THE CHARTERED INSTITUTE OF TAXATION

The Chartered Tax Adviser Examination

May 2009

Taxation of Owner-Managed Businesses

Advisory Paper

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 only. Do not write in the left-hand margin.
- 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 the law elements in this paper in accordance with Scots law or Northern Ireland law should tick the appropriate box on the front of each answer folder.

1. You are the tax adviser for a new client Mr Charles Levern. Mr Levern wholly owns a successful engineering company that has been trading for a number of years. Your firm is responsible for his personal tax and his company's tax affairs. During your initial review of the client, you noted that Mr Levern has not made any provision for retirement. You raised this with Mr Levern and he had asked that you draft a letter explaining the tax relief for employer and employee pension contributions and any restrictions on that relief.

   You are required to draft the letter requested by Mr Levern. (10)

2. Laser DVD Ltd is a UK company with two equal shareholders, Nigel Jackson and Alison Wilson. The company manufactures laser components found in DVD players and has a year end of 30 June. Nigel and Alison are full-time working directors and are both higher rate taxpayers.

   On 1 March 2007 Laser DVD Ltd lent Nigel Jackson's adult daughter, Jessica, £30,000 to clear her student debts. £8,000 was repaid on 25 June 2007, £10,000 was repaid on 1 August 2007, £5,000 was repaid on 10 April 2008 and the remainder was repaid on 15 July 2008.

   On 1 December 2007 Laser DVD Ltd lent Nigel Jackson £50,000. Nigel failed to make any repayments and the company wrote off the entire loan on 1 August 2009.

   On 16 February 2008 the company lent Alison Wilson £20,000 to purchase a racehorse. This amount was fully repaid by her on 1 May 2009. Alison also lent Laser DVD Ltd £25,000 on 17 April 2008 which the company treated as a separate account rather than netting it with the loan to Alison.

   You are required to explain the tax consequences for Laser DVD Ltd of the various loan transactions described above. (10)

3. Paul Windmill is the managing director and majority shareholder of Windmill Ltd, a company that services office photocopiers. The company's year end is 31 December. Windmill Ltd operates from four locations throughout the UK. In the year ended 31 December 2008 the following took place:

   1) The company transferred two employees from the Birmingham office to the Newcastle office and paid them £12,000 each as compensation for the losses arising on the sale of their houses in Birmingham.

   2) Several employees were members of a trade union. Paul Windmill dislikes trade unions and so the company paid each employee that was a member £5,000 for them to give up their rights to trade union membership.

   3) Fred Winter, the financial controller of Windmill Ltd obtained an MBA from the Open University. Fred financed the costs of the course and examinations himself. Fred's salary is £33,000 per annum. Windmill Ltd paid him £1,500 as an award for obtaining his MBA qualification.

   4) Alan Simpson is an audit director with a well known large accountancy practice. He has been approached by Paul Windmill with a view to him joining Windmill Ltd as finance director. Paul has offered Alan, as an inducement to join Windmill Ltd, either a cash lump sum payment of £15,000 or alternatively 5% of Paul's existing shares in the company. As at 31 December 2008 Alan had not made up his mind on the proposed offer of employment.

Continued

3. *Continuation*

5) Paul is a huge sports fan and the company gave a £2,000 prize to Larry Roberts for being voted the best British performer at the 2008 Olympics in a competition run at the time. Larry won four gold medals at the Olympics.

Paul is determined to retain and motivate key employees and so he granted some share options to the sales director Clive Freeman during the year. Clive is a higher rate taxpayer. The options were granted on 16 July 2008 with a stipulation that they must be exercised no later than 16 July 2023. The option is to acquire 1,000 ordinary shares in Windmill Ltd from Paul Windmill's existing shareholding at a price of £7 per share. The shares cost Paul £1 each when he set up the company in 2003. At the time of the grant Clive paid £2,000 for the option. Paul obtained a valuation of the company as at 30 June 2008 of £11 per share. It was anticipated that the options will be exercised at such time as the company is sold. However, Clive received some inheritance monies during the summer of 2009 and both he and Paul agreed that he could exercise his option in November 2009 at which time it is expected that the market value of the shares will be £15 per share. The shares are not subject to restrictions.

Paul has come to you for advice on the tax issues relating to the above.

You are required to write a letter to Paul Windmill dealing with the following:

1) **In respect of the five matters highlighted above, any requirements for Windmill Ltd to report or account for tax. You should also briefly comment on the deductibility of the items for Corporation Tax purposes.** (10)

2) **The tax implications arising for Clive when he exercises his option and subsequently sells his shares. You should assume that the market value of the shares at the date of exercise is £15 per share and that the entire share capital of the company will be sold to an unconnected third party on 24 August 2010, when the shares are worth £20 each.** (4)

3) **The tax implications for both Windmill Ltd and for Paul Windmill when Clive exercises his option in November 2009.** (6)

Total (20)

4. Your firm has recently taken on a new client, the Valley View Dental Practice. Steve, Nadeem and Chris commenced in partnership as dental practitioners on 1 October 2004. Steve is the senior partner and personally owns the dental surgery premises. He charges the partnership a commercial rent for the use of the building.

The three partners shared profits equally and their capital sharing ratio was also split equally. Each of their wives also works in the practice as dental nurses, one part-time and the other two full-time.

During the summer of 2008 Steve heard from his friend Mark, who went to dental college with Steve and who was also the proprietor of a dental practice in the town, that it was more tax efficient to run a dental practice through a limited company. Mark had recently incorporated and he mentioned to Steve that significant goodwill had arisen which resulted in big tax savings.

Steve decided to take Mark's advice and Valley View Dental Practice ceased trading on 30 September 2008. Valley View Dental Practice Ltd, which was incorporated in August 2008, commenced trading on 1 October 2008.

Edward Clifton is a dental practice valuation specialist. He has valued the goodwill of the practice at £750,000 as at 30 September 2008 based on a number of factors specific to the dental profession and expects that should the practice be sold in the open market it could be sold for an amount of £750,000 in excess of net assets.

The largest asset class on the practice balance sheet at 30 September 2008 was plant and machinery which mainly comprised dentist chairs and dental equipment.

You are required to:

1) **Discuss the tax implications of the incorporation of the practice based on the information provided.** (14)

2) **Explain the tax implications of the various remuneration and profit extraction strategies that are now available to Steve, Nadeem and Chris as directors and shareholders of Valley View Dental Practice Ltd.** (6)

Total (20)

5. Shielder Ltd, based in Wolverhampton, is an unquoted trading company controlled by Steve Slater who owns 100% of the shares in the company. He subscribed for the 500 ordinary shares of £1 each at par 15 years ago when he set up the company. Steve is also the managing director.

Shielder Ltd manufactures and sells gas tanks to energy and utility companies. The company year end is 30 April 2009. You have reviewed the company's balance sheet and Corporation Tax computations and ascertain the following:

1) Plant and Machinery Pool Tax Written Down Value carried forward – £370,000
2) Fixed Assets (Cost) – £650,000
3) Stock (Cost) – £80,100
4) Cash – £120,000
5) Goodwill – £75,000 (Representing an engineering patent acquired from a rival business in June 2001)
6) Shares in subsidiary (see below) – £80,000
7) Creditors – £67,439
8) As at 30 April 2009, Shielder Ltd has capital losses carried forward of £9,000.
9) The company owns 100% of the share capital in a dormant subsidiary Dalken Ltd. The only asset currently owned by the company is a plot of land purchased in May 1997 for £80,000. The land was acquired as a speculative investment. The company borrowed from the bank to purchase the land but the loan has long since been redeemed and the company is debt free.
10) The company is paying Corporation Tax at the large company rate.

Steve is currently considering three separate offers in respect of the company:

1) Gasrite plc, a quoted energy company wishes to purchase the entire share capital of Shielder Ltd for £850,000.
2) Tumular Industries Ltd, a rival trading company wishes to purchase the following assets for £725,000 allocated as follows:
    a) Plant and Machinery – £500,000
    b) Stock – £120,000
    c) Goodwill – £105,000
3) A private investor is interested only in the land in Dalken Ltd and is offering £150,000 to purchase the land. Steve recently had the land valued by a surveyor in anticipation of a sale and paid £1,750 for the valuation. He estimates that the legal fees for the disposal will be £1,890.

Based on the figures contained in the 2009 accounts and Corporation Tax computation and the three offers, Steve wants to know the likely tax consequences of each offer. He is a higher rate tax payer who will make no other capital disposals in the year.

You are required to draft a letter to Steve Slater advising him of the tax issues surrounding the three offers which he has received including the tax payable under each offer, an explanation of any reliefs claimed, and an explanation of how Steve may access the proceeds. You should assume that any sale will take place on 31 May 2009 and that 2008/09 rates and allowances apply. (20)

6. Dickson, Clowes and Markins are a firm of Surveyors. The partnership makes up accounts to 30 June each year and the partners share the profits equally. On 1 January 2009, the partnership accepted a new partner Geoffrey Beatson who will be entitled to a quarter-share of the profits.

For the accounting period ended 30 June 2008, the accounts reveal a profit before tax of £789,000 and the following additional information:

Partner drawings:

Dickson - £19,000
Clowes - £17,500
Markins - £19,200

1) In July 2007, the firm moved into new premises and paid the landlord a lease premium of £21,000 (which they had deducted in arriving at the profit of £789,000) in respect of a 21 year lease.

2) In May 2008, the firm renewed their IT system and purchased a brand new server for £85,000.

3) The new offices had no air-conditioning so the firm paid for a system to be installed in May 2008 at a cost of £40,000.

4) The TWDV of the general pool at 6 April 2008 was £14,768.

5) The firm decided to adopt UITF 40 in the year ended 30 June 2005 and the amount of the UITF 40 adjustment income was £300,000. Details of the profits (before capital allowances and before adding on any UITF 40 adjustment income) for that and subsequent years are as follows:

30 June 2005	£450,000
30 June 2006	£280,000
30 June 2007	£320,000

The initial UITF 40 adjustment income was £300,000.

6) The partnership estimates that profits for the year ended 30 June 2009 will be £850,000. This estimated figure includes capital allowances and the lease premium adjustment.

Geoffrey Beatson, who is 47 years old, had no other income in the year ended 5 April 2009. He made a gain of £18,796 on the sale of some quoted shares. He also took out a loan of £96,000 in order to make a capital contribution to the partnership. In the year to 5 April 2009 he paid £4,700 interest on the loan.

You are required to

1) Calculate the adjusted trading profit for the partnership for 2008/09. (13)

2) Calculate Geoffrey's Income Tax, Capital Gains Tax and National Insurance Contributions liability due for payment on 31 January 2010. You should also comment on any reliefs available to Geoffrey. (7)

Total (20)