be required to pay two classes of national insurance as a self-employed individual.

1. Class 2 – is payable at the flat rate of £2.10 per week. You will have to pay this from the first week of self-employment in August 2005. You may be exempt payment if you can prove your self employed profits in the tax year are less than £4,345.

2. Class 4 - is payable on your self employed profits in the tax year at the following rates:-

For profits between £4,895 and £32,760	8%
For profits over £32,760	1%

In your first year of trading, you will have to pay both employed NIC & self-employed NICs. There are rules to prevent you overpaying NIC. I will be able to provide further advice in this regard if you can provide me with more details about your expected levels of employed & self employed income.

VAT Registration

It is possible for you to voluntarily register for VAT, whatever your turnover level, but as you are in retail trade and therefore are likely to charge more VAT than you recover, this will not be advantageous.

Compulsory registration is required when your annual sales exceed £60,000 or if you expect your sales in the next month to exceed £60,000.

You will need to keep a record of your monthly sales to assess your annual sales on a rolling basis. Please contact me should the figure for annual sales exceed £60,000.

When your annual sales exceeds £60,000, you will be required to register for VAT within 30 days of the end of the month ("the relevant month") in which the limit was exceeded. Unless you request an earlier registration date, you will be required to charge VAT from the end of the month following "the relevant month".

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

Yours sincerely

A D Viser

Answer 2

Janet Hacker VAT Return for the quarter ended 31 March 2006

		£	**£**
Output VAT	Takings	48,500	
	VAT at 7/47ths		7,223
	Rental income exempt		
Input VAT	Purchases	7,900	
	VAT at 7/47ths		1,177
	Salaries are outside the scope of VAT		
VAT payable	Output VAT	7,223	
	Input VAT	(1,177)	6,047
Net Outputs	Takings	48,500	
	Output VAT	(7,223)	
	Rental income	10,000	51,277
Net Inputs	Purchases	7,900	
	Input VAT	(1,177)	6,723

Adam & Co
High Street
Newtown

1 November 2006

Mr J Hacker
Hackers
Fore Street
Newtown

Dear Janet

VAT & Accounting Year End

Further to your recent meeting with our tax partner, I have set out below further explanation regarding the above issues.

VAT – election to waive exemption

1. Currently, the rental income from the property is exempt from VAT. This can lead to input VAT relating to the property being irrecoverable. In previous periods the input VAT has been recoverable because it has been small in total & falls within de-minimus levels to allow full recovery.

   However, a significant element of the VAT on the future repair work will be irrecoverable. I summarise below my estimate of the "lost" VAT:-

	£
Total VAT = 17.5% of £30,000	5,250
Element recoverable through own trade (40%)	(2,100)
VAT lost	3,150

   This VAT will be irrecoverable since it exceeds the de-minimus level of £625 per month on average.

   By electing to waive exemption on the property you may be able to recover this lost VAT since the rental income from the property will no longer be exempt and input VAT relating to the property will be recoverable.

2. Once the election is made, you would have to charge VAT on all future supplies made in relation to the property. This would include charging VAT on the rental income as well as on a future sale or granting of a lease of the building.

   When an election is made for a building, or part of, it is effective in relation to the entire building. Although only 60% of the offices are let, the option to tax will be effective for the entire building.

3. VAT registered tenants will be able to reclaim input tax suffered.

   Non-VAT registered tenants (e.g. many small businesses) – will suffer the VAT element or you will have reduce the net rent to suffer the VAT element yourself.

Accounting Year End

You currently have a 31 January accounting year end. Under self-assessment, the year ended 31 January 2006 is assessed in the tax year 2005/06. In your case, with rising profits, this year-end is not advantageous for your cash flow. For example, a 30 April year end would mean that for 2005/06, you would be assessed to tax on the profits for the year ended 30 April 2005 (i.e. a period with lower profits).

I have set out in the enclosed schedule a comparison of your assessable profits for the tax years 2005/06 to 2007/08 for your current 31 January year end and if you change your year end to have a 15 month period of account to 30 April 2007.

As you can see from the schedule, changing your year-end will have a significant improvement on your immediate cash flow.

I trust the above is useful, if you would like to take any further action regarding an election to waive exemption on the property or to change your accounting year end, please do not hesitate to contact me.

Yours sincerely

A D Viser

Janet Hacker Year end change

	2005/06	2006/07	2007/08	Total
Current assessable income				
Year ended 31 January 2006, 2007 & 2008	72,500	85,000	100,000	257,500
Change of year end to 30 April 2007				
Year ended 31 January 2006	72,500			
12 month period ended 30 April 2006 = 9/12x72,500 + 3/15x110,000		76,375		
12 month period ended 30 April 2007 = 12/15 x 110,000			88,000	
	72,500	76,375	88,000	236,875
Reduction in income assessed				20,625
Tax payments reduced at marginal rate (= 40% tax & 1% Class 4 NIC)				8,456

Period to April 07 will be 15 months from February 2006

£85,000 + (3/12 x £100,000) = £110,000

Answer Q3 PART 1

GEORGE & CO MEMORANDUM

TO:	File
FROM:	A Tax Senior
DATE:	10 November 2006
REF:	10001/AT/775/06/11
SUBJECT:	Mr Dart – Purchase of shares in SW Brick Company Ltd

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Further to my recent discussions with Mr Dart concerning the proposed purchase of the entire issued share capital of SW Brick Limited , I now summarise the potential methods of dealing with this and the tax implications of each alternative.

1. Possible methods of acquisition.

There are effectively two methods of structuring the purchase either as :-

a) A direct purchase from Mr Jones by Mr Dart (mix of shareholding with wife is possible.
b) A group purchase by Dart Development Limited or by Dart Builders Limited.

Under either method there are certain similar consequences and certain specific differences.

2. Tax Consequences

a) Small Company limits

As Mr Dart (or Mr Dart and his wife) will own an extra company either directly or in the existing group, the small company limits etc will be divisible by an extra company, 3, one more than the existing 2. This will potentially have an effect on the corporation tax liabilities of all companies

b) VAT

As the shares in the company are to be purchased and not the trade and assets there will be no effect on the existing VAT position of the company. Company could consider a group registration for all companies or adding new company to an existing group.

c) <u>Capital Allowances</u>

The existing capital allowance pool of the company will continue unaltered as ownership of assets remain in company. This will be the case for both plant and machinery and industrial building allowance purposes.

d) <u>Trade Losses</u>

If the company has any trading losses brought forward they could potentially be lost if there is any significant change in the nature of the trade.
If the company is purchased in the group then group relief for future losses will be available against other company profits in group.

Answer Q3 PART 2

GEORGE & CO
MEMORANDUM

TO:	File
FROM:	A Tax Senior
DATE:	10 November 2006
REF:	10001/AT/775/06/11
SUBJECT:	Mr Dart – Purchase of business and assets of SW Brick Company Ltd

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Further to my recent discussions with Mr Dart concerning the proposed purchase of the business and assets of SW Brick Company Limited , I now summarise the potential methods of dealing with this and the tax implications of each alternative.

3. Possible methods of acquisition.

There are effectively three methods of structuring the purchase either as :-

a) A direct purchase from Mr Jones by Mr Dart (mix of shareholding with wife is possible.
b) A group purchase by Dart Development Limited or by Dart Builders Limited.
c) A purchase as an unincorporated entity in personal name.

Under each method there are certain similar consequences and certain specific differences.

4. Tax Consequences

a) Purchase of Goodwill

If the goodwill is purchased via a limited company corporation tax relief will be available for its amortisation over its estimated useful life. If purchased via an unincorporated entity relief will only be available on a future disposal.

b) VAT

On the basis that the business is VAT registered it is likely that the purchase of the business in any of the three forms would satisfy the conditions for a transfer of a going concern on the basis that the entirety is to be acquired and to be operated in similar form. Will

need to ensure that VAT registration issues are dealt with. This will avoid the need to charge VAT on the sale.
In addition group registration could be considered.

c) Purchase of Property

The property should qualify for Industrial Building Allowances provided it is put to qualifying use. The allowances however will be based on the residue of expenditure at sale over remaining life. This is not the same as the purchase price. The claim will therefore be on £400,000.
As an alternative/addition a claim for capital allowances on fixtures in the building could also be considered. Further information will be required.

d) Purchase of plant and machinery

Capital allowances will be available on the purchase price and provided the enterprise is small/medium a first year allowance will be available.

e) Corporation Tax/ Income Tax

If the purchase is via a limited company any profits will be liable to corporation tax and the above issues re:associated companies will apply.
If as unincorporated entity the profits will be taxable at individuals marginal rate of tax, losses however can be offset against other income.

Answer Q3 PART 3

GEORGE & CO
MEMORANDUM

TO:	File
FROM:	A Tax Senior
DATE:	10 November 2006
REF:	10001/AT/775/06/11
SUBJECT:	Mr Jones – Tax implications on sale of shares in SW Brick Company Ltd or sale of business and assets.

Further to my recent discussions with Mr Dart concerning the proposed sale of the above , I now summarise the potential tax implications of the two methods of sale.

5. Sale of shares.

The disposal of shares will give rise to a capital gain for Mr Jones. As the company is a trading company the disposal will potentially qualify for Business Asset Taper Relief. If Mr Jones has held the shares for greater than two years the rate will be 75% (50% if held for at least one year)
Further information will be required as regards date/cost of acquisition to ascertain the potential liability. Other reliefs that may be of relevance would be Market value at 31 March 1982 if applicable and indexation. The gain would be taxable at Mr Jones's marginal tax rate likely to be 40%.

6. Sale of assets

If assets are sold then various corporation tax issues must be considered for the sale of the business and assets by the company. A balancing charge will arise on the disposal of the plant and also on the disposal of the building on the basis that Industrial Buildings Allowances have been claimed.
In addition the disposal of the goodwill and the building will give rise to gains liable to corporation tax.
These items will all be liable to corporation tax .

The sale of the business and cessation of trading will give rise to the end of an Accounting period of the company which could affect the tax rate.

After settling the corporation tax liabilities the company will be left with a balance of cash available for distribution. This could be paid as a dividend liable at the dividend rate for Mr Jones (equal to 25% of the net distribution if all liable at higher rate.)
Alternatively the company could be liquidated and the assets be distributed. Distributions in a liquidation are chageable to capital gains not as dividends. Gains would be taxed as at 1. above.

Answer Question 4 PART A.

No of companies in group **6 (Hulk included even though non-resident)**

Limits	**Normal**	**10000**	**50000**	**300000**	**1500000**
	Divide by no. assoc	**1667**	**8333**	**50000**	**250000**

	DRAGON	**BAT**	**ROBIN**	**JOKER**	**PENGUIN**	**HULK**
Trading Profits	4000	0	205000	0	260000	0
Trading losses b/fwd	0	0	-20000	0	0	0
	4000	0	185000	0	260000	0
Interest Received	2000	0	0	10000	30000	0
Interest Paid against interest received	0	0	0	-10000	0	0
Rental income	0	0	20000	9000	0	0
Rental inc losses b/fwd	0	0	-30000	0	0	0
	6000	0	175000	9000	290000	0
Surplus non-trade deficit	0	0	0	-9000	0	0
Profits Chargeable to Corporation Tax before group relief	6000	0	175000	0	290000	0
Group Relief from Bat Ltd	0	0	-90000	0	0	0
Group Relief from Joker Ltd	0	0		0	0	0
	6000	0	85000	0	290000	0
Losses		90000		70000		72000
set against DIII income				-10000		
		90000		60000		
Max for group relief		-90000				0
Against other income				-9000		
Surplus Non trade deficit c/fwd				51000		
Trade losses c/fwd		0				72000
Capital losses b/fwd and c/fwd		30000			20000	
PCCT as above	6000	0	85000	0	290000	0
Tax thereon at 0%		NIL		NIL		NIL
Tax thereon at 30%			25500		87000	
less:marginal relief (250,000 - 129444)*85000/129444*11/400			-2177		0	
Tax thereon at 19%	1140					
less:marginal relief (8333-6000)*(6000/6000)*19/400	-111					
	1029		23323		87000	
	0.17153					
Non-group dividend						
Total Dividends received			100000			
less:inter group £100,000*60%			-60000			
			40000			
Gross up to convert into FII			44444			
Profits for marginal relief calculations (85000 + 44444)			129444			

ANSWER 4B

Under the Non-Corporate Distribution regime if a company has an underlying rate of corporation tax of less than 19% makes one or more non-corporate distributions.
A non-corporate distribution is a distribution to a person who is not a company.
The underlying rate of tax is the corporation tax charged as a percentage of its basic profits.
Dragon Holdings Ltd has an underlying rate of tax of less than 19%, 1029/6000 = 17.15% . If a distribution had therefore been made the NCD regime would have applied.
The distribution of £30,000 would exceed the PCCT of £6000 and as a result the corporation tax would increase to 19%*£6000 = £1140.
In addition would have surplus distributions of £24,000 which in a group would be transferred to subsidiary and not be carried forward. Would have no effect if transferred to Robin Ltd as already paying at more than 19%

ANSWER 4C.

GEORGE & CO MEMORANDUM

TO:	File
FROM:	A Tax Senior
DATE:	10 November 2006
REF:	10001/AT/775/06/11
SUBJECT:	Mr & Mrs Johnson – Associated Companies

Further to my your discussions with Mr and Mrs Johnson I now write to summarise the tax implications of having more than one company.

Direct / Group Companies

It is first important to note that the Corporation Tax liability of each company can be dependent on how many companies are associated to it. The potential tax implications are in relation to the rate of corporation tax chargeable on its profits.
The rates of corporation tax are in relation to the small companies rates. For a single company the following apply:

Profits less than or equal to £10,000 - 0%
Profits greater than £50,000 but less than or equal to £300,000 - 19%
Profits greater than or equal to £1,500,000 - 30%
Marginal rates of tax apply between these limits.

If however the company has any 'associates' these limits are divided by 1+ the number of associates. For example if company has two associates the limits are divided by three.

Associates

A company is associated with another company if one of the two has control of the other or both are under the control of the same person or persons.
Control means the ability to exercise or to acquire control including:
The greater part of the share capital or issued share capital
Or
The greater part of the voting power
Or
So much of the issued share capital as would give the right to receive the greater part of the income
Or
The right to the greater part of the assets in a distribution on a winding up

Connected Persons

In addition there may be attributed to any person the rights or powers of any associate or associates of his/her.
An associate of any individual is:
Any relative i.e spouse , parent or remoter issue or brother or sister
Any business partner of the individual
Any trustee of a settlement of which they are settlor

The Inland Revenue do exclude by concession certain relatives but as far as Mr & Mrs Johnson are concerned not spouses. This means that any shares held by Mr are deemed held by Mrs and vice versa

Summary

In summary the number of companies controlled either directly or indirectly by Mr & Mrs Johnson can affect the rates of tax charged on profits and the plan to hold shares alone will have no affect.
It is important to note that if a company earns profits of over £1,500,000 the number of associates will have no effect in any event as can't pay more than 30% tax rate.

Answer 5.

Adam & Co
High Street
Newtown

1 November 2006

Mr A Hopkirk
Make Scents
Fore Street
Newtown

Dear Mr Hopkirk

First Year of Trading

As requested, I have set out below answers to your queries regarding tax issues for your first year of trading.

Tax Adjustments

I have enclosed a schedule showing the adjustments required to the accounts for tax purposes. The schedule shows the accounting loss of £33,750 is adjusted for tax purposes to £33,550.

Utilisation of the Tax Loss

The loss in the first year of trading can be utilised as follows:-

1. Carry-forward against future profits of the same trade.
2. Offset other income in the tax year or previous tax year.
3. Offset a loss in early years of trading against other income in the preceding three years, earliest year first.

I recommend that the loss is offset against the income in the preceding year first as this will reduce the income which is being taxed at 40%. The other forms of relief are not so advantageous.

Assessable Income for 2003/04 to 2006/07

In addition, the enclosed schedule sets out your assessable income for the above tax years.

VAT Cash Accounting Scheme

If a business' annual turnover exceeds £825,000 at the end of a VAT period then the business must leave the scheme at the end of that VAT period.

However, if it can be demonstrated that the increase in turnover was a "one-off" and there are reasonable grounds for expecting the turnover for the next year to be less than £660,000 then HM Revenue & Customs may allow use of the scheme to continue.

With your expected increase in turnover in the second year, it is possible that you will need to leave the scheme by 30 April 2007.

This may cause further demands on your working capital since you will be required to account for VAT on an invoice basis and therefore possibly pay VAT to HM Revenue & Customs before the customer has paid the relevant invoice.

HM Revenue & Customs do allow the option to settle the additional VAT arising from leaving the cash accounting scheme six months after the end of the final VAT period for which cash accounting was used, and I would recommend that this option is utilised when the company leaves the scheme

VAT Annual Accounting

The annual accounting scheme is available to businesses with expected annual turnover less than £660,000. Businesses have to leave the scheme when their turnover exceeds £825,000.

The main feature of the scheme is that it allows businesses to complete only one VAT Return per year rather then being required to complete one per quarter. Estimated payments on account are made based upon the VAT paid in the previous year.

The advantage is a reduction in administration costs for completing quarterly returns. However, there is a disadvantage that if your turnover is rising there is a of an unexpectedly large VAT liability arising after completing the annual return.

Since your turnover will soon exceed £825,000, I do not recommend you apply to join the Annual Accounting Scheme.

I trust the above information is useful, if you have any queries, please do not hesitate to call me.

Yours sincerely

A D Viser

1 Mr Hopkirk **Tax Adjustments for the year ended 30 April 2006**

		£	£
Net loss per accounts			(33,750)
Add:	Depreciation	6,250	
	Adjust for finance lease asset	(535)	5,715
Add:	Bad debts	1,450	
	Allow specific bad debts	(825)	625
Add:	Legal fees	1,025	
	Allow employee contracts prepared	(325)	
	Allow debt collection	(500)	200
Less:	Capital allowances		(6,340)
	40% 1st year allowance for shelving & fixtures		
Sch DI loss for the year			(33,550)

2 Mr Hopkirk **Assessable income for 2003/04 to 2006/07**

				£
2003/04	Employment income			20,000
	Less:	Loss carry back from 2006/07	1 months	(2,796)
				17,204
2004/05	Employment income			50,000
	Less:	Loss carry back from 2005/06	11 months	(30,754)
				19,246
2005/06	Sch DI income			Nil
2006/07	Sch DI income			Nil