November 2023 Examination

PAPER 2

BUSINESS TAXATION

Part I Suggested Answers

Candidates will be given credit for relevant points not on the mark scheme.

1. Carlos – assessable profit

Tax year		£	
2021/22	Year ended 30 April 2021	29,000	1
2022/23	Year ended 30 April 2022	27,000	1
	5 months ended 30 September 2022	14,000	½
	Transitional overlap relief	(8,000)	½
		33,000	
			(3)

2. Alexia should have notified HMRC within six months of the end of the end of the tax year in which she became chargeable to tax i.e. by 5 October 2022 **(½)**.It appears as though the error was careless **(½)** and so the maximum penalty will be 30%**(½)** of the potential lost revenue of £10,000 due on 31 January 2023 **(½)**. This percentage may be reduced to a minimum of 10% **(½)** for a prompted disclosure within 12 months of the tax becoming due **(½)** and assistance given to HMRC **(½)**.

Max **(3)**

3. Sam, Marianne and Rana – profit allocation

		£	
9 months to 30 September 2022	9/12 x £161,000	120,750	½
3 months 31 December 2022	3/12 x £161,000	40,250	
		£161,000	

	Total £	Sam £	Marianne £	Rana £	
P/e 30 September 2022	120,750				
Interest 5% x £150,000 x 9/12	(5,625)	5,625			1
Balance 50:50	115,125	57,562	57,563		½
P/e 31 December 2022 Balance	40,250	22,137	10,063	8,050	½
Total		£85,324	£67,626	£8,050	

		£	
Tax year 2022/23:			
Balance p/e 31 December 2022		8,050	½
Estimate to 5 April 2023	3/12 x £180,000 x 20%	9,000	1
Assessable profits		£17,050	

(4)

4. Kit will be liable to an automatic penalty of £100 as the return should have been filed by 31 January 2022 **(½)**.

   Additional daily penalties could be levied of £10 per day for up to 90 days as Kit has filed the return more than three months late (after 30 April 2022) **(½)**.

   As the return was actually filed more than six months late, there will be a tax geared penalty of 5% **(½)** of the tax liability of £7,400 shown on the return (5% x £7,400 = £370) **(½)**. The payments on account are not deducted for the purposes of calculating the penalty**(½)**.

   Kit has 12 months from the filing date of 31 January 2022 to amend his return: before 31 January 2023**(½)**. Once the return is filed, the tax geared penalty will be reduced to 5% of the amended liability **(½)** of £5,300 (£265). As this is lower than £300, the penalty will be reduced to £300**(½)**.

   HMRC will have 12 months from the end of the quarter following the actual filing date to enquire into Kit's return: until 31 October 2023**(½)**. Max (4)

5. Takuto Ltd

		General pool	Special rate pool	Allowances	
		£	£	£	
Year ended 31 July 2022					
WDV b/f		6,800	47,900		
Fork lift truck	First payment only	7,000			½
	AIA	(7,000)		7,000	½
WDA 18%/6%		(1,224)	(2,874)	4,098	**1**
				£11,098	
5 months ended 31 December 2022					
WDV b/v		5,576	45,026		
Fork lift truck	Balance	7,000			½
	AIA	(7,000)		7,000	
Delivery truck		25,000			
	Super deduction (130%)	(25,000)		32,500	**1**
WDA 18%/6% x 5/12		(418)	(1,126)	1,544	½
				£41,044	
					(4)

6. Jactow Ltd

		£	£	
Sales proceeds			500,000	
Selling costs			(6,700)	½
			493,300	
Cost		175,000		½
Extension		60,000	(235,000)	½
Indexation	(278.1-164.4)/164.4		(121,100)	1½
	0.692 x £175,000			
Gain			137,200	
				(3)

7. Shelac Ltd - loan relationships

1) Interest on the loan to buy machinery is treated as a trading deduction **(½)**.
2) Interest on late paid Corporation Tax is a non-trade loan relationship deficit **(½)**.
3) Interest on late paid PAYE is not deductible**(½)**.
4) Interest on the loan to buy the property let to a third party is a non-trade loan relationship deficit **(½)**.
5) The arrangement fees for the above loan are also a non-trade loan relationship deficit**(½)**.
6) The employee debt written off is a non-trade loan relationship deficit**(½)**.

(3)

8. Berlet Ltd – structures and buildings allowance

1) The cost of the land does not qualify for structures and buildings allowance **(½).**
2) The legal and planning costs also do not qualify for structures and buildings allowance **(½).**
3) The costs associated with preparation of the land do qualify **(½).**
4) The plumbing and heating system will not qualify as it qualifies for plant and machinery allowances as integral feature **(1)**.

The allowance can be claimed from 1 January 2024 when the factory is brought into use **(½)**. (3)

9. Daphil Ltd – company administration

	Due date for return	
12 months ended 31 March 2022	30 June 2023	**(½)**
3 months ended 30 June 2022	30 June 2023	**(½)**

The payment relating to the 12 months to 31 March 2022 was due on 1 January 2023 **(½),** and so will be late and will incur interest at 3.5% for the two-month period from 1 January 2023 to 1 March 2023 **(½)**. The payment for the 3 months to 30 June 2022 was due on 1 April 2023 **(½)** so repayment interest 0.5% is due for one month. **(½)**.

(3)

10. Meera – gain on lease

		%	
30 April 2008	35 years	91.981	½
30 April 2022	21 years	74.635	½

		£	
Sales proceeds		95,000	
Cost	£75,000 x 74.635/91.981	(60,856)	1½
Gain		34,144	
Annual exemption		(12,300)	½
Taxable gain		£21,844	

(3)

11. Tadej, Frank and Alice – capital gains

The painting and the workshop are both chargeable assets for Capital Gains Tax **(½)**. The car is an exempt asset even though capital allowances may have been claimed **(½)**.

The gain on the painting will be calculated on the difference between the net auction proceeds and the value of the fees **(½)**. The gain may be subject to the rules for chattels**(½)**.

The gain or loss on the workshop is subject to rollover relief **(½).** The gain is deferred until the earliest of: **(1)**

- the disposal of the leased workshop
- ceasing to use the leased workshop
- 10 years from acquisition of the leased workshop

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Max (3)

12.Matt – averaging claim

The five-year averaging claim is available because:

The average of four years prior to 31 March 2023 is:

(60,000 + 48,000 + 52,000 + 47,000)/4 = £51,750 **(1)**

And the test for five-year averaging shows that the trading profit for the year ended 31 March 2023 is less than 75% of the four-year average:

34,000/51,750 = 66% Therefore averaging applies. **(1)**

Profits for each year from 2019 – 2023 become:

(60000 + 48,000 + 52,000 + 47,000 + 34,000)/5 = £48,200 **(1)**

Any increases or decreases in tax for the earlier years are adjusted through the balancing payment for 2022/23**(1)**. (4)

Part II

13.

1)

Conditions for the cash basis to apply

(a)

Gita must have made an election for the cash basis/ticked the cash basis box on the return **(1/2)** in respect of 2020/21 **(1/2)**.

Her total business receipts must not have exceeded £150,000 in 2020/21 (the first year of the election) **(1/2)**.

(b)

Her total business receipts in 2021/22 must not have exceeded £300,000 otherwise the cash basis could not be used in 2022/23 **(1/2)** as receipts exceed £150,000 in 2022/23 **(1/2)**.

(maximum 2 marks)

2)

Trading profit for the year ended 5 April 2023

	£	
Cash sales	165,000	**(1/2)**
Credit sales (£9,000 **(1/2)** - £700 **(1/2)**)	8,300	
Proceeds from computer (£800 *not balancing allowance* **(1/2)** × 40% **(1/2)**)	320	
Bank interest received *(give if omitted but full calc performed)*	0	**(1/2)**
Purchase of materials	(39,000)	**(1/2)**
Administration expenses (£15,000 - £3,000)	(12,000)	**(1/2)**
Gita's drawings *(give if omitted but full calc performed)*	-	**(1/2)**
Train tickets	(4,700)	**(1/2)**
Taxable trading profits	£117,920	

(5 marks)

3)

National Insurance Contributions:

	£
Class 2: (£3.15 × 52) **(1/2)**	164
Class 4:	
£(50,270 – 11,908 **(1/2)**) × 10.25% **(1/2)**	3,932
£(117,920 **(1/2)** – 50,270 **(1/2)**) × 3.25% **(1/2)**	2,199
	6,295

(3 marks)

4)

Deductible amounts for the car

Gita can claim capital allowances on the purchase price of the car **(1/2)** at 18% as emissions do not exceed 50 g/km **(1/2)**. Only the business use portion is deductible **(1/2)** being 80% (12,000/15,000) **(1/2)**. The business use portion of the running costs would also be deductible **(1/2)**.

Alternatively, Gita could claim a fixed rate deduction of £5,000 ((10,000 × 45p) **(1/2)** + (2,000 × 25p) **(1/2)**), and no other deductions **(1/2)**.

(4 marks)

5)

Actions to take regarding disclosing financial information to Gita's bank, a third party

Steps relating to Robert:

Check that his professional indemnity insurance covers giving financial references for clients **(1/2)**.

Steps relating to Gita:

Revise (or check) the terms of the engagement letter to cover this work **(1/2)**.

Obtain Gita's confirmation (possibly in engagement letter) **(1/2)** that she will not hold Robert responsible for any unintended consequences of releasing the information/for not getting the mortgage **(1/2)**.

Steps relating to the bank

which should be taken so that Robert does not inadvertently assume a duty of care towards the bank **(1/2)**:

Include a clear notice / caveat / disclaimer in the reference letter **(1/2)** stating that the returns/ income figures were prepared for the client **(1/2)** and that Robert assumes no liability or responsibility to the bank **(1/2)**.

Set out the terms of letter including limitations on scope of the information **(1/2)** eg that the letter does not give comment on Gita's current or future income/ Robert has no responsibility to update the content **(1/2)**.

Credit would be awarded for other suggestions given in the ethical guidance but only where this is appropriate to this scenario and level of risk.

(maximum 4 marks)

Total 18 marks

14.

1)

Capital gains on transfer of a building to a partner

This is a chargeable disposal by each of Anton and Bembe **(1/2)**. They are each charged on 30% of the gain **(1/2)**, which is calculate as the market value of the building at transfer less cost **(1/2)**.

Camilo has a notional gain of 40%/Camilo's 40% gain is not charged to Capital Gains Tax **(1/2)**. His base cost is the market value of the building on transfer **(1/2)** less the notional gain **(1/2)**.

(3 marks)

2)

Double entries to record disposal

1 mark per double entry

Dr	Disposal account	£40,000	
	Cr Plant and machinery cost account		£40,000
Dr	Provision for depreciation (£40,000 - £12,000)	£28,000	

	Cr	Disposal account		£28,000
Dr	Bank/cash		£8,000	
	Cr	Disposal account		£8,000
Dr	Profit and loss account (loss = £8,000 – 12,000)		£4,000	
	Cr	Disposal account		£4,000

(4 marks)

3)

Input VAT recoverable for the quarter ended 31 March 2023

	£	£	
For multiplying by 20% consistently			**(1/2)**
Input VAT:			
Input recoverable per question		500	**(1/2)**
Raw materials 5,000 × 90% **(1/2)** × 20%		900	
Entertaining UK customers		0	**(1/2)**
New machine £30,000 × 50% **(1/2)** × 20%		3,000	**(1/2)**
Input tax recoverable		£4,400	

(3 marks)

4)

VAT deregistration

The partnership can deregister if it is expected to make taxable supplies in the next 12 months of less than £83,000 **(1/2)**. Current sales are £20,000 per quarter (equivalent to £80,000 for 12 months) and decreasing, so the partnership can deregister **(1/2)**.

If the partnership deregisters, the final VAT return must include output VAT **(1/2)** on any business assets (such as the new machine) on hand at deregistration **(1/2)**. This is unless the VAT would not be more than £1,000 which is unlikely to be the case here **(1/2)**.

(maximum 2 marks)

15.

1)

Heads of Agreement

It allows the two companies to set out the terms of the transaction **(1/2)** such as which assets are being sold and at what price **(1/2)**.

It allows them to identify any commercial issues that might arise **(1/2)** and should be dealt with before the contract is agreed and completed **(1/2)**.

Possible legally binding terms could include:

Confidentiality – Tafanda Ltd agrees not to disclose any information provided by Hazmol Ltd to anyone else during the negotiations **(1/2)**.

Exclusivity period – Hazmol Ltd agrees not to negotiate with other parties for a specified period **(1/2)**.

Costs – the costs that are to be reimbursed if the sale does not go ahead **(1/2)**.

(maximum 3 marks)

2)

Trading loss for the period ended 31 January 2023

	£	
Accounting loss	(450,000)	
Add back		
Depreciation	26,000	**(1/2)**
Loss on disposal of machinery	10,000	**(1/2)**
Redundancy costs	-	**(1/2)**
Fine for breaching fire safety regulations	15,000	**(1/2)**
Debt collection agency costs	-	**(1/2)**
Write-off of bad debts	-	**(1/2)**
Plus overall balancing charge (£104,000 (W2) – 25,000 (W1))	79,000	**(1/2)**
Tax-adjusted trading loss	£(320,000)	

Working 1: Capital allowances

	General pool £	Special rate pool £	Total allowances £	
TWDV b/f	245,000	0		
Disposals:				
Various general pool machinery	(185,000)			**(1/2)**
Zero emission car	(5,000)			**(1/2)**
Solar panels		(30,000)		**(1/2)**
Total	55,000	(30,000)		
Balancing allowance (no WDA)	(55,000)		55,000	**(1/2)**
Balancing charge (no WDA)		30,000	(30,000)	**(1/2)**
	0	0	25,000	

Working 2: balancing charge on sawing machine

Balancing charge (not via pool) **(1/2)** = £80,000 × 130% **(1/2)** = £104,000

(7 marks)

3)

Loss relief

A claim against total profits in the current period **(1/2)** must be made first **(1/2)**.

A terminal loss relief claim should be made/ loss is a terminal loss **(1/2)** as the loss arises in the last 12 months of trading.

Therefore, the remaining loss is carried back three years **(1/2)**, latest years first **(1/2)** against total profits **(1/2)**.

The loss is offset before the deduction of qualifying charitable donations **(1/2)**.

Credit can be given for some marks above for the operation of the relief if the point is demonstrated in the calculations.

	Year ended 30/9/2019 £	Year ended 30/9/2020 £	Year ended 30/9/2021 £	Year ended 30/9/22 £	4 months ended 31/1/23 £

Trading profit	300,000	240,000	110,000	87,000	-	(1/2)
NTLR income	12,000	12,000	12,000	12,000	4,000	(1/2)
Total profits	312,000	252,000	122,000	99,000	4,000	
Current year loss relief					(4,000)	
Carry back three years		(95,000)	(122,000)	(99,000)		
QCD	(10,000)	(10,000)				(1/2)
Taxable total profits	302,000	147,000	0	0		(1/2)*

**For giving TTP for each period as required, after loss relief applied matching candidate's explanation*

The claims must be made by 31 January 2025 (two years from end of accounting period of loss) **(1/2)**.

(maximum 5 marks)

16.

1)

Business asset disposal relief

Storage building - business asset disposal relief is not available as the sale of a single asset is not a material disposal of a business *or alternatively*, this is not an associated disposal as there is no material disposal of the shares in the company. **(1)**

Tigret plc shares – business asset disposal relief is not available as Jacob has not worked for the company or *alternatively* Jacob has not owned at least 5% of the ordinary share capital. **(1)**

Only one reason needed per disposal for full credit.

(2 marks)

2)

Capital Gains Tax

	£	
Gain on storage building (W1)	70,000	
Gain on Tigret plc shares (W2)	4,800	
Chargeable gain	74,800	
Less annual exempt amount	(12,300)	(1/2)
Taxable gain	62,500	
CGT		
(£37,700 – £29,430) **(1/2)** £8,270 × 10%	827	(1/2)
(£62,500 - £8,270) £54,230 × 20%	10,846	(1/2)
	£11,673	

Working 1: disposal of storage building

	£	
Deemed proceeds (market value)	270,000	(1/2)
Cost (not including roof repairs)	(90,000)	(1/2)
	180,000	
Less gift relief (balance)	(110,000)	(1/2)
Chargeable gain (£160,000 – £90,000)	70,000	(1/2)

Working 2: Tigret plc shares

	£	
Proceeds	85,000	
Less broker fees	(200)	**(1/2)**
Cost 10,000/12,000 **(1/2)** × £96,000 **(1/2)**	(80,000)	**(1/2)**
Chargeable gain	4,800	

(6 marks)

3)

Badges of trade

There appears to be a profit motive **(1/2)**, as she has bought rare garments which she can sell to specialist buyers, doubling her money **(1/2)**. *Also awarded if part of a discussion of the reason for the acquisition/sale.*

There are frequent transactions of the same type **(1/2)**, with Sasha selling 10 garments at festivals every month and a rare garment on average online each month **(1/2)**.

Sasha has made changes to the garments to make them more saleable /increase profits **(1/2)** by repairing them **(1/2)**.

The nature of the items **(1/2)** is such that they can be used personally, as Sasha has done, but the quantity of several hundred garments requiring a separate building indicates trade **(1/2)**.

The length of ownership of the items now seems short **(1/2)** with Sasha selling rare items soon after buying them **(1/2)**.

The existence of sales/business organisation suggests trading **(1/2)** evident by advertising online / attending sector festivals/ use of a separate building for the activities **(1/2)**.

Credit given for other relevant points indicative of trading, provided these are supported by the information given, rather than speculative.

(maximum 5 marks)