



**Association of Taxation Technicians**

## **Examination**

May 2007

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### **PAPER 3 – PART II**

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### **BUSINESS TAXATION: HIGHER SKILLS**

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TIME ALLOWED – 3 HOURS  
(for Part I and Part II)

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- You are required to answer **all** questions in Part I (printed separately) and Part II.
- The maximum number of marks for each question in Part II is shown in brackets.
- For Part II, start each answer on a new sheet of paper.
- All workings should be shown and made to the nearest month and pound unless the question requires otherwise.
- Marks are specifically allocated for good presentation.

1. Belle has owned “Shampoodle & Setter”, a dog grooming parlour for many years. On 1 June 2006, Belle decided to incorporate and begin trading as a limited company. She transferred her business to “Shampoodle & Setter Ltd” in exchange for £100,000.

The £100,000 was made up of 85,000 ordinary shares in the company with a value of £1 each and £15,000 cash. The value of the assets of the business and the capital gains at the date of the transfer were as follows:

	<u>Market value</u>	<u>Gain (after indexation)</u>
	£	£
Freehold land and buildings	65,000	25,000
Goodwill	24,000	15,000
Plant and machinery	10,000	3,000
Stock	500	
Debtors	1,500	
Creditors	<u>(1,000)</u>	
	<u>£100,000</u>	<u>£43,000</u>

**You are required to:**

- 1) **Explain the operation of s.162 TCGA 1992 and calculate the taxable gain together with the revised base cost of the ordinary shares for Belle.** (5)
- 2) **Discuss the difference between trading as a sole trader and a company, considering rates of tax on profits, National Insurance and payment dates for tax.** (7)
- 3) **Discuss the two main documents which have to be presented to Companies House in order that a limited company may be formed.** (4)

Total (16)

2. On 1 May 2006 Charlie commenced self-employment running a clothes shop. His results for the year ended 30 April 2007 are as follows:

	£
Net profit for the period	68,000

This figure is after the deduction of the following expenses:

Depreciation	6,025
Light and heat	2,100
Motor expenses	3,200
Professional fees	1,500
Repairs and renewals	2,000

Charlie lives in a flat above the shop. Of the expenses for light and heat, 50% relates to the flat.

During the year Charlie drove 10,000 miles in total of which 2,000 miles were for private purposes.

Professional fees include £1,000 for legal fees in relation to the purchase of the shop and £500 for accountancy.

The repairs and renewals expense includes £500 for decorating the shop during May 2006 and £550 for decorating the private flat.

Charlie also purchased the following assets:

		£
8 April 2006	Fixtures and fittings	35,000
1 August 2006	Motor car	13,000
10 September 2006	Computer	2,000

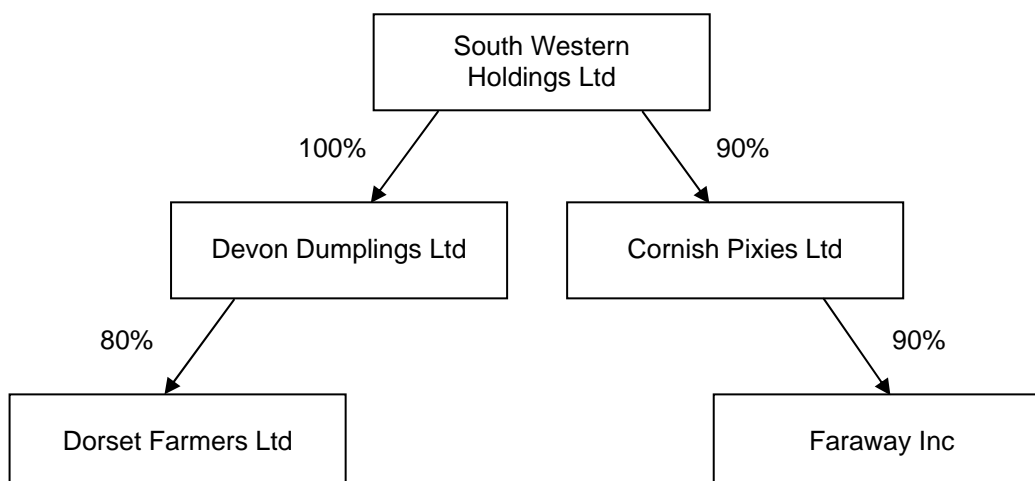
The only other income Charlie received in 2006/07 was dividends from a UK company of £2,250. This was the actual amount received.

**You are required to:**

- 1) **Calculate Charlie's tax adjusted trading profit for the year ended 30 April 2007.** (6)
- 2) **Calculate Charlie's Income Tax payable for 2006/07.** (4)

Total (10)

3. Mark owns all of the shares in South Western Holdings Ltd. This company is dormant apart from the holding of shares in other companies as follows:



All companies had prepared accounts for the year ended 31 March 2007 and were resident in the UK except for Faraway Inc, a company resident in the Asian republic of Ciam.

The results for the active companies were as follows:

	<u>Devon Dimplings</u> £	<u>Cornish Pixies</u> £	<u>Dorset Farmers</u> £	<u>Faraway Inc</u> £
Trading profit/(loss)	200,000	(80,000)	450,000	(90,000)
Schedule A	35,000	-	40,000	-
Schedule DIII deficit	-	-	(30,000)	-
Capital gains/(losses)	(10,000)	-	20,000	-
Dividends received from Dorset Farmers	45,000	-	-	-

In addition you are advised that Devon Dimplings had trading losses brought forward of £20,000.

- 1) **You are required to calculate the Corporation Tax liabilities of Devon Dimplings Ltd and Dorset Farmers Ltd for the year ended 31 March 2007 on the basis that the most beneficial tax claims and elections are made. Clearly state any losses to be carried forward.** (9)

On 31 May 2007 Devon Dimplings Ltd acquired a 90% holding in Somerset Scrumpy Ltd, a company resident in the UK but with a 31 August annual accounting date. Budget projections for Somerset Scrumpy Ltd estimate that the company will make a loss for the year to 31 August 2007 of £100,000 and for the year to 31 August 2008 of £60,000.

- 2) **Explain how relief for these losses can be claimed against the profits of the South Western Holdings Group companies for any relevant periods, clearly stating any restrictions that may arise.** (4)

Mark is considering the alternative of changing the accounting reference date of Somerset Scrumpy Ltd to be the same as for the other companies in the group after acquisition.

- 3) **Explain whether, and if so how, a company can change its accounting reference date.** (2)

Total (15)

4. The shares in Amberhouse Ltd are held by Mr and Mrs Foster in equal shares. The company was incorporated on 1 December 2005, commenced to trade on 1 January 2006 and had prepared accounts for the year ended 31 December 2006.

These accounts showed a profit of £410,000 after deducting the following items:

Pension contributions £25,000 (including an accrued contribution of £10,000 paid on 30 April 2007)

Wages and salaries £45,000 (including an accrued bonus of £15,000 paid on 30 April 2007)

Interest payable £40,000 (including accrued interest of £20,000 on loans to the company from Mr and Mrs Foster not payable until 31 January 2008)

Legal and Professional fees £20,000 including:

Costs in relation to purchase of trading premises	£2,000
Costs in relation to company formation	£3,000
Costs in relation to obtaining mortgage finance	£2,500
Debt collection fees	£2,000

Repairs and maintenance £15,000 including:

Electrical works in newly built extension	£3,000
Repair to roof damaged in recent storm	£4,000

Equipment leasing charges £4,000 including:

Car hire charges of £4,000 in respect of a car with a market value of £24,000

In addition the accounting profit also included a £9,000 dividend received on 30 June 2006 from a minority quoted share holding.

- 1) You are required to calculate the company's Corporation Tax liability in respect of this period. (9)**

Mr and Mrs Foster have also asked your advice as to which is the most tax-efficient means of extracting monies from the company; salary, dividends or interest on loans to the company. Mr Foster is a higher rate taxpayer; whilst Mrs Foster has no other income.

- 2) You are required to briefly explain the taxation implications of these three possible methods for each shareholder. (Calculations are not required.) (6)**

Early in April 2007, Mr and Mrs Foster decided to expand the business by purchasing a second property to be used as a warehouse for the storage of goods. They have decided that this will be acquired by a new company, Amberhouse (Storage) Ltd. The shares will again be held directly by Mr and Mrs Foster. This company will rent the property to Amberhouse Ltd on an arm's length basis. This will be the only source of income for the company.

- 3) You are required to briefly explain the potential effect that this structure will have on the future tax liabilities of each company. (4)**

Total (19)