



July 2026 Examination

PAPER 2

Business Taxation

Suggested Answers

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

1. Saul

1) Tax adjusted profits

	£	£	
Income received			
Sales income received		46,000	
Sale of motorcycle		-	$\frac{1}{2}$
		<u>46,000</u>	
Allowable expenses paid			
Plumbing supplies		24,000	
Motorcycle expenses	24p x 400	96	$\frac{1}{2}$
Car expenses	45p x 6,200	2,790	$\frac{1}{2}$
Wages		-	$\frac{1}{2}$
Light and heat	10% x 900	90	$\frac{1}{2}$
Use of home more beneficial	£10 x 10	100	1^*
Fixed household costs	Working	488	
Storage unit rent	2/3 x 3,750	2,500	$\frac{1}{2}$
		<u>29,974</u>	
 Taxable trade profits		 <u>£16,026</u>	 (4)

* $\frac{1}{2}$ for correct calculation, $\frac{1}{2}$ for use of most beneficial figure

Working

Fixed household costs	£	
Council tax	1,200	
Insurance	300	
Mortgage interest	2,400	
	<u>3,900</u>	$1\frac{1}{2}$
 Business use 1/8	 <u>£488</u>	 $\frac{1}{2}$
		(2)

Total (6)

2) Car or van

Van

If Saul buys a van, then he will be able to deduct £16,800 (70% x £24,000) ($\frac{1}{2}$) from his trading profits for the year ended 31 March 2027 ($\frac{1}{2}$). He estimates that his profits will be £25,000. At current rates of Income Tax and National Insurance, this will save him Income Tax and National Insurance of 26% x (25,000 – 12,570) = £3,232 ($1\frac{1}{2}$: ($\frac{1}{2}$) for tax ($\frac{1}{2}$) for NIC and ($\frac{1}{2}$) for restriction to PA) in the year ended 31 March 2027 as profits will be reduced by £16,800 and the remaining personal allowance will reduce trading profits to Nil.. When he sells the van after three years, 70% of the net sales proceeds will be added to his taxable trading profits and be taxed at 26% = £2,730 ($\frac{1}{2}$). The net cost of the van over three years would therefore be 24,000 – 15,000 – 3,232 + 2,730 = £8,498 (1).

Car

There would be no immediate deduction for the car against Saul's profits for the year ended 31 March 2027 ($\frac{1}{2}$). He can claim capital allowances for the car at 6% in a separate pool ($\frac{1}{2}$). Over the three

years he will be able to reduce his tax and National Insurance by £24,000 - £15,000 = 9,000 x 70% x 26% = £1,638 (1). The net cost would therefore be £9,000 - £1,638 = £7,362 (½).

Conclusion

The car would be cheaper overall, but Saul may prefer the earlier tax saving of a van (½) **mark given for any reasonable conclusion**.

Total (7)

3) VAT on van or car costs

Van

VAT can be reclaimed on the purchase (½) of the van. As the van will be used for both business and private purposes, then the input VAT claimed will be restricted to the business proportion (½).

Car

VAT on the initial cost of the car is blocked (½) and cannot be reclaimed, because there will be some private use (½) of the car.

Requirements

To claim any input tax, Saul will need to have a VAT invoice (½) with the supplier's details and VAT number (½), addressed to him (½), on which the VAT has been correctly charged (½).

(credit will be given for any relevant points, including detailed VAT invoice requirements)

Max (4)

Total (17)

2. Jazu Ltd

1) **Calculation of total taxable profits/(losses)**

Adjustment to profit:

		£	
Loss per the accounts		(43,600)	
Depreciation		13,000	½
Rental expenses		15,800	½
Post cessation factory costs	(34,000-15,800) x 3/12	4,550	1
Excess redundancy	48,000 – 4 x 8,000	16,000	1
Legal costs (others allowed)	(3,300 + 1,000)	4,300	1½
Entertaining (customers only)	1,250 x 10/25	500	1
Donation		600	½
Profit on disposal of fixed assets		(133,700)	½
Rental income		(36,000)	½
Capital allowances	Balancing charge	31,600	½
		<u>£(126,950)</u>	(7½)

Capital allowances:

General
pool
£

WDV b/f		15,400	
Disposal value	48,000 – 1,000	(47,000)	1
Balancing charge		<u>£31,600</u>	

(½ for calculation, ½ no WDA)

Rental income:

	£	
Rental income	36,000	½
Rental expenses	(15,800)	½
Rental profit	<u>£20,200</u>	(1)

Total taxable profits/(losses)

	31 December 2022	31 December 2023	31 December 2024	p/e 30 September 2025	p/e 31 December 2025	½ (split final year)
	£	£	£	£	£	
Trading profit	20,000	35,000	25,000	-	-	½
Rental income	12,000	18,000	17,000	15,150	5,050	1*
Capital gain (450,000 – 330,000 -3,300)					116,700	1½**
	32,000	53,000	42,000	15,150	121,750	½ no loss relief 12/25
Loss relief: p/e 30/9/25				(15,150)		½
y/e 31/12/24			(42,000)			½
y/e 31/12/23		(53,000)				½
y/e 31/12/22	(16,800)					
QCD	(600)	Lost	Lost	Lost	(600)	1***
Total taxable profit	14,600	-	-	-	£121,150	(6½)

* ½ included in computation; ½ correct split

** **1** correct calculation; ½ inclusion in correct period

*** ½ inclusion of QCD, ½ lost when losses set off

Loss relief memo:

	£
Loss for the period ended 30 September 2025	(126,950)
P/E 30/9/25	15,150
Y/E 31/12/24	42,000
Y/E 31/12/23	53,000
Y/E 31/12/22 (balance)	<u>16,800</u>

Loss

-

(16)

2) Corporation Tax filing requirements: year ended 31 December 2025

Two returns (½) will be required for the year ended 31 December 2025. The first return will be for the nine months ended 30 September 2025 (½), when the company ceased trading (½). The second return will be for the three months from October to December 2025 (½) when the company's accounting period ends (½). Both returns will be due by 31 December 2026 (½).

Max (2)

3.

To: directors@payrop.com

From: adviser@accountants.com

Subject: Sale of shares in Payrop Ltd to Talass plc

Date 10 May 2027

Dear Akshar and Ulrika

I am writing in response to your email about the potential sale to Talass plc.

I have set out below the potential tax consequences for each of the shareholders.

The sales proceeds are expected to be £5,000,000. As there are 1,250 shares, the sales proceeds per share will be £4,000. The proceeds received by each shareholder will be (1):

	No of shares	£
Akshar	500	2,000,000
Ulrika	400	1,600,000
Sandi	100	400,000
Alex	250	1,000,000
	1,250	5,000,000

Akshar

The cost of Akshar's shares was £500 and so his gain will be £1,999,500 (½). Akshar qualifies for business asset disposal relief (BADR) (½). As he has previously made a claim for entrepreneurs' relief of £500,000 (½), he will only be able to claim BADR on £500,000 (½) with that part of the gain taxed at 18% (½). The remaining gain of £1,499,500 will be taxed at 24% (½) after deducting the annual exempt amount of £3,000 (½). This gives capital gains tax (CGT) payable of £449,160 (£429,160 with BADR at 14%) Ulrika

The cost of the shares held by Ulrika was £400 and so she will have a gain £1,599,600 (½). Ulrika also qualifies for BADR on the sale of her shares up to her lifetime limit of £1,000,000 (½). The remaining gain of £599,600, less her annual exempt amount will be taxable at 24%. This gives CGT payable of £323,184 (£283,184 with BADR at 14%).

Sandi

Sandi doesn't qualify for any reliefs, other than her annual exempt amount. The deemed cost of her shares was £60,000 (½), less the gain held over of £59,900 (½) = £100. Her gain will be £399,900 (½), which will be taxed at 18% within her basic rate band and 24% for any excess (½). The exact amount can be calculated if the amount of her employment income is provided.

Alex

Alex will not be entitled to BADR as she is not a director or employee of the company (½). She will be entitled to claim investors' relief on the shares that she acquired in March 2020 (½) as these are new ordinary shares (½) in an unlisted trading company (½) that she has held for at least three years (½) and she has not been an employee or director (½). The gain on these shares will be $50 \times £4,000 = £200,000$ (½) less the cost of £47,000 = £153,000, which will be taxed at 18% (½). However, she will not be able to claim on the shares acquired in June 2024 as she has not held the shares for more than 3 years (½). The gain on these shares: $200 \times £4,000 = £800,000$ less the cost of £188,000 and her annual exempt amount of £3,000, will be taxed at 24% (½). This gives CGT payable of £173,700. (£167,580 with IR at 14%).

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

Yours sincerely

Anne Adviser

Max (11)

2) Information for Talass plc

The request to provide information to Talass plc could be a breach of confidentiality (½), and may have unintended consequences (½), such as Talass plc withdrawing their offer or making a claim against our firm.

We need to ensure that we don't acquire a duty of care to Talass plc (½). This will include a clear notice to Talass plc, that any information was prepared for Payrop Ltd and no liability is accepted to Talass plc, if they chose to rely on the information (½).

The letter of engagement (½) should also ensure that Payrop Ltd require consent (½) before any information is disclosed to Talass plc.

As this would be a high risk situation (½), then it is suggested in the Professional Rules and Practice Guidelines, that Talass plc and/or their advisers be asked to exclude the firm from liability or be held harmless as a consequence of providing information (½).

Max (4)

(Credit given for all points made which are relevant to the situation)

Total (15)

4. Kaleb

1) Capital allowance on plant and machinery:

	FYA @100% £	AIA @ 100% £	General pool £	Special rate pool £	Private use asset £	CA claim £
			0	2,100	0	
Additions						
New machinery		<u>140,000</u>				
Hire purchase car	<u>38,000</u>					
Car purchased for owner					<u>45,000</u>	(1/2)
Disposals						
Machinery			<u>(48,000)</u>			(1/2)
Car - SRP				<u>(1,900)</u>		(1/2)
Balance FYA	38,000 <u>(38,000)</u>	140,000	(48,000)	200	45,000	
AIA		<u>(140,000)</u>				38,000 (1/2)
Small pools write off				<u>(200)</u>		140,000 (1/2)
Balancing charge			<u>48,000</u>			200 (1/2)
WDA x 6%						(48,000) (1/2)
	0	0	0	0	<u>(2,700)</u>	<u>1,350(50%)</u> (1/2 + 1/2)
					<u>42,300</u>	<u>131,550</u>

- The waste disposal system would be classified as part of the building and will not qualify as plant. (*List A, s.21 CAA 2001*) (1/2)
- Altering a building for the purposes of installing plant and machinery qualifies for capital allowances (CAA 2001, s.25). (1/2) As the business is VAT registered, the VAT will be recoverable, and the VAT exclusive cost should be included for capital allowances (1/2) The full cost of £140,000 (£165,200+£2,800)/1.2) can be claimed as an AIA. (1/2).
- The disposal of the machinery is deducted from the general pool as machinery is a general pool item. (1/2) The VAT exclusive amount of £48,000 (£57,600/1.2) is deducted. (1/2) This makes the general pool negative and so a balancing charge is made to bring the general pool back to 0 (1/2)
- No capital allowances are available on the leased car as there is no legal ownership of the car. (1/2)
- The capital cost of the hire purchase car is eligible for capital allowances when the car is brought into use regardless of the payment dates. (1/2) A first year allowance can be claimed as it is an electric vehicle (1/2) The VAT inclusive capital cost of the car is included as VAT on cars is blocked. (1/2) No private use adjustment is required as it is used by an employee. (1/2)
- The new car for Kaleb is eligible for special rate writing down allowances as CO2 emissions are above 50g/km (1/2). This is adjusted for private use as the car is used by the owner of the business (1/2)

7. The disposal of the car from the special rate pool leaves the SRP at less than £1,000 and therefore a writing down allowance of the remaining amount can be claimed as this is a small pool. (CAA 2001, s.56A)(1/2)

2)

To determine employment status, the factors that indicate self-employment must be weighed against the factors that indicate employment. (1/2)

There are several factors that indicate employment.

- Gary is not able to provide a substitute – if he is sick or on holiday, an agency is used. (1/2)
- Control – Gary must complete his work on weekday evenings– both his time and location of work are controlled by Kaleb (1/2)
- There appears to be a mutuality of obligations in respect of a long-term arrangement (1/2)

There are several factors that indicate self-employment:

- Gary must provide his own equipment (1/2)
- Gary must make improvements in his own time (1/2)
- Gary has a range of other residential customers (1/2)
- Gary may have the opportunity to profit if he can complete the work to an appropriate standard quicker than anticipated. (1/2)

3)

If Gary is classified as an employee:

- Kaleb will have to register Gary as an employee (1/2) and deduct income tax and employee National Insurance at source under PAYE. (1/2)
- Kaleb will have to pay Class 1 secondary National Insurance contributions. (1/2)
- These will be 15% on Gary's salary above £5,000. (1/2)
- Kaleb will have to pay Gary holiday/sick pay. (1/2)
- Kaleb may need to pay HMRC for historical unpaid tax and NICs and for any penalties that HMRC imposes (1/2)

(max 2 marks)

5. Noyla Ltd

1)

	£	
Proceeds	686,000	1/2
Less selling costs	(4,000)	1/2
Add Structures and buildings allowances claimed	<u>28,275</u>	W1
Net proceeds	710,275	
Less cost including acquisition expenses (248,000+5,200)	(253,200)	1/2+1/2
Less enhancement expenditure (£186,000+£3,000+£2,500)	<u>(191,500)</u>	1/2 +1/2

Gain before indexation allowance	265,575	
Indexation allowance (£253,200 x 0.101)	<u>(25,573)</u>	W2
Chargeable gain	<u>240,002</u>	

Working 1 Structures and buildings allowances

$$(\pounds 186,000 + \pounds 2,500) \times 3\% \times 5 = \pounds 28,275$$

Working 2 – indexation allowance

$$((278.1 - 252.6) / 252.6) = 0.101 \text{ (rounded to 3dp)}$$

$$\pounds 253,200 \times 0.101 = \pounds 25,573$$

2)

Rollover relief is available if Noyla Ltd sell a qualifying asset and reinvests the proceeds in another qualifying asset.

Both the asset being sold and the new asset(s) must be used for trading purposes.

The new asset(s) must be brought into use as soon as acquired but HMRC will allow a short gap for enhancing or altering the asset providing it is not used for other purposes in the meantime.

Qualifying assets include land and buildings and fixed plant and machinery.

The asset sold and asset bought do not need to be in the same category. Noyla Ltd has sold land and buildings but can rollover the gain into the land and buildings acquired (the factory) and/or the fixed plant and machinery (the industrial equipment).

The new asset must be acquired within the period one year before the sale of the old asset and three years after the sale of the old asset. Noyla Ltd acquired the new factory in August 2025, within 12 months before the sale of the old factory and purchased the industrial equipment the day after the sale of the old factory. Both are within the qualifying time period.

To claim full rollover relief, the asset being sold must be used wholly for trading purposes. As the old factory was let out for part of its ownership, it has partial non-trade use, and only partial rollover relief can be claimed.

Rollover relief is also restricted if the full (business) proceeds are not reinvested.

(Max 5 marks)

3)

A rollover relief claim on the acquisition of the new factory will defer the gain by reducing the base cost of the new factory by the amount of the rolled over gain.

This will result in an increased gain when the new factory is eventually sold.

As the industrial equipment only has a useful life of 30 years, it is a depreciating asset.

Rather than reducing the base cost of the industrial equipment, a rollover relief claim would result in the gain being frozen.

The frozen gain will crystallize on the earlier of:

- Noyla Ltd selling the industrial equipment
- Noyla Ltd ceasing to use the industrial equipment in its trade

- 10 years after the acquisition of the industrial equipment (1/2)

6. Val

1)

Lease 1

	£	
Proceeds	131,040	(1/2)
(2% $\times$ (40-1)*£168,000)		
Less legal fees	(1,750)	(1/2)
	129,290	
Less cost	(54,600)	(1/2)+(1/2)
(£220,000 $\times$		
£131,040/(£168,000+£360,000)		
	<u>74,690</u>	

Lease 2

	£	
Proceeds	88,000	(1/2)
Cost	(82,587)	(1/2)+(1/2)
(170,000*39.399/81.100)		
	<u>5,413</u>	

Land

	£	
Proceeds	38,000	(1/2)
Less legal fees	(600)	(1/2)
Net proceeds	37,400	
Less cost including acquisition expenses (w)	(20,731)	
Less enhancement expenditure	(15,000)	(1/2)
Chargeable gain	<u>1,669</u>	

Working: cost including acquisition expenses

	£	
Cost	46,000	
Legal fees	800	
Auctioneer fees	<u>2,300</u>	
Cost including acquisition expenses for eight acres	<u>49,100</u>	(1/2)
Cost including acquisition expenses allocated to the three sold acres	<u>20,731</u>	(1/2)
49,100*38,000/(38,000+52,000)		

2)

Machine

The machine is a wasting chattel but is not exempt as it is used in Val's trade and capital allowances have been claimed. (1/2)

The machine is sold at a loss but this is not an allowable loss for capital gains as Val will already have had relief for the loss through capital allowances. (1/2)

First edition book:

Books are non-wasting chattels. As the sales proceeds are more than 6,000 and the cost less than 6,000, the gain on disposal is restricted to 5/3 (proceeds - 6,000). (1/2)

The gain is:

	£	
Proceeds	10,000	(1/2)
Less cost including acquisition expenses (£2,400+£240)	<u>(2,640)</u>	(1/2)
Chargeable gain	<u>7,360</u>	

The gain is restricted to £6,667 (5/3(10,000-6,000)). (1/2)

3)

Shares in Halval Ltd

Due to the issue of shares to Mo in June 2024, Val's shareholding was reduced from 8% to 4%. Halval Ltd, therefore, ceased to be Val's personal company. (1/2)

The conditions for BADR will, therefore, not be met on the disposal of the shares in January 2026. (1/2)

Prior to the issue of shares to Mo in June 2024, the conditions for BADR were met:

- Halval Ltd was a personal trading(1/2) company as Val held more than 5% (1/2) of the shares – she held 8%
- The shares had been held for at least two years (1/2)
- She had been a director of the company for at least two years. (1/2)

As the shares issued to Mo in June 2024 were paid for in cash (1/2) and issued and subscribed for commercial reasons (1/2), the share issue to Mo is a relevant share issue.

Val can make an election to deem that her shares were disposed of and reacquired in June 2024, immediately before the dilution. (1/2) This will result in a notional gain with deemed proceeds of £36,000 in June 2024. (1/2) A claim for BADR can be made for this notional gain. (1/2)

The election must be made by the first anniversary of 31 January following the tax year in which the notional disposal is made. (1/2) As the notional disposal was made in 2024/25, the election must be made by 31 January 2027. (1/2) The claim for BADR must be made by the same date. (1/2)*

The actual disposal in January 2026 realises a gain (with base cost of £36,000) where the gain is not subject to BADR. (1/2)

**Tutorial note: A claim for BADR would need to be made by the first anniversary of 31 January following the tax year in which the gain is treated as accruing. If students consider deferring the notional gain until the eventual sale of shares, the gain will accrue in 2025/26, making 31 January*

2028 the relevant date for a BADR claim. The deferral election is contingent on making the dilution election so students will not obtain marks for going straight to this or stating time limit of 4 tax years following the year of notional gain i.e., 5 April 2029 as the actual sale of the shares beforehand takes precedence. Where students cover both points marks will be awarded accordingly.

(Max 6 marks)