THE CHARTERED INSTITUTE OF TAXATION

The Chartered Tax Adviser Examination

November 2008

PAPER IIA

GENERAL PRACTICE

TIME ALLOWED – 3 HOURS

- You should answer all of the questions.
- Start each answer on a new sheet of paper and write on one side of the paper only.
- All workings should be shown and made to the nearest month and pound unless the question specifies otherwise.
- Marks are specifically allocated for presentation.
- Candidates who answer any relevant legal aspects in this paper in accordance with Scots law or Northern Ireland law should tick the appropriate box on the front of the answer folder.

1. One of your clients, Mr Cod, a VAT registered sole trader making standard rated and zero rated supplies, is in the process of acquiring the trade and assets of another business from Flounder Ltd. The business to be acquired makes a mixture of standard rated and exempt supplies. Mr Cod has asked for your advice on the VAT implications of the acquisition.

The projected turnover of the combined business for the next 12 months is as follows:

	£
Standard rated supplies	600,000
Zero rated supplies	120,000
Exempt supplies	80,000

Once he has completed the acquisition, Mr Cod will consider relocating to new premises being constructed that are likely to cost in the region of £400,000. All of the merged trading activities currently undertaken in premises he owns and in Flounder Ltd's premises will then be relocated to the new premises. The two old trading premises will then be sold for approximately £200,000 each.

You are required to write a letter to your client explaining the VAT implications of the acquisition and the proposed relocation. (10)

2. Mr and Mrs Scraggy have recently had a meeting with your tax partner. They have held a portfolio of properties since 1998 which are let on a short term basis to students. They advertise from their premises "Scraggy Lets" and have a website, although much of the letting arises as a result of word of mouth at the Students Union. Mrs Scraggy deals with the administration and they engage a handyman to carry out repairs to the properties.

They have heard that incorporation may be beneficial from a tax point of view and would like advice on the tax implications of incorporation. Although they had not acquired the properties with the intention of resale, they may sell some or all of the properties at a later date and would therefore also like advice on how incorporation may affect a subsequent sale of properties, particularly as they may sell some of their properties to pay off the bank borrowings and would like advice on these possibilities.

The assets and liabilities of the enterprise are as follows:

	Market Value	Book Value	Original Cost
	£	£	£
Properties	850,000	200,000	200,000
Debtors	50,000	50,000	N/A
Cash	35,000	35,000	N/A
Creditors	70,000	70,000	N/A
Bank loan	450,000	450,000	N/A

You are required to prepare an internal memorandum to the tax partner:

1) **Considering whether Mr and Mrs Scraggy's property portfolio will be regarded as an investment or the running of a business.** (6)

2) **Advising on the tax implications of a possible incorporation and a possible future sale of properties.** (9)

Total (15)

3. Mr Perry, a sales executive, has advised you that his employment with Spooks Solutions Ltd, who had employed him since April of this year, was terminated on 31 October 2008. This happened very suddenly after the monthly sales review meeting.

He informed you that a compromise agreement was being drafted by the lawyers under which he will receive a lump sum at the end of November of £90,000. This payment will cover all his entitlements set out below together with an ex-gratia element.

He has provided you with the following information:

1) Annual Salary £150,000; October's salary has not been paid.

2) Two weeks holiday pay had been accrued to the end of October.

3) First level bonus targets for the each of the seven months had been achieved which amounted to 5% of salary earned to date.

As regards termination and the requirement for notice to be given, the relevant clauses from the employment contract read as follows:

5. Termination

5.1 The employment commences on 1 April 2008 and is subject to termination by either party giving the other three months notice.

5.2 To the extent that notice in 5.1 is not given, the company will pay a sum to the employee equal to the salary of that period.

You are required to:

1) Calculate the Income Tax and National Insurance to be deducted by the Company on the payment of £90,000. (10)

2) Explain how the Income Tax and National Insurance treatment may differ if:

(a) clause 5.2 gave the company a discretion to pay; or

(b) there was no clause 5.2 at all. (5)

Total (15)

Note: Candidates should assume that 2007/08 Rates and Allowances continue to apply.

4. Haddock Ltd is the holding company of a manufacturing and retailing group comprising five wholly owned UK resident trading subsidiaries. Haddock Ltd does not trade, but owns most of the group's properties and charges rent to the various subsidiaries for their use. Haddock Ltd also receives dividends from the subsidiaries and interest from surplus funds on deposit.

The group companies' tax adjusted results for year ended 31 March 2008 are as follows:

	Haddock Ltd	Snapper Ltd	Turbot Ltd	Mullet Ltd
	£	£	£	£
Trading profit	-	150,000	375,000	-
Trading loss	-	-	-	(500,000)
Rental income	120,000	-	-	-
Dividend income (Group companies)	80,000	-	-	-
Bank interest	45,000	-	10,000	-
Management expenses	(200,000)	-	-	-
Dividends paid	50,000	20,000	60,000	-

Snapper Ltd, Turbot Ltd and Mullet Ltd were all owned throughout the year ended 31 March 2008. It is anticipated that Mullet Ltd will have profits of approximately £250,000 in year ended 31 March 2009.

In addition to the above, a further wholly owned trading subsidiary, Pilchard Ltd, was disposed of on 1 October 2007. Pilchard Ltd had been loss making for a number of years and was sold to the company's management, who are hoping to turn the business around and utilise the accumulated trading losses of £450,000 against future profits. Of these trading losses, £370,000 had accumulated up to 31 March 2007, with the balance arising in year ended 31 March 2008. The board of Haddock Ltd had decided to dispose of Pilchard Ltd to its management and received shareholder approval on 1 July 2007, but it had taken three months to arrange the necessary finance. The factory that Pilchard Ltd traded from had been transferred from Haddock Ltd on 30 June 2006 for its then market value of £500,000. The factory had been acquired for £200,000 in February 1996 by Haddock Ltd and Industrial Buildings Allowances of £64,000 had been claimed by the group in respect of £160,000 qualifying expenditure. The shares in Pilchard Ltd had cost £100 when the company was set up in April 2000, and the agreed disposal proceeds were £500,000.

An additional trading subsidiary, Whiting Ltd, was acquired by Haddock Ltd on 1 December 2007. Whiting Ltd had accumulated trading losses of £700,000 and capital losses of £450,000 at 30 September 2007, the company's old accounting date. Whiting Ltd made a further trading loss of £240,000 in the six months to 31 March 2008, the company's new accounting date.

You are required to:

1) **Calculate the corporation tax payable by each of the six companies after utilising losses in the most efficient way, and taking advantage of any other appropriate relieving provisions, giving explanations of other options considered.** (14)

2) **Explain the treatment of the losses of Pilchard Ltd and Whiting Ltd and how they may be utilised in future.** (6)

Total (20)

5. Mr Smart is the controlling director/shareholder of Smart Delicatessens Ltd, a trading company, which he formed in November 1981. He owns 700 of the issued £1 ordinary shares. His sons, Paul and Terry, each own 150 of the remaining 300 issued shares. Paul and Terry are also directors.

Mr Smart is 65 years old and would like to retire from the company. He needs to realise the value of his shares to fund his retirement and he has agreed with his sons that control of the company should remain in the hands of the family. Mr Smart's shares have been valued at £700,000 although neither Paul nor Terry can personally afford to buy him out. Mr Smart has been advised that all of these objectives may be satisfied by the company purchasing his shares. The company has sufficient distributable reserves and its articles allow for the repurchase of shares. A 70% shareholding had been valued in 1982 as being worth £70,000.

Mr Smart, a higher rate taxpayer, has not been advised of the tax implications and neither has the financing of the buy back been addressed. It may be that the consideration is loaned back to the company and repayment to Mr Smart is made as and when cash flow permits or that some of the freehold shops are sold to provide the cash.

In the form of a file note you are required to:

1) **Calculate the potential tax liabilities arising if the purchase is treated as an income distribution and if it is treated as a capital distribution.** (6)

2) **Set out the conditions that need to be satisfied in order for it to be treated as a capital distribution, ignoring the financing issues.** (6)

3) **Comment on the possible consequences for a capital distribution arising from the financing solutions of the loan back and the sale of shops.** (4)

4) **Explain any income tax relief which may be available, assuming the purchase was treated as a distribution and being one made at market value.** (4)

Total (20)

Note: Candidates should assume that 2007/08 Rates and Allowances continue to apply.

6. You recently met with Peter Clark, whom you have advised for many years. At your meeting, he advised you that he had recently taken up an appointment as trustee and personal adviser to the Wells family. He had never acted as trustee before, and is seeking your advice.

The background to the Wells family is as follows:

Julian and Vanessa Wells have been married for four years, both being divorcees with grown up children from each of their previous marriages. Their combined estate is currently valued at approximately £2.5 million. Neither Julian nor Vanessa have made a Will.

Peter now acts as trustee for the two Wells family trusts. On 20 December 2001, Julian's father had set up a discretionary trust for Julian and his brothers. Julian's father transferred farmland worth £450,000, which he had acquired in 1985. In 1991, the farmland was let under a tenancy which provided that vacant possession could be obtained with two years notice. Julian's father had made chargeable transfers, after reliefs, in the previous tax year of £250,000, but had not made any other gifts in the tax year the trust was set up. The Inheritance Tax was paid by the trustees. The current value of the land is £800,000 and it is estimated that it will be worth £1 million by December 2011. Julian is looking to stop working in the City and have the farm transferred to him, which his father and brothers have agreed to.

The other trust was set up by Vanessa's family in 2000 and consists of investments worth £500,000. Vanessa is the life tenant.

You are required to write a letter to Mr Clark advising him of:

1) **The Inheritance Tax consequences of appointing the farm out of the trust to Julian in November 2008, stating any liabilities arising.** (10)

2) **The Inheritance Tax consequences of leaving the farm in the trust.** (4)

3) **The Inheritance Tax treatment of Vanessa's family trust if the funds are appointed out to Vanessa or her children, or remain within the trust on termination of her life interest.** (3)

4) **The tax advantages of using trusts in the Wills of Julian and Vanessa rather than simply providing for everything to be left to the surviving spouse.** (3)

Total (20)

Note: Candidates should assume that the nil rate band for 2008/09 and subsequent years is £312,000.