Association of Taxation Technicians

Examination

May 2008

PAPER 3 – PART II

BUSINESS TAXATION: HIGHER SKILLS

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

- 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. Teresa Noble has been the sole proprietor of "The Nail and Beauty Salon", since qualifying as a beautician. She started the business on 1 January 1999. On 31 March 2008, Teresa transferred the whole of the business to a limited company called Varnish Ltd, for consideration of 50,000 £1 shares and £100,000 cash. Teresa's new position is managing director of Varnish Ltd.

The market values of the assets within the business on 31 March 2008 were as follows:

1)	Goodwill	£10,000 This has all been generated by Teresa and does not have any cost.
2)	Freehold premises	£120,000 This building was acquired on 31 December 1998 for £73,000.
3)	Plant and equipment	£20,000 No fixed plant is included in this figure.

Teresa has always prepared accounts to 31 December each year. The trading income for the past three years is as follows:

	£
Year ended 31 December 2005	48,000
Year ended 31 December 2006	32,000
15 months ended 31 March 2008	75,000

Teresa has overlap profits of £8,000 and capital losses brought forward of £3,000.

The tax written down value of the general pool at 1 January 2007 was £13,000.

You are required to:

1) **State the conditions that must be satisfied in order for incorporation relief to apply.** (3)

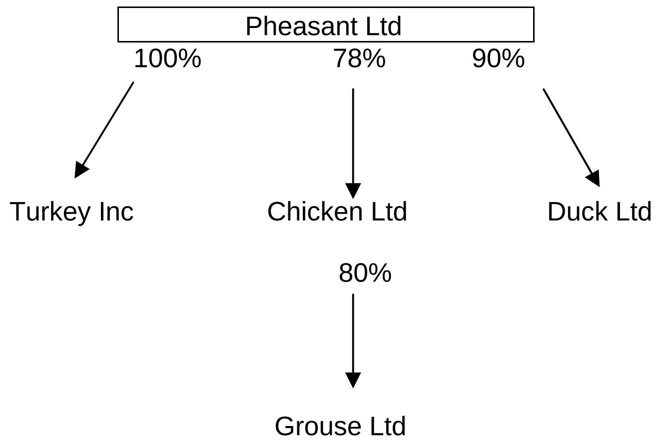
2) **Calculate the Capital Gains Tax, if any, arising on the transfer of the business.** (5)

3) **Advise Teresa of the consequences of disapplying incorporation relief. Your answer should include any relevant calculations and state the time limit for making the election.** (5)

4) **Calculate Teresa's trading income assessment for 2007/08.** (2)

Total (15)

2. Pheasant Ltd is a publisher of country and sporting magazines and has the following group structure:



Pheasant Ltd and Duck Ltd both have an accounting year end of 31 December. Turkey Inc, Grouse Ltd and Chicken Ltd all have accounting year ends of 30 September. Turkey Inc is resident in the US. All companies are trading companies.

The most recent results for each company are as follows:

Year ended 31 December 2007

	Pheasant Ltd	Duck Ltd
	£	£
Schedule DI Profit/(loss)	(150,000)	320,000
Trading loss brought forward	(62,000)	(16,000)
Schedule DIII deficit	(13,000)	(10,000)

Year ended 30 September 2007

Turkey Inc	–	Trading loss of US $500,000
Grouse Ltd	–	Schedule D Case I Profit £270,000
		Trading loss brought forward £250,000
Chicken Ltd	–	Schedule D Case I Profit £644,000

The Exchange rate is £1 = US $1.95

You are required to:

1) Advise the Pheasant Ltd group of the maximum amount of group relief available. (6)

2) Calculate the Corporation Tax payable by each company, assuming the group relief is used in the most beneficial manner. (6)

3) Explain how the accounting reference dates of the subsidiaries may be changed, to bring their accounting year ends in line with that of the parent. (3)

Total (15)

3. Malcolm Harrison is the managing director and majority shareholder in a new client, The Rock Hill Hotel Ltd. He has telephoned you this morning to advise that a PAYE compliance officer from HM Revenue & Customs will be visiting the hotel to carry out a review of the company.

During the conversation it became apparent that Malcolm has some concerns over a self-employed maintenance contractor, Bill. Bill has carried out work at the hotel on a regular basis over the last five years. In fact, of Bill's average annual total fee income of £22,000, £20,500 was derived from work done at the hotel.

Malcolm's closing comment to you was "anyway it can't be a problem because Bill and I have always agreed that any work was carried out on a self-employed, no commitment either way, basis".

A meeting to discuss matters with Malcolm has been arranged for tomorrow.

1) You are required to prepare a memorandum for discussion at your meeting setting out the factors that will need to be considered in relation to the employment/self-employment status of Bill and the likely approach that HM Revenue & Customs will take. It should include in general terms an outline of the potential financial implications for the company. Calculations are not required. (12)

You have now discovered that a second maintenance contractor, Tim, provides his services to the hotel via his own limited company, TM Contracting Ltd.

The relevant income and expenditure details for TM Contracting Ltd over the last twelve months are as follows:

	£
Turnover – being work done solely for Rock Hill Hotel Ltd	22,000
Less – expenses	
Salary paid to Tim's wife	4,000
Pension contributions	2,000
Travel costs from home to hotel	500

2) You are required to summarise the potential tax and National Insurance consequences for both TM Contracting Ltd and the hotel if the status of Tim is challenged by HM Revenue & Customs. (3)

Total (15)

4. Alastair Green owns the entire issued share capital of Hiro Ltd. Hiro Ltd has no business or assets except for the ownership of shares in its two wholly owned trading subsidiaries, Eden Ltd and Nathan Ltd.

Each of these subsidiaries owns its own trading premises. The property owned by Nathan Ltd cost £150,000 six years ago and is now valued at £500,000. The property owned by Eden Ltd was purchased recently for £200,000. Each company makes profits of approximately £200,000 before tax per annum. The issued share capital of each company is 100 ordinary £1 shares issued at par to Hiro Ltd on formation.

Alastair is now considering disposing of the business and assets of Nathan Ltd and is planning to use the monies to expand the business of Eden Ltd and to redevelop the recently acquired trading premises.

Alastair is considering two alternative methods of dealing with this:

1) A sale of its business and assets by Nathan Ltd; or
2) A sale of the entire issued share capital of Nathan Ltd.

You are required to:

1) Prepare a memorandum for discussion with Alastair summarising the tax implications of both of these alternatives. Your memorandum should also discuss any relevant reliefs or exemptions that are available. (9)

During your subsequent discussions with Alastair, you discover that if he could achieve a high enough price he would consider selling the whole of the group by selling his entire shareholding in Hiro Ltd. He would then use some of the monies to set up a new company to be involved in the operating of a car valet business.

You are required to:

2) Outline the tax implications of this alternative, assuming that the tax rates and allowances for 2007/08 continue to apply to future years. (3)

3) Summarise the procedures that must be followed when allotting and issuing new shares in an unquoted limited company. (3)

Total (15)