# The Chartered Tax Adviser Examination

May 2008

## PAPER IIA – GENERAL PRACTICE

## Suggested Answers

QUESTION 1

A Smith
TaxWorld
23 Bird Street
London W1 4LQ
May 2008

B Jones, Finance Director
Education Age
26 South Street
London W1 5SY

Dear Brian,

**Charity Tax reliefs**

Thank you very much for contacting me. I can reply as follows.

Donations are generally not subject to income or corporation tax in the charity's hands. This is so, whether they are in the form of cash, goods or land.

Donations made by individuals towards the cost of constructing the learning centre are eligible for gift aid relief. This relief permits the charity to reclaim from HM Revenue and Customs basic rate income tax paid by the donor on the gift.

The donor's basic rate band is extended by the gross amount of the donation – so the amount donated x 100/78. A higher rate taxpayer may claim additional tax relief via his tax return for the difference between the 40% higher rate and the basic rate tax withheld at source.

For a gift to be eligible for gift aid relief certain conditions need to be met

1. There must be no condition as to repayment of the gift
2. No benefits may be received or if they are received they must meet the restrictions imposed in the legislation. S418 ITA 2007 refers.
3. The donation must be in the form of a sum of money.
4. A gift aid declaration is completed

The cash donations would seem to qualify for gift aid, subject to the gift aid declaration being completed. However, certain of the donations have been made with a condition that they must be spent on the Learning Centre, failing which they must be repaid to the donors. This amounts to a condition as to repayment. Accordingly, these donations will not qualify for gift aid.

The donation made by the engineering company to the charity will fall to be treated as a qualifying donation and may be deducted from the company's taxable profits as a charge on income.

It should also be noted that the donation by the engineering company is made gross, without deduction of tax. Accordingly, there is no tax for the charity to reclaim.

The gift of the land will not qualify for gift aid since it is not a gift of money. However, the landowner may be able to claim a deduction against his total income for the year in which the gift is made. The deduction is computed as the market value of the land at the time the donation plus the incidental costs of disposal less the value of any benefit that the landlord receives in consequence of making the disposal. In this case the benefit will be the value of the educational courses that are to be provided to him.

A certificate will need to be provided by the charity to the landlord in order to obtain the relief.

The gift of the land constitutes a disposal for capital gains tax purposes. Since the disposal is being made to a charity it will be treated as being made at nil gain nil loss to the charity. S257(2) TCGA 1992 refers.

Whether or not a sponsorship payment qualifies for gift aid relief will depend on what benefit if any the Solicitor is receiving in return. A plaque which commemorates the gift would probably be regarded as a mere acknowledgement of the gift and would not invalidate a claim for gift aid. However, the provision

of advertising may be treated as a benefit received in consequence of the gift. Unless this benefit has a value less than the limits set out at S418 ITA2007, so £25, the donation would not qualify for gift aid.

In addition the charity may be regarded as carrying out a trade of the provision of advertising. Such a trade is unlikely to be treated as falling within the primary purpose of the charity. Any profits made would therefore be taxable.

Do contact me if you have any questions.

Yours sincerely

A Smith

Tax Adviser

## QUESTION 2

John Smith
Tax UnLtd
2 Pound Street
London SW1 3XJ

6 May 2008

Jack Johnson
Powernut Ltd
Unit 2, Chains Road Trading Estate
Chislehurst
Kent BR2 6YP

Dear Jack,

**Employee Taxation**

Further to our meeting last week, I am now able to come back to you with advice on the various payroll related matters which we discussed.

**Company car**

The provision of the company car will give rise to a taxable benefit of £3,315 chargeable on the managing director's daughter. The calculation is as follows:

£(20,100 + 2,000) x 18% x 10/12.

This charge will need to be declared on the daughter's P11D for the year to 5 April 2008. Note that the list price of the motor car must be increased for the cost of any accessories added to the car. If the car was actually provided by reason of her father's employment, the benefit would need to be reported on his P11D. However, given the extent of business mileage, this appears not to be the case here.

No deduction is available from the employment income charge because the car is used predominantly for business purposes. The fact that the car is made available for the employee's private use is sufficient to trigger the charge.

Class 1A NIC of £424 (3,315 x 12.8%) will also be payable and due for payment on 19 July 2008.

**Fuel scale charge**

The fuel scale charge is £2,160 for the year (18% x 14,400 x 10/12). This charge is triggered merely because the fuel is provided for private use and is not reduced because that use is low. This charge too will need to be disclosed on the daughter's P11D

The charge may only be avoided if the daughter is required to and actually does reimburse all of the fuel for her private use. HMRC publish recommended reimbursement rates for different vehicles, and these rates change from time to time based on prevailing fuel prices. As it appears that her private mileage may be low, it may be cheaper for her either to pay for all fuel and reclaim the business element only, or to reimburse the company for all private fuel, than to pay the tax on the provision of private fuel.

Class 1A NIC of £276 (£2,160 x 12.8%) will also be payable and due for payment on 19 July 2008.

**Scholarship**

The provision of a scholarship to the Managing Director's son will be deemed to be by reason of the Managing Director's employment if the scholarship is provided by arrangements entered into by the employer. Accordingly any payments made will form part of the Managing Director's gross pay for PAYE purposes and will trigger a charge to Class 1 National Insurance (Employer's and Employee's).

**Termination of employment**

Statutory redundancy pay is specifically exempted from being taxed as earnings under S62 ITEPA 2003.

Further redundancy pay may also be exempt from being taxed as earnings whether the money derives from a specific scheme which forms part of the terms on which the employees give their services, or whether it is an ad hoc payment. The maximum amount which may be paid tax free (including any statutory redundancy pay) is £30,000.

However, Powernut Ltd should take care that the payment is genuinely for redundancy and not a reward for services, for example having met a production target, or is any way contractual. In this case it would be treated as taxable earnings. HM Revenue & Customs permits employers to submit a proposed redundancy scheme to HM Revenue and Customs for advance clearance that the scheme will not be treated as earnings.

In this case, as more than £30,000 is being paid in total, the excess of £2,000 will certainly be taxable and should be subject to PAYE. If the employee's employment has already been terminated when payments are made then PAYE at the basic rate only should be operated. No class 1 NIC will be payable.

The benefit (if any) of taking ownership of the car will be calculated on the difference between the market value of the car and the amount, £500, paid by the employee. This appears to be part of his redundancy package. Since the package already exceeds £30,000, this benefit will be assessed on the employee in the year the employee takes ownership of the car. As part of the redundancy package, no national insurance contributions will be payable.

For the second employee, provided that the payment in lieu of notice is genuine compensation for breach of the employee's contract, it should not be taxable as earnings. Class 1 NIC will not be due on any of the payment. If there is a contractual entitlement to pay in lieu of notice or even an option under the contract to make such a payment then it will likely be taxable. Class 1 NIC will also be due on this payment. More information is required here and it would be helpful to see the employee's contract of employment.

## Travel costs

Travel from home to a permanent workplace constitutes ordinary commuting and no tax relief is due. A permanent workplace is defined as a place which:

> "the employee regularly attends in the performance of his duties of employment and which is not a temporary workplace".

Assuming that the factory is a permanent workplace then all payments to him for journeys from his home to the factory must be disclosed on the employee's P11D. No claim for relief may be made by the employee. The payment of allowances from the factory to the clients need not be disclosed on the P11D so long as the payments are equal to or less than the approved mileage payments of 40p per mile for the first 10,000 miles and 25p per mile thereafter. Any amounts paid in excess of this sum must be disclosed on the employee's P11D. Payments relating to mileage allowances are subject to class 1 NIC to the extent that the amount received by the employee exceeds the tax allowable mileage (ie from the factory to the clients) at the 40p rate only. Note the 25p rate does not apply for national insurance purposes when mileage exceeds 10,000.

Regular travel between the factory and the depot is likely to be treated as travel between two permanent workplaces and as such mileage payments will not be taxable or subject to class 1 NIC provided that they remain within the limits above.

**Overseas secondment**

I note that the overseas secondment will not last for more than one complete tax year. Accordingly UK PAYE must continue to be operated on earnings received by the employee. The round sum accommodation allowance will likewise be subject to PAYE. Consequently it may be preferable for the employer to contract directly with the landlord or a hotel rather than paying a taxable allowance.

Since the secondment will last less than two years it is likely that the supplier's premises in Abu Dhabi will be treated as a temporary workplace. Accordingly the costs of travel to and from Abu Dhabi, the cost of renting temporary accommodation and other subsistence costs e.g. meals will be not be taxable expenses. Therefore, rather than paying a round sum accommodation allowance, the company should provide the accommodation directly and reimburse meals if necessary against receipts.

Since the secondment lasts less then 52 weeks then Class 1 NIC continues to be payable in full on the employee's salary and accommodation allowance.

The provision of private medical insurance in relation to duties of overseas employment will not attract a charge to income tax or NIC.

Please do not hesitate to contact me if you have any questions

Kind regards

Yours sincerely

John Smith

## QUESTION 3

Barry Rogers<br>Tax Advisor<br>8 Durrington Rise<br>London NW3 7GY

17 May 2008

Judith Johnson
Judith's Cabs
3 Cat Street
Oxford
OX2 7DE

Dear Judith

**PROPOSED INVESTMENTS AND IMPACT ON YOUR TAX LIABILITY**

**INVESTMENTS**

Thank you for contacting me about your proposed investments. You should consider taking advantage of the Enterprise Incentive Scheme (EIS). This scheme provides tax relief on subscriptions for share capital in certain unquoted qualifying trading companies. The reliefs available are summarised as follows:

**Income tax relief.** A tax reducer calculated of 20% of the amount invested is available to a maximum investment of £400,000.

**Disposal relief**. If the shares on which income tax relief has been obtained are retained for more than three years then any gains made on disposal of the shares are not charged to capital gains tax.

**Capital gains deferral relief**: The proceeds from any chargeable gain may be reinvested in ordinary shares in an EIS qualifying company in order to defer that chargeable gain. The relief is limited to the lowest of 1) the amount reinvested 2) the chargeable gain 3) the amount specified in the claim. The gain so relieved is not charged to capital gains tax until the shares are sold or certain other chargeable events. The reinvestment must take place one year before or three years after the date of the chargeable gain.

In addition should you make a capital loss on the disposal of qualifying EIS shares, that loss can be set off against your income.

In each case, once the shares are issued the company making the share issue will need to apply to HM Revenue & Customs (HMRC) to confirm that the share issue qualifies for EIS. If HMRC agree that the share issue qualifies a certificate for each investor will be issued to the company. At that point the claim for EIS relief may be made by the investors.

Liftco Ltd has yet to begin trading. Preparing to trade is a qualifying activity for EIS purposes. However a claim for EIS relief may not be made until four months after the company has commenced to trade, so 1 October 2009 in this case.

The manufacture of shipboard cranes is a qualifying trade for EIS purposes in that it is not listed as an excluded activity in the tax legislation. However, I note with concern that your son is proposing to subscribe for a 32% stake in the company. EIS income tax relief and disposal relief are not available to an investor who, together with associates owns 30% or more of the ordinary share and loan capital of the company as you would be regarded as "connected" with the company. Your son would be counted as an associate and thus your combined holdings would amount to 42%. EIS deferral relief does, however, remain available as there is no "connected person" restriction for this relief. You may therefore wish to discuss with your son the available tax reliefs and whether he would wish to reduce his investment so that you are both able to receive EIS income tax relief.

It is permissible to invest in a holding company such as Eurodog Holdings under EIS, so long as that company is a holding company of a group and the business of that group does not consist wholly or as to a substantial part of non-qualifying activities. Non-qualifying activities would include investment business which appears to be what Canine Investments Ltd is engaged in. A substantial part would be taken to mean greater than 20%. Further information is needed to determine as to whether this test is breached. I note also that Eurodog Ltd has some overseas operations. It is a requirement of EIS that the trade of the group be conducted wholly or mainly in the United Kingdom. According to an HMRC Statement of Practice "wholly or mainly" is interpreted to mean more than half. It is further stated that HMRC will take into account the totality of the trading activities, such as the location of capital assets and of purchasing and processing activities. Further information is again needed to determine whether this test is met for this group and accordingly whether the EIS reliefs are available.

None of the EIS reliefs are available on the investment in Myphone Ltd, since the shares carry a preferential right to an annual 10% dividend. The various EIS reliefs only apply to new subscriptions for ordinary shares.

From a tax relief point of view you should firstly invest £100,000 in Eurodog Holdings, thereby obtaining EIS income tax relief as well as deferral relief. A further £200,000 should be invested in Liftco shares where EIS deferral relief only may be claimed. This claim may only be initiated four months after the company has begun to trade – so October 2009. Given that the self assessment return for the year ended 5 April 2008 will need to have been filed by then and capital gains tax paid the claim for deferral relief will need to be made by amendment to the existing tax return and will result in a repayment of capital gains tax.

Income tax payable under self assessment for the year to 5 April 2008 is £6,455. Please see appendix for workings. This is due for payment on 31 January 2009 together with the first payment on account for the year to 5 April 2009 of half of this amount, £3,227.

Please contact me if you have any questions on any of the above.

Yours sincerely

Barry Rogers

QUESTION 4

**MEMORANDUM**

**To**: General Practice Partner
**From**: Tax Adviser
**Date**: 8 May 2008
**Subject**: Mr Sutcliffe – Tax implications of Emigration

I understand that Mr Sutcliffe is considering emigrating to Spain and you are meeting with him next week to discuss a number of issues. I set out below the UK capital gains tax and inheritance tax implications as you requested.

1 **UK Capital Gains Tax of Sale of UK properties**

As Mr Sutcliffe has lived in UK all his life he has been UK resident, ordinarily resident and also UK domiciled. He would therefore be liable to UK capital gains tax if the properties are sold in a tax year that he is resident or ordinarily resident in UK.

Mr Sutcliffe's plans to spend 6 months in UK and 6 months in Spain would mean that he is unlikely to lose his UK residence status due to either the 183 day test or the 91 day "habitual and substantial" test. He therefore needs to carefully consider the number of days that he spends in the UK in future.

The recent Gaines-Cooper case has indicated that it is not merely a mathematical test that needs to be applied in considering a person's residence status. The basis for the decision reached went beyond looking at the relevance of Booklet IR20 and primarily considered the facts surrounding the taxpayer's overall lifestyle concluding that he had always been, and never lost, his residence in the UK. It was also held that Gaines-Cooper was ordinarily resident and domiciled in the UK.

Should he become non UK resident then there would be no UK CGT on the sales of the UK properties provided he remains non UK resident for at least 5 complete tax years, otherwise the gains would be subject to UK CGT on his return to the UK within the 5 year period.

2 **Sale of Tykes Developments Ltd to Trueman Homes plc**

The sale of Tykes Developments Ltd to Trueman Homes plc for shares in the AIM listed company would not give rise to an immediate disposal for CGT purposes as this would appear to fall within s135 to s137 TCGA 1992, provided there is no tax avoidance motive. The shares acquired would take over the £100 base cost and CGT history of the Tykes Development Ltd shares.

Clearance under s138 TCGA 1992 should be sought to confirm this, but is unlikely to be granted if there are clear plans to emigrate at the time of the share exchange.

UK gains could potentially arise on the sale of the new shares if disposed of during a tax year that Mr Sutcliffe is UK resident or ordinarily resident, or if Mr Sutcliffe returns to the UK within 5 tax years (see paragraph 1 above)

As far as the earn-out is concerned the tax treatment will depend upon how it is payable. If the earn-out consideration is in the form of cash the net present value of the future consideration would be chargeable at the time of the takeover, and thus subject to UK CGT if at a time that Mr Sutcliffe is UK resident or ordinarily resident, based on the principle established in Marren v Ingles.

If however, the earn out is payable in shares or securities in Trueman Homes plc s138A TCGA specifies that the earn out right is treated as a security and a gain or loss will arise when the new securities are disposed of. Again if this is during a tax year that Mr Sutcliffe is not UK resident the gain would not be subject to UK CGT unless he returns to the UK within 5 tax years.

3 **Potential UK inheritance tax payable if death May 2010**

As Mr Sutcliffe has been UK domiciled all of his life he will remain UK domiciled for 3 further years following his loss of UK domicile under common law. It may in any case be that his plans are insufficient to displace his domicile of origin in the UK. Therefore should he die in Spain in May 2010 his estate will continue to be liable to UK inheritance tax (the estate may also be liable to Spanish death duties).

The gifts and transfers in the 7 years prior to death and the worldwide estate at death will be subject to UK inheritance tax as follows:

**Lifetime transfers**

13 Jan 2002 gift to son – exempt as > 7 years before death

| | £ |
|---|---|
| 14 Feb 2004 gift to daughter – potentially exempt transfer | 50,000 |
| Less: Annual exemptions 2003/04 and 2002/03 | (6,000) |
| | 44,000 |

No IHT payable as below £350,000 nil band

| | £ |
|---|---|
| 15 March 2005 transfer to A&M trust (PET) | 250,000 |
| Less: Annual exemption 2004/05 | (3,000) |
| | 247,000 |
| Cumulative transfers (44,000 + 247,000) | 291,000 |
| No IHT payable as below £350,000 nil band | |

| | £ |
|---|---|
| 16 April 2006 transfer to trust | 250,000 |
| Less: Annual exemptions 2006/07 and 2005/06 | (6,000) |
| | 244,000 |

| | £ |
|---|---|
| Cumulative transfers (44,000 + 247,000 + 244,000) | 535,000 |
| Nil rate band at death | (350,000) |
| Chargeable | 185,000 |

| | £ |
|---|---|
| IHT payable @ 40% | 74,000 |
| Less: taper relief, 4-5 years = 40% | (29,600) |
| IHT payable by trustees | 44,400 |

Note: Although this transfer would have been chargeable during lifetime there would have been no IHT payable as below the 2006 nil band.

**Chargeable Estate**

| | £ | £ |
|---|---|---|
| Shares in Trueman Homes plc (Note) | 10,000,000 | |
| 100% BPR | (10,000,000) | |
| UK investment properties | | 4,800,000 |
| Spanish villa | | 300,000 |
| Home in Ilkley | | 1,500,000 |
| Other assets | | 400,000 |
| Chargeable Estate | | 7,000,000 |
| Nil rate band fully used | | |
| Thus IHT payable @ 40% | | 2,800,000 |

Note – BPR applies as the Trueman shares plus the Tykes shares held for more that 2 years

QUESTION 5

Tax Advisers LLP
Sticky Wicket Road
London WC2 4AP

7 May 2008

Mr I T Harris
Cricket Lane
Durham
NE7 8BT

Dear Mr Harris

**HARRIS IT SUPPORT LTD – TAX ISSUES ARISING FROM NEW BUSINESS VENTURE**

Following our initial meeting, and in accordance with your instructions set out in the engagement letter dated 19 April 2008, I set below my answers to the points that you raised.

1 **Managed service companies and personal service companies**

As you are aware the arrangement under which you supplied your services in the past was a mechanism for mitigating PAYE and National Insurance and is no longer tax effective following measures introduced by Finance Act 2007.

Your operations through your new company are likely to fall within the personal services rules, referred to as IR35 which the managed service company structure was designed to avoid.

This means that the deemed payment in respect of income from "relevant engagements" is subject to PAYE and national insurance contributions after certain allowable deductions.

The main allowable deductions are as follows:

- Business travel and subsistence
- Pension contributions on your behalf
- Capital allowances on any asset provided relief would have been available as an employee
- Any salary and associated employers NIC already paid during the period
- Any benefits on which PAYE and employers NIC has already been charged
- A general 5% deduction from the income from relevant engagements

An estimate of this amount is shown in Appendix 2. The amount is deemed paid to you on 5$^{th}$ April and the PAYE and NIC is due on **19$^{th}$ April.**

Although this results in a significant amount of PAYE and National Insurance Contributions being payable it is less than the amount due under the managed service company legislation. The main differences for managed service companies are as follows:

- PAYE and Class 1 national insurance contributions apply to the total amount received, inclusive of travelling expenses
- No general 5% deduction from total income chargeable
- No deduction for pension scheme contributions paid by the company
- No deduction for capital allowances
- PAYE and NIC payable monthly instead of 19$^{th}$ April following end of tax year, hence cash flow disadvantage.

The other main difference concerns the actual liability for the PAYE and National Insurance Contributions. In the case of the Managed service Company the liability is primarily that of the

MSC itself and you would receive income net of any PAYE and NIC. Under the IR35 rules the liability for PAYE and NIC falls on the personal service company, in your case Harris IT Support Ltd and ultimately borne by you personally.

2 **VAT registration**

As the taxable turnover of the business will exceed the VAT registration threshold (currently £64,000), the company will be required to register for VAT once the registration limit is reached on a cumulative basis. This is unlikely to be until the end of March 2009 (after 11 months) when the cumulative turnover reaches approximately £66,000. However you may voluntarily register earlier and as your clients are VAT registered there would be no commercial disadvantage other than the additional administration involved.

If you VAT register without using the flat rate scheme then you are able to recover input tax on your purchases and expenses. Your business will therefore be more profitable than without VAT registration.

The flat rate scheme is a very straightforward scheme designed specifically for smaller businesses. Rather than accounting for VAT on your sales (output VAT) and then deducting VAT on your costs (input VAT) you merely apply a flat rate percentage to your VAT inclusive turnover. The flat rate percentage for IT consultants is 13%, however there is a 1% reduction for the first year of newly registered businesses, so in your case 12% applies for the first year of trading. However you would still need to charge VAT of 17 ½ % on your invoices to your customers.

Based on your estimated turnover of £75,000 the output VAT (17 ½ %) would be £13,125, so your VAT inclusive turnover would be £88,125. The 12% flat rate is then applied to this VAT inclusive amount and £10,575 would be due. As you can see from the calculation in Appendix 1 this is not only simpler than the normal method, but you also end up paying over less VAT to HM Customs and Excise. Note that under the flat rate scheme the business cannot reclaim input VAT on any costs other than capital items costing more than £2,000 inclusive of VAT per single item.

3 **Deemed payment under IR35 rules**

An estimate of the deemed payment under the IR35 rules in respect of your income from relevant engagements paid via Harris IT Support Ltd is **£51,302.** This is based on 11 months to 5 April 2009.

A schedule showing the computation of the amount due is in Appendix 2.

The payment is deemed made on 5th April 2009 and the associated PAYE and NIC would be due on by **19th April 2009**.

4 **Estimated corporation tax liability**

As the company's year end is 30 April the deemed payment on 5 April would be deductible for corporation tax purposes, together with the associated employers NIC. The estimated corporation tax liability for year ended 30 April 2009 as detailed in Appendix 3 is **£1,390,** and this is due for payment **by 1 February 2010**.

I trust that the above answers your specific questions in relation to your new company, but if you require any further explanation please do not hesitate to contact me.

Yours sincerely,

**CT Adviser**

**Tax Advisers LLP**

**APPENDIX 1**

**FLAT RATE SCHEME CALCULATION (full year)**

| | |
|---|---|
| Estimated fees and expenses | £75,000 |
| Fees and expenses inclusive of VAT at 17.5% | £88,125 |
| Flat rate percentage 13% less 1% | 12% |
| Flat rate VAT due | £10,575 |
| Future years @ 13% | £11,456 |

**Normal VAT calculation:**

| | £ | £ |
|---|---|---|
| Output VAT £75,000 x 17.5% | | 13,125 |
| Input VAT on expenses: | | |
| Parking | 600 | |
| Telephone and internet | 1,800 | |
| Computer costs | 500 | |
| Accountancy | 1,000 | |
| Software licence fees | 500 | |
| Total | 4,400 | |
| Estimated input VAT @17.5% | | 770 |
| Mileage 6,000 x 11p x 7/47 | | 98 |
| VAT due | | 12,257 |

| | |
|---|---|
| First year saving | £(12,257 – 10,575) = £1,682 |
| Subsequent years | £(12,257 – 11,456) = £801 |

**APPENDIX 2 – ESTIMATED DEEMED PAYMENT ON 5 APRIL 2009 (11 months)**

| | £ |
|---|---|
| Fee income from relevant engagements | 66,000 |
| 5% deduction | (3,300) |
| | 62,700 |
| Recharged expenses | 2,750 |
| | 65,450 |
| Travelling expenses | (2,750) |
| Pension contributions | (5,500) |
| Salary and benefits in kind | NIL |
| | 57,200 |

Deemed Payment = DP
DP + (DP – £5,225) x 12.8% = £57,200

| | |
|---|---|
| **Deemed payment £57,200 x 100/112.8** | **51,302** |
| Employers NIC (£51,302 – 5,225) x12.8% | 5,898 |

**APPENDIX 3 – ESTIMATED CORPORATION TAX PAYABLE**

**YEAR ENDED 30 APRIL 2009**

| | £ | £ |
|---|---|---|
| Turnover (net of flat rate VAT) (88,125 – 10,575) | | 77,550 |
| Less: | | |
| Wages and salaries (deemed payment) | 57,200 | |
| Pension costs | 6,000 | |
| Motor and travel | 3,000 | |
| Telephone and internet | 1,800 | |
| Accountancy | 1,000 | |
| Use of home as office | 600 | |
| Computer consumables | 500 | |
| Software licence fees | 500 | |
| | | 70,600 |
| Net profit | | 6,950 |
| **Schedule D case I trading profit** | | **6,950** |
| **Corporation tax due @ 20%** | | **1,390** |

## QUESTION 6

**To**: Audit Partner
**From**: T Adviser
**Subject**: Tax Issues arising from Meeting with Geoff Ryder
**Date**: May 2008

**Goodwill**

The disposal of the goodwill to Planeworks Ltd is a chargeable gain for tax purposes. Planeworks Ltd is a "connected" company since Geoff owns the entire share capital. Accordingly it is deemed not to be a bargain at arm's length and an open market value must be used when reporting the consideration for the sale to HM Revenue & Customs.

The business which was incorporated had been trading for just over one year. Assuming that it is a trading business taper relief at 50% will be available to reduce the gain on the goodwill, which will be taxable at your marginal rate. The annual exemption for the year will be available to reduce the gain, if not otherwise used.

Geoff should be aware that HM Revenue & Customs may seek to challenge the value of the goodwill - £200,000, which you computed. This is particularly the case since the business had been trading for such a short period of time prior to its incorporation and the company's subsequent performance has been weak. In the event that a lower valuation is agreed then HM Revenue & Customs may seek to treat part or all of the £60,000 which has been drawn down as remuneration or as a distribution. Planeworks would then be required to pay over the resulting PAYE and Class 1 NIC liability.

If a higher valuation is agreed then additional CGT may be payable. As the disposal occurred in 2006/07 any CGT due should have been paid by 31 January 2008. Therefore interest will be applying to any outstanding liability.

However as the disposal took place as a result of the incorporation of Geoff's business relief under s.162 TCGA 1992 may apply unless either,

- Incorporation relief is disapplied by 31 January 2010, or
- Not all conditions are fulfilled
  ie to be fulfilled the business must be transferred as a going concern, all assets (except cash) must be transferred and the consideration must be wholly or partly in shares.

Geoff may wish to disapply incorporation relief due to the proposed sale of the business to Europlane Ltd (see below) and therefore preserve the taper relief available. Further information needs to be gathered to determine the best course of action for Geoff.

**Loan finance**

Planeworks is a close company for tax purposes since it is wholly owned by Geoff. John Ryder is his son and therefore an “associate” for tax purposes. Corporation tax is payable at 25% of the value of the loan advanced to John Ryder – so £12,000. The losses that the company has made cannot be offset against this amount. The tax was payable by nine months and one day after the end of the accounting period in which the loan was advanced, so by 1 Jan 2008. It should be paid as soon as possible to prevent further interest accruing. If some or all of the loan is repaid to the company then a proportionate amount of the tax may be reclaimed, by nine months and one day after the end of the accounting period in which the repayment takes place.

The loan should be reported on the appropriate supplement to the tax return for the period to 31 March 2007.

Since the loan is interest free then a benefit in kind arises on the son based on the official rate of interest, currently 6.25%, but 5% before 6 April 2007. This gives a benefit, taxable on the son of £600 for the period to 5 April 2007 (48,000 x 3/12 x 5%) and £3,000 (48,000 x 6.25%) for the year to 5 April 2008. Class 1A NIC at 12.8% will also be payable on these sums. It is noted that the benefit was omitted from the P11D for 2006/07. A revised P11D should now be submitted for John Ryder.

Income tax at 20% should have been withheld on the interest paid to Mrs Mitchell. The payments of interest and the income tax deducted should then be reported on form CT61. This form and payment of the income tax due must be submitted to HM Revenue & Customs fourteen days after the calendar quarter in which the interest is paid. If this has not happened Geoff should pay over the tax due now to HM Revenue & Customs together with Form CT61 and seek repayment of the tax due from Mrs Mitchell. Interest payable to Aeroworld Ltd is not subject to deduction of income tax at source so long as Aeroworld Ltd is resident in the UK.

**Tax returns**

The company is required to submit a company tax return (form CT600A) for the period ended 31 March 2007 and another return for the period ended 31 March 2008. The deadline for submitting these returns is 31 March of the following year, failing which a £100 penalty becomes payable. A further £100 is payable if the return is submitted more than three months late. The 2007 return is therefore late and should be submitted as soon as possible to prevent further penalties accruing.

**Sale of company**

The disposal of the business constitutes a change of ownership. We should therefore consider whether there will be a major change in the nature or conduct of the trade within three years of that change. If so and in accordance with S768 ICTA 1988 any unrelieved trading losses brought forward at the time will be lost. Whilst this will primarily be of concern to the purchaser, whether or not the purchaser is able to use the losses may affect the price which Geoff will receive on a sale.

It is stated at S768 (4) that a major change in the nature or conduct of the trade includes “ a major change in the type of property dealt in or services or facilities provided, in the trade, or a major change in the customers, outlets and markets of the trade”.

At SP 10/91 HM Revenue & Customs indicate by way of example that where a company operating a dealership in one kind of car switches to a operating a dealership in another make of car satisfying the same market that would not constitute a major change since there is no major change in the type of property dealt in. In this case likewise there is no major change in the kind of property dealt in. The company is merely expanding its range of aeroplanes it produces. Accordingly the losses brought forward at the time the company is purchased should be available to be carried forward to offset against future trading profits.

Since a portion – two thirds - of the workshop was used in a personal company, which conducted a trade, then the gain made on the sale of that portion will be eligible for rollover relief. The proceeds from the sale will need to be invested in a qualifying asset, eg land and buildings or business goodwill within three years after or one year before the building is sold and the new asset will need to be used in a trade carried on by Geoff or his personal company. The rollover relief will be restricted to the extent that the proceeds are not reinvested in a new qualifying asset.

The gain made on that part of the workshop which was not used by the personal company will not be eligible for rollover relief. The gain will instead be taxed at 18%.

It should also be noted that no balancing charge or balancing allowance will arise for the purposes of Industrial Buildings Allowance when Geoff disposes of the workshop.

[NOTE: Candidates will receive full credit whether they refer to the taper relief rules or the rules applicable to 2008/09 which are not yet legislated.]