Association of Taxation Technicians

Examination

November 2007

PAPER 3

BUSINESS TAXATION: HIGHER SKILLS

ANSWERS (without marks)

PART I

Answer 1

a) Indexed gains 72,000

Less relief under S162 TCGA 1992	
$72{,}000 \times \frac{80{,}000}{80{,}000 + 40{,}000}$	(48,000)
Gain before taper relief	24,000
Taper relief – Business Asset	
Assets owned 1-2 yrs therefore 50%	12,000
Gain after taper relief	£12,000

b) Base cost of Claudius shares

M V at acquisition	80,000
Less: gains rolled over	(48,000)
Base Cost of shares	£32,000
	======

Answer 2

Income from relevant engagements	40,000
Less: Deduction at flat rate of 5%	(2,000)
Less: Actual salary	(10,000)
Less: Employer's NIC	(636)
	27,364
Less ER NIC $£27{,}364 \times \frac{12.8}{112.8}$	(3,105)
Deemed employment payment	£24,259
	=======

Answer 3

2003/04 – 12 months to 30 September 2003	20,000	
2004/05 – (18,000 + 30,000) ÷ 2	24,000	

(As profits in the year to 30 September 2004 do not exceed 70% of the profits for the year to 30 September 2005, full averaging relief is available.)

2005/06 - Profits in the year to 30 September 2006 are between 70% and 75% of the averaged figure of £24,000. Adjustment will be:

3(24,000 – 17,500) – ¾ (24,000)

19,500 – 18,000 = 1,500

Therefore, 24,000 – 1,500		£22,500
		======
2006/07 - 12 months to 30 September 2006	17,500	
Adjustment re 2005/06	1,500	
		£19,000
		======

Answer 4

VAT Control Account

	£		£
Bank Account	4,250	Balance b/fwd	4,250
Purchases (52,875 x 7/47)	7,875	Output VAT (88,125 x 7/47)	13,125
Fixed Asset (2,000 x 17.5%)	350		
Balance c/fwd	4,900		
	£17,375		£17,375
	======		======

The VAT on the purchase of the computer for Andromeda's son is ignored as private.

Answer 5

<u>FRS19 Reconciliation</u>

Expected Tax charge based on accounting profit

2,000,000 x 30%	600,000
Actual Tax Charge (WI)	585,000
Understatement	£15,000
	======

Explained by:

Tax effect of permanent differences

Entertaining	(10,000)		
Legal fees	(5,000)		
Dividend	45,000		
	£30,000	x 30%	£9,000

Tax effect of timing differences
Capital allowances/depreciation

(120,000 – 100,000) x 30%	6,000
	£15,000
	======

W1 - Actual Tax Charge

Profit per accounts		2,000,000
Add back:	Depreciation	100,000
	Legal fees	5,000
	Business Entertaining	10,000
		£2,115,000
Deduct:	Dividends	(45,000)
	Capital Allowances	(120,000)
		£1,950,000
		========
Corporation Tax @ 30%		£585,000

Answer 6

Year	Basis period	Working	Assessment
2004/05	1.6.04 – 5.4.05	15,000 x 10/15	10,000
2005/06	1.9.04 – 31.8.05	15,000 x 12/15	12,000
2006/07	1.9.05 – 31.8.06		20,000
Overlap profits	1.9.04 – 5.4.05	7/15 x 15,000	7,000

Answer 7

A VAT registered person will be eligible for voluntary deregistration if H M Revenue & Customs are satisfied that the value of his taxable supplies (net of VAT) in the following twelve month period will not exceed £59,000.

H M Revenue & Customs will cancel a person's registration from the date the request is made (or from an agreed later date)

Answer 8

Net profit per accounts		125,000
Add:	Pension Contributions accrued	5,000
	Depreciation	13,500
	Client Entertaining	2,500
	Bonus payment not made within 9 months of the year end	3,000
		£149,000
Less:	Dividends received	(5,000)
	Capital allowances	(15,000)
Schedule DI		£129,000
		=======

Answer 9

When a close company makes a loan to a participator, the company must make a notional tax payment equivalent to 25% of the loan (S419 tax)

Once the loan is repaid, H M Revenue and Customs will repay the tax.

The notional tax payment is due 9 months and 1 day after the end of the accounting period (1 October 2007).

The tax will be refunded 9 months and 1 day after the end of the accounting period in which the loan is repaid (1 October 2008).

Answer 10

Post cessation receipts should be included in the final computation of trade profits and taxed in the final year of assessment.

If income is received after cessation, and not included in the final computation of trade profits, the income will be taxed as other income in the year of receipt.

Answer 11

When a company commences to trade.

When a company first comes within the charge to corporation tax.

Immediately after the previous accounting period finishes.

On the commencement of winding up.

Answer 12

A restrictive covenant is a legally binding agreement which restrains a person from taking a specified course of action – e.g. it may prevent an employee from leaving to join a competitor within a given period.

The amount received by the employee will be taxed as employment income in the year of payment.

The payment made is a fully tax deductible trading expense.

Answer 13

A company is associated with another if one controls the other or both are under the control of the same person.

Whether such a company is UK resident or not is irrelevant

Control is deemed to be given by holding over 50% of the issued share capital or voting rights, or being entitled to over 50% of the distributable profits or assets on a winding up.

Dormant companies are ignored.

Therefore Vital Limited has two associated companies, Vitax Limited and Vitrois SARL.

Answer 14

Companies limited by guarantee are companies that have no share capital. The liability of the members is limited to the amount that they undertake to contribute in the event of a winding up.

The liability of a member of a limited company (whether private or public) is limited to the amount unpaid on their shares.

The shares of a private company cannot be offered to the public, whereas those of a public company can.

A public company must have a minimum allotted share capital of £50,000 of which at least one quarter must be paid up.

Answer 15

The share capital account records the nominal value of fully paid shares issued at the Balance Sheet date.

The share premium account records an amount equivalent to the difference between the price at which the shares are issued and their nominal value i.e. the premium. For example a £1 share issued at a value of £3, will have a premium of £2.

Distributable reserves are those reserves which can be paid out to the member of a company (such as profit and loss reserves). Non distributable reserves cannot be paid out e.g. a surplus on a revaluation reserve.

PART 2

Answer 1

	FYA	Gen Pool	Expensive Car	Business Use 55%	Total Allowances
TWDV b/f		£13,600			
Additions not qualifying for FYAs 7.12.05		£ 2,500			
Car 12.1.06			£18,000		
Allowances			£(3,000)	x 55%	£1,650
Disposals Machinery		(£4,000)			
Disposal Furniture		(£2,000)			
		£10,100			
WDAs at 25%		(£2,525)			£ 2,525
Additions qualifying for FYA (5.8.05)	£4,375				
FYA @ 40%	(£1,750)	£2,625			£ 1,750
Tax WDV c/f		£10,200	£15,000		£5,925

The profit for assessment is therefore £120,000 (125,925-5,925).

The profits of the partnership are now split as follows:

	Total	Jessica	Melissa	Liam
Period 1.7.05 – 31.12.05 (6/12ths)				
Salaries (6/12ths)	£14,750	£5,000	£6,750	£3,000
Interest on capital @ 10% (6/12ths)	£ 1,900	£ 750	£ 900	£ 250
Balance to be split	£43,350	£14,450	£14,450	£14,450
Profit (6/12ths)	£60,000			
TOTAL for period to 31.12.05		£20,200	£22,100	£17,700

	Total	Jessica	Melissa	Liam
Period – 1.1.06-30.6.06 (6/12ths)				
Salaries (6/12ths)	£14,750	£5,000	£6,750	£3,000
Interest on capital @ 10% (6/12ths)	£ 1,900	£ 750	£ 900	£ 250
Balance to be split	£43,350	£17,340	£17,340	£ 8,670
Profit (6/12ths) 2:2:1	£60,000			
TOTAL for period to 30.06.06		£23,090	£24,990	£11,920

Trading income assessments for 2006/07 are:

Jessica £43,290
Melissa £47,090
Liam £29,620

Part 2

In the absence of a formal partnership agreement, a partnership will be dealt with under Partnership Act 1890.

PA 1890 provides that:
Unanimity is required to expel a partner
The partnership will dissolve automatically on the death or retirement of a partner
All partners are entitled to take part in the management of the business.
Profits and losses are shared equally
No interest is to be paid on the partners' original capital
Partners are entitled to 5% interest on advances in excess of their original capital investment. .

Answer 2

Part 1

Withholding tax is a direct tax imposed at source by the overseas country. It is always potentially recoverable.

Underlying tax is the overseas equivalent of corporation tax**.** It applies where a UK company receives a dividend from a foreign company in which it holds at least 10% of the voting power.

The net amount of dividend paid to BB Ltd will be 70% x £35,000 x 95% = £23,275.

The dividend must be grossed up for inclusion as foreign income in BB Ltd's PCTCT for the year ended 31 December 2006:
£23,275 x 100/95 = £24,500 x 100/(100-24) = £32,237.

Relief will be available for both the withholding tax (£1,225) and underlying tax (£7,737) as the overseas tax suffered is less than the UK CT on that source of income.

Part 2

Cost	750,000	
Less Land	(450,000)	
Legal Cost	(25,000)	
Potential Qualifying Cost		275,000

General office allowed if cost is less than 25% of potential qualifying cost.

275,000 x 25%	=	68,750
Offices	=	50,000

Therefore offices qualify

IBAs £275,000 @ 4% = 11,000

<u>Part 3</u>

Professional Privilege concerns the confidentiality which advisers have in relation to papers, documents and other communications which have come into their possession as a result of their relationship with a client.

As a general rule, professional advisers are under no duty to disclose client's details, due to the confidentiality between adviser and client.

However, there are exceptions to this rule, where an adviser will disclose information without the prior consent of the client. These circumstances are where disclosure is:

- in the public interest.
- required under statutory authority, such as Acts of Parliament.
- required by court order.

Part 4

Tax avoidance is the use of legitimate means to reduce the amount of tax paid, for example, ISAs. Avoidance is legal, provided that the sole purpose of an arrangement is not to avoid tax.

Tax evasion is illegal and a taxpayer who falsifies information to reduce his tax liability may be subject to criminal penalties or investigation.

Long Form Answer 3

		Owl	Buzzard	Kestrel	Hawk
Profits chargeable pre capital transactions		365,000	60,000	345,000	76,800
Add Capital gains/intangibles		75,000	0	27,000	0
Less:Goodwill amortisation		0	0	0	-1,800
	Basic Profits	440,000	60,000	372,000	75,000
	gross dividend received	10,000	20,000	0	0
	profits	450,000	80,000	372,000	75,000
Upper limit		1,500,000	1,500,000	1,500,000	1,500,000
divided by 4 (Dormant hold not included)		375,000	375,000	375,000	375,000
short period as cease at 30 November = 11/12				343,750	
small company limit		300,000	300,000	300,000	300,000
divided by 4 (Dormant holding company Not included)		75,000	75,000	75,000	75,000
		30%	Marginal	30%	19%
	@30%	132,000	18,000	111,600	14,250
Marginal relief (375,000-80,000)*(60,000/80,000)*11/400			-6,084		
		132,000	11,916	111,600	14,250

OWL LIMITED
Chargeable Gains Computation

Sale Proceeds	Jul-06			850,000	
less: Market Value 1982	Mar-82	100,000			
Cost of extension	Jan-86	125,000			
				-225,000	
Less: Indexation					
on 31.3.82 value	100,000 @	147.0%		-147,000	
on extension	125,000 @	103.8%		-129,750	
				348,250	
Less: Roll-Over	Gain		348,250		
Restriction of roll-over					Proportion of
Sale Proceeds		850,000			Gain(say)
Qualifying re-investment (Buzzard Limted)	property	-525,000			185,105
Qualifying re-investment (Hawk Limited)	property	-200,000			70,516
(Hawk Limited)	fixed plant	-50,000			17,629
			-75,000		
				-273,250	
Revised chargeable gain after roll over relief				75,000	

BUZZARD LIMITED
Purchased Property
30% non business use

Total cost of property	750,000
less: Roll over claim	-185,105
Revised base cost	564,895

(Restriction of roll over relief due to partial re-investment of sale proceeds.)

KESTREL LIMITED

sold 30/11/2006

GOODWILL

SALE PROCEEDS		100,000
less: Cost	72,000	
less: amortisation @	-27,000	
£6,000 per annum		-45,000
		55,000
Less: rollover relief (note)		-28,000
Chargeable		27,000

SHORT LEASEHOLD

SALE PROCEEDS		45,000
LESS:COST		
60,000 x 37.406/53.191		-42,194
((35.414+((39.399-35.414)/12*6) = 37.406		
		2,806
LESS:INDEXATION £42,194 @ 12.3% (But Restricted)		- 2,806
		0

Note

As the proceeds have been fully reinvested by Hawk, the amount available for relief is the excess of the proceeds over the cost of the old asset, i.e. 100,000 – 72,000 = 28,000.

HAWK LIMITED

Purchased 01-Oct-06

Goodwill	100,000	
Freehold property		200,000
	100,000	200,000
Roll-over relief		-70,516
Reinvestment re intangible asset	-28,000	

Revised base cost after roll-over + reinvestment	72,000	129,484
Relief over ten years @	7,200	per annum
1 Oct to 31 Dec = 3 months	1,800	

Fixed plant and machinery

The gain of £17,629 held over against the fixed plant and machinery does not reduce the base cost. The gain will crystallise on the earliest of:

- The date the fixed plant and machinery is disposed of
- The date the fixed plant and machinery ceases to be used in the trade
- Ten years after the date on which the fixed plant and machinery was acquired.

Marks were also awarded for:
1. Granting claim for capital allowances on plant and machinery.
2. Method marks for understanding concepts
3. Details of rules for a chargeable gains group

Long form answer 4 - 1a)

Schedule A Rental Income	**£**	**£**
Property 1 let 1/8/06		
Let for six months £30,000 * 6/12	15,000	
Property 2 let 1/1/07		
Let for one month £45,000 *1/12	3,750	
	----------	18,750
Less: Property Management Expenses		(5,000)
Less: Capital allowances		
Property 1 £51,000 *6/12 *25%	6,375	
Property 2 £78,000 *1/12 *25%	1,625	
	----------	(8,000)

		5,750

Non-Trade Credits/(Debits)

Interest Received				8,000
Less: Interest payable	£210,000*8%*7/12	9,800		
	£350,000*9%*2/12	5,250		
		---------	(15,050)	
Less: Arrangement fees	£4,200*7/60	490		
	£7,000*2/96	146		
		---------	(636)	
			-------	15,686

			Net Deficit	(7,686)

Management Expenses

Annual Filing fee	15	
Accountancy	2,000	----------
The company formation fees are treated as capital and are not deductible for tax purposes	---------	(2,015)

Summary

Schedule A income	5,750	
Less:Non-Trade Deficit	(5,750)	
	--------	NIL
Non-Trade Deficits as above	7,686	
Less:set against Schedule A	(5,750)	

Non-Trade Deficit c/fwd	1,936	

Excess Management Expenses c/fwd	2,015	

Note

1. Equal marks can be obtained if management expenses offset in preference to non-trade deficits

2. Candidates would also be rewarded for mentioning that reasonable loan arrangement fees are deductible in the year of payment. (HMRC view ‘reasonable’ as a few basis points only. A basis point is equal to 0.01%.)

Long form answer 4 – 1b)

Any interest must be paid with deduction of 20% tax at source

The tax deducted must be paid over to HMRC under the CT61 regime on a quarterly basis. The quarter dates are 31 March, 30 June, 30 September and 31 December. In addition as the year end is 31 January there is a further return period.

The interest will be deductible for corporation tax purposes provided paid in or within 12 months of accounting period if accrued therein.

Dividends can only be paid if the company has sufficient distributable reserves

Dividends must be voted by directors in general meeting and can be interim or final in nature. A final dividend can only be voted at an AGM rather than a general meeting.

Dividends are not deductible for corporation tax purposes.