May 2026 Examination

PAPER 2

Business Taxation

Suggested Answers

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

1. Ben

1)

		£	
Profit/(loss) per accounts		(30,867)	1/2
Add:			
Depreciation	5,780		1/2
Customer entertaining	612		1/2
Accounting fees for personal tax return	100		1/2
Car insurance (20% x 620)	124		1/2
Motor costs (20% x 340)	68		1/2
Drawings	12,300	18,984	1/2
Adjusted profit/(loss) before capital allowances		(11,883)	
Less capital allowances (W)		(11,440)	1/2
Trading loss		(23,323)	

Working: Capital allowances

	General pool £	Private use asset – electric car	Allowances	
Tax written down value brought forward	10,800	0		(1/2)
Additions (no AIA in cessation period)	28,000			(1/2)
	38,800			
Disposals				
Car – market value		(9,200)		(1/2)
Testing machine	(20,000)			(1/2)
Total	18,800	(9,200)		
Balancing allowance	(18,800)		18,800	(1/2)
Balancing charge (20% private use)		9,200	(7,360)	(1/2)
Total	0	0	11,440	

2)

Taxable income for each period:

	2023/24 £	2024/25 £	2025/26 £	
Taxable trading profits (before transition profits) (W1)	64,000	23,300	NIL	(1/2)
Transition profits (W2)	1640	1640	4,920	
Trading income	65,640	24,940	4,920	
Terminal loss relief (W3)		(15,303)	(4,920)	(1/2)+(1/2)
Revised trading income	65,640	9,637	NIL	
Property income	15,000	15,000	15,000	(1/2)
Total income	80,640	24,637	15,000	
Personal allowance	(12,570)	(12,570)	(12,570)	(1/2)

Taxable income	68,070	12,067	2,430

W1 Trading profits:

	£	£	
2024/25			
3/12 x £56,000	14,000		1/2
9/12 x £12,400	9,300		1/2
		23,300	
2025/26			
3/12 x £12,400	3,100		
8/8* (£23,323)	(23,323)		
		(20,223)	(1/2) for identifying there is a loss.

W2 Transition profits:

Year	£	
2023/24		
£8,200/5	1,640	(1/2)
2024/25		
£8,200/5	1,640	(1/2)
2025/26		
£8,200 – £1,640-£1,640	4,920	(1)

W3 Terminal loss:

Final 12 months of trade is 1 March 2025- 28 February 2026.

Period	£	£	
1 March 2025 – 5 April 2025 (1month)			
1/12 x £12,400	1,033	0*	(1)
6 April 2025– 28 February 2026 (11 months)			
3/12 x £12,400	3,100		(1/2)
8/8 x (£23,323)	(23,323)		(1/2)
	(20,223)	(20,223)	
		(20,223)	

*As a profit arises in the period to 5 April 2025, this profit is ignored.

Loss memo

	£
Terminal loss	20,233
2025/26 trading income	(4,920)
	15,303
2024/25 trading income	(15,303)
	NIL

3) As Ben knows that his 2025/26 tax liability will be less than the tax due for 2024/25, he can ask HMRC to accept lower payments on account. (1/2)

He can specify the amount he wishes to pay. (1/2)

Ben can make this claim:

- in the tax return for 2024/25 (1/2) – Ben was aware of the situation prior 31 January 2026, the submission deadline for this return. (1/2)
- online or by post (1/2) by completing form SA303 (1/2), giving reasons why the payments on account should be reduced. (1/2) This would need to be done by 31 January 2027. (1/2)

4) Ben must notify HMRC within 30 days of ceasing to make taxable supplies. (1/2)

The deregistration takes effect from the date of ceasing to make taxable supplies. (1/2)

Ben had scrapped all assets apart from the car and the new testing machine as these had no re-sale value.

On the final VAT return, Ben has to account for VAT on the assets that remain on hand as if they were supplied in the course of furtherance of the business. (1/2)

No input VAT would have been recovered on the car as it is a blocked item. (1/2) Therefore no output VAT is due on the cessation of trade. (1/2)

There will be output VAT due on the deemed supply of the new testing machine. (1/2) As the value of the machine was £20,000, the VAT would exceed £1,000 (1/2) and so would be included in the final VAT return. (1/2)

2. Teri

1) The sale of cars can either be considered a trade or a capital disposal.

If the sales are considered a capital disposal, no tax will arise as cars are exempt from capital gains tax. (1/2)

The overall impression from the badges of trade is that a trade does not exist. (1/2)

Badge of trade	Explanation
Profit-seeking motive (1/2)	Teri purchased the cars because of their love for cars, restoration and attending car shows. While they were each sold at a profit, it does not appear that this was the motivation for Teri when acquiring the cars. (1/2)
Number of transactions (1/2)	Teri has now sold four cars in the last three years. This is unlikely to be considered habitual and continuous activity. (1/2)
Nature of the asset (1/2)	Classic cars are often purchased for personal enjoyment. (1/2)
Existence of similar trading transactions or interests (1/2)	There is no connection to an existing trade – Teri's other activities are not related to classic cars. (1/2)
Changes to the asset (1/2)	The cars are being restored to a condition that enhances their value. This may be indicative of trade. (1/2)

The way the sale was carried out (1/2)	The first two sales were made through a chance meeting with another enthusiast. The later sales were through a specialist online marketplace which is not in itself indicative of trade. The sales had to be made to raise money which indicates that a trade did not exist. (1/2)
Source of finance (1/2)	The cars were purchased from long term savings which indicates that a trade does not exist. (1/2)
Interval of time between purchase and sale (1/2)	The cars have been purchased over the past 31 years and have been held for a long time. This indicates that a trade did not exist. (1/2)

(max 3 marks for badges of trading, max 3 marks for application to facts given)

2)(a)

	£	
Income from employment	18,000	(1/2)
Trading income (W1)	15,200	
	33,200	
Less Personal allowance	(12,570)	(1/2)
Taxable income	20,630	

W1 Trading income:

As Teri's expenses are less than £1,000, they should claim the trading allowance instead.

	£	
Income from trade	16,200	(1/2)
Less trading allowance	(1,000)	(1/2)
Trading income	15,200	

(b)

	£	
Trading income	15,200	(1/2)
Less lower profits limit	(12,570)	(1/2)
	2,630	
Class 4 National Insurance contributions at 6%	158	(1/2)

Teri will be due to pay the Class 4 National Insurance contributions by 31 January 2027. (1/2)

3) As Teri started to receive trading income in 2025/26, they have until 5 October 2026 to notify HMRC. (1/2)

If the deadline is missed, penalties are calculated as a percentage of potential lost revenue (1/2)

The potential lost revenue would be the Income tax and National Insurance contributions unpaid at the due date because of failure to notify (1/2). This would be £3,198. (W1)

As Teri was aware of the need to notify but chose not to, this would be a deliberate failure to notify. (1/2)As HMRC were tipped off about the business by one of Teri's students, it will be a prompted disclosure. (1/2)

As Teri only accepted payment in cash such that there was no trace of the business, it may appear that steps were taken to conceal the self-employment activity. (1/2) If this is the case the maximum penalty will be £3,198 (100% x £3,198) (1/2) and the minimum penalty will be £1,599 (50% x £3,198). (1/2)

If there is no concealment, penalties will be a maximum of £2,239 (70% x £3,198) (1/2) and a minimum of £1,119 (35% x £3,198). (1/2)

W1 Potential lost revenue

	£	
Income Tax on trading income (£15,200 x 20%)	3,040	1/2
National Insurance on trading income	158	1/2
	3,198	

(max 5 marks)

3. Darren

1)

a) As the building is transferred to Darren's spouse, it is a 'no gain, no loss' transfer. (1/2) No gain arises for Darren on the disposal. (1/2)

b) As this is a gift to a connected person, market value must be used when calculating the disposal. (1/2)

	£	
Market value	38,300	(1/2)
Less cost	(8,000)	(1/2)
Gain before gift relief	30,300	

A gift relief (1/2) claim can be made as this is a disposal of shares in an unquoted trading company (1/2)
The relief is restricted (1/2) as the company has only one chargeable asset but as two of the three floors of the building are not used in the trade, only one third will be chargeable business assets. (1/2)

	£	
Gain before gift relief	30,300	
Less gift relief: 30,300 x 1/3	(10,100)	(1/2)+(1/2)
Chargeable gain	20,200	(1/2)

c) The matching rules apply:

Same day	0	
Next 30 days	4	
s.104 pool	6	
	10	(1/2)

	£	
Proceeds	730,080	(1/2)
Less matched cost	(285,160)	(1/2)
Less s.104 pool cost (W1)	(91,086)	(1/2)
Chargeable gain	353,834	

Working 1 - s.104 pool

	Number of shares	Cost £	
4 January 2018 -purchase	30	339,120	(1/2)
1 September 2021- disposal	(8)	(90,432)	(1/2)
	22	248,688	
12 October 2023 - purchase	12	267,468	(1/2)
	34	516,156	
4 May 2025 - disposal	(6)	(91,086)	(1/2)
	28	425,070	

Total for part 1 (10)

2)

	Investors relief	Other gains	
	£	£	
Shares in Hyxvel Ltd	20,200		
Bitcoin		353,834	
Less AEA		(3,000)	(1/2)
Less loss b/f		(1,000)	(1/2)
Taxable gain	20,200	349,834	
Tax on shares			
£20,200 x 14%		2,828	(1/2)
Tax at basic rate		553	(1/2)
(£23,270 (W)- £20,200) = £3,070 x 18%			
Tax at higher rate		83,223	(1/2)
(£349,834-£3,070)= £346,764 x 24%)			
Capital Gains Tax liability		86,604	

Investors relief is available on the share disposal as the shares are in a trading company (1/2) that were subscribed for on/ after 17 March 2016 (1/2) held by Darren for at least three years (1/2) and for which Darren had never worked.(1/2) So the gain is taxed at 14%.

Working: basic rate band

As Darren has trading income of £27,000. The remaining basic rate band available for the taxation of gains is:

	£	
Basic rate band	37,700	(1/2)
Used by trading income	(14,430)	(1/2)
(£27,000-£12,570)		
	23,270	

Max (5)

Total (15)

4. Chalt Ltd

1) Calculation of Corporation Tax liability

		£	
Profit per the accounts		185,000	
Pension contributions owed		2,400	½
Finance lease interest on vans	No adjustment	-	½
Depreciation		34,000	½
Less depreciation on leased assets		(7,600)	½
Loss on sale of machinery		8,600	½
Dividends received		(3,400)	½
Capital allowances	Working	(3,183)	½
50% sales proceeds – Balancing Charge	(2,900/2)	1,450	½
SBA	(3% x £56,000)	(1,680)	1
Total taxable profits		215,587	
Dividends		3,400	½
Augmented profits		£218,987	
Tax liability			
Tax at 25%	215,587 x 25%	53,897	½
Marginal relief	3/200 x (250,000 – 218,987) x 215,587/218,987	(458)	1½
Tax liability		£53,439	

Working – Capital allowances

	General pool £	Special rate pool £	Allowances £	
WDV b/f	26,000	17,000		
Sales proceeds (15,000 – 1,500)	(13,500)			1*
Disposal of 50% FYA equipment (2,900/2)		(1,450)		½
	12,500	15,550		
WDA 18%/6%	(2,250)	(933)	3,183	1
WDV c/f	10,250	14,617		
			£3,183	

* credit for adjustment made in the correct column

(10)

2)

On the sale of the warehouse, the structures and buildings allowance claimed will be apportioned for the period up to sale **(½)**. The total structures and buildings allowance claimed will be added to the sales proceeds for the building for chargeable gain purposes **(½)**.

The sale of the warehouse is a disposal and generates a chargeable gain for the company. The gain will be calculated as the net sales proceeds, less the original cost and the cost of the extension **(½)**. Chalt Ltd will be able to claim Indexation Allowance on the original cost up to December 2017 **(½)**, but not the extension **(½)**. The gain will then be included in Chalt Ltd's total taxable profits **(½ no credit if mention annual exempt amount)**.

As land and buildings used in the trade, both warehouses are qualifying assets **(½)** for rollover relief **(½)**. The amount of the gain that can be rolled over depends on how much of the sales proceeds are reinvested. If not all the net sales proceeds are reinvested, then the remainder will be chargeable **(½)**. The proceeds reinvested will be deducted from the cost of the new warehouse **(½).** The new warehouse needs to be bought within 36 months of the sale of the old warehouse **(½)**.

Max (5)

Total (15)

5. Dout Ltd

1) Memorandum to James re client acceptance procedures for Dout Ltd.

Memo

To James

From Anne Adviser

We should comply with the identification requirements set out in anti-money laundering guidance **(½)**.

We should assess the risks of having Dout Ltd as a client **(½)**, and whether the risks can be managed **(½)**. In particular we should consider:

1) Dout Ltd appears to have been spending a lot of money on advertising and sponsorship and has offices in a prestige location. We should consider the directors' personal circumstances and the sources of funding **(1)**.
2) Dout Ltd is a competitor of another client, Eben Ltd. We will need to consider, whether we can act for both clients e.g. by using different partners and client teams **(1)**.
3) We will need to consider the company's attitude to compliance with taxation law as they have missed filing tax returns **(1)** and in particular should only act if the directors agree to correct the March 2025 Corporation Tax return **(1)**.
4) The firm should consider the Consumer Contracts (Information Cancellation and Additional Charges) Regulations 2013 **(½)**.

½ given for mention of professional clearance and engagement letters.

(maximum of 2 marks for generic points and 3 for discussion of points relevant to Dout Ltd)

½ mark extra for more discussion of the conflict of interest point.

Max (5)

2) Explanation of penalties and interest

To: directors@dout.com

From: an adviser@taxadvisers.com

Date 10 May 2026

Dear Luca and Raul

Penalties for late filed Corporation Tax returns

The first Corporation Tax return was for the year ended 31 March 2024 and should have been filed by 31 March 2025 **(½).** Dout Ltd was liable to a penalty of £100 immediately after the due date **(½)**, which would have been increased to £200 as the return still wasn't filed by three months after the due date (30 June 2025 **(½)**). As the return still hadn't been filed by 18 months after the end of the accounting period (30 September 2025) **(½)**, there will be a tax geared penalty **(½)**. The amount of the penalty is calculated on the basis of the unpaid amount of tax due at 30 September 2025 **(½)**. Based on the estimated accounts that you have prepared for the year ended 31 March 2024, this would be £18,750 less the three payments of £2,000 made between July and September 2025 at 10%: £1,275 **(½)**. There will be a further £1,275 **(½)** to pay as the return still wasn't filed by 24 months after the accounts year end (31 March 2026) **(½)**.

Your second Corporation Tax return was for the year ended 31 March 2025 and was filed by 31 March 2026 and so no penalty will be due **(½)**.

Potential penalties for incorrect return

You have filed a return for the year ended 31 March 2025, but it was estimated and you think that the liability is too low. You have until 31 March 2027 to file the correct figures **(½)**, which will avoid any penalties for an incorrect return. If the return is not corrected then there could be a penalty. At the moment, the error looks to be careless **(½)**. The maximum penalty could be 30% **(½)** of any tax underpayment **(½)**. However, this could be reduced to nil **(½)** if the error is disclosed promptly to HMRC **(½)**. If a penalty is charged, then it may be suspended for up to two years **(½)** if conditions can be agreed with HMRC **(½)**.

Interest on late paid Corporation Tax

There are no penalties for tax paid late, but interest will be due **(½)**.

The Corporation Tax payment for the year ended 31 March 2024 was due on 1 January 2025 (nine months after the end of the year end) **(½)**. Interest at 7% will be charged on the outstanding balance until it is fully paid **(½)**.

Although the Corporation Tax payment for the year ended 31 March 2025 was paid before the due date of 1 January 2026 **(½)**, any additional tax will be charged interest **(½).**

If you have any queries on the explanations given, please do not hesitate to contact me.

Yours sincerely

Anne Adviser Max (10)

Total (15)

6. Flick Ltd

1) Calculation of gain on the grant of the lease

		£	
Sales proceeds		19,200	½
Cost	150,000 x 19,200/(40,000 + 160,000)	(14,400)	1½
Chargeable gain		£4,800	

		£	
Premium		40,000	
Less capital element	40,000 x 2% (25-1)	(19,200)	1
Income element		£20,800	

(3)

2) Corporation and Capital Gains Tax implications of the two options.

Flick Ltd will be granting a short lease on the factory **(½)**. The sales proceeds will be split between a capital element and an income element **(½)**. The income element will be taxed as income from property **(½)** with the ongoing rental income. The capital element will be a chargeable gain subject to corporation tax **(½)**. The loss on the plant will not be allowable to set against any gain **(½)**. The sales proceeds of the plant will be deducted from the capital allowance general pool and may result in a balancing charge **(½)**.

Flick Ltd will continue in existence with income from rent less any expenses **(½)**.

If Hugo sells the shares in Flick Ltd, then he will be liable to Capital Gains Tax on the difference between the sales price and the original cost of £100 **(½)**. For at least two years **(½)**, Hugo has owned more than 5% **(½)** of the share capital of Flick Ltd, a trading company **(½)** and worked for the company **(½)**. He will therefore be eligible to claim business asset disposal relief (BADR) on the disposal **(½)**. This means that the gain on the shares will be taxable at 14% **(½)**.

From Hugo's point of view all the sales proceeds will be in his hands and can be spent as he wishes **(½)**.

Max (7)

3) Capital Gains Tax on the office building.

If Hugo sells the office building when he sells the company shares, he will be liable to Capital Gains Tax on the disposal. He will be eligible to claim BADR **(½)** on the disposal as he will be making a material disposal (the disposal of the company shares) and also making an associated disposal **(½)**. He has also owned the building for more than three years **(½)** and the building has been used by Flick

Ltd for more than two years **(½)**. The gain will therefore be taxable at 14%. The building will need to be sold shortly after the shares to qualify **(½)**. The BADR relief will be restricted as rent is charged but at less than the market rate **(½)**.

If Hugo sells the building in two years' time, then, assuming Capital Gains Tax rates are the same, then he will be taxed at rates between 18% and 24%, depending on his other income **(½)**. He will not be eligible for BADR**(½)**, as the sale would no longer qualify **(½)** as an associated disposal as although it will have been sold within three years **(½)**, it will have been used for another purpose ie rented out **(½)**.

Max (5)

Total (15)