May 2021 Examination

PAPER 2

Business Taxation

Part I Suggested Answers

1. A taxpayer may appeal if they disagree with a decision made by HMRC. This may be because they do not agree with the interpretation of legislation by HMRC (½) or they believe that HMRC has made a mistake i.e. incorrect amendment to a return or incorrect closure notice after an enquiry. (½)

   Notice of appeal must be given in writing within 30 days (½) of the amendment and should give the grounds for the appeal. (½)

   If an appeal cannot be settled by agreement, HMRC may offer a review. (½) The case is then reviewed by an HMRC officer who was not previously involved. (½)

   If a review is not offered by HMRC (½) or the tax payer does not agree with the decision of the review officer, (½) they can ask for the appeal to be heard by the Tribunal, (½) which is an independent legal body which consists of independently appointed expert tax judges and/or panel members. (½)

   Maximum 4 marks

2.

2018/19	1.12.18 to 5.4.19	(½)	£4,000	4/5 x £5,000	(½)
2019/20	1.12.18 to 30.11.19	(½)	5,000	£5,000	(½)
			14,000	7/12 x £24,000	(½)
			£19,000		
2020/21	1.12.19 to 31.10.20	(½)	10,000	5/12 x £24,000	(½)
			6,000	Period ended 31.10.20	(½)
	Less: overlap		(4,000)	1.12.18 to 5.4.19	(½)
			£12,000		

   Maximum 4 marks

3. As Reece is a self employed taxpayer, he must keep records for at least five years and ten months after the end of the tax year to which they relate. (½) (ie five years after the 31 January following the end of the tax year).

   Reece should therefore have retained all records needed for his returns from 2015/16 (to be kept until 31 January 2022). (½) This will be records for the year ended 31 December 2015 onwards. (½) He is therefore missing records for the tax returns 2015/16 to 2017/18 (ie to the year ended 31 December 2017).(½)

   A penalty may be charged for failure to retain proper records. (½)The maximum penalty is £3,000 (½) for each failure to maintain records sufficient to support entries in the return. Therefore Reece may be charged up to £9000 (£3,000 x 3) for failure to retain records. (½)

   Maximum 3 marks

4. Relief is given for qualifying payments made post cessation by deducting them in arriving at the net income for the tax year in which the expense is actually incurred. **(½)**

In order to be an allowable post-cessation expense, it must be one that would have been deductible in calculating the trading profits, **(½)** and it must be within 7 years of the cessation of the trade**. (½)**

The debt collection expenses are a qualifying payment. **(½)**

The legal fees to defend a claim for faulty workmanship are a qualifying payment. **(½)**

The private insurance premium is not a qualifying payment. **(½)**

The maximum amount of these reliefs which can be deducted each year is restricted to £50,000 or 25% of Gorka's total adjusted income if greater. **(½)**

The unrelieved post cessation expenses can be treated as a capital loss and set against chargeable gains in the tax year of payment. **(½)**

Relief needs to be claimed within one year of 31 Jan following the end of the tax year for which deduction is to be made. **(½)**

Maximum 3 marks

5. Anja Ltd should have notified chargeability to Corporation Tax by 30th April 2021. (½)

Anja Ltd has deliberately failed to notify chargeability to Corporation Tax. (½) It does not appear to be concealed. (½) Therefore the maximum penalty would be 70% of potential lost revenue. (½) This would be £9,800. (½)

The penalty may be reduced in the event of unprompted or prompted disclosure. (½) The percentages reduce to 20% for unprompted or 35% for prompted disclosure. (½)

The penalty for failure to notify chargeability will not be charged if there is reasonable excuse (½) however having insufficient funds is not considered a reasonable excuse. (½)

Maximum 4 marks

6. Axuml Ltd

	Year ended 30 June 2018	2019	2020
	£	£	£
Trade profits	2,000	2,900	1,000
Non-trading profit	3,100		2,400
Non-trading deficit carry back	(3,100)		
Non-trading deficit in year		(2,900)	
Chargeable gain	2,500		2.600
Non-trading deficit carried forward			(6,000)
Chargeable	4,500	0	0

Set -off :	£	
30 June 2018	3,100	Carried back (½) restricted to non-trading profit only (1)
30 June 2019	2,900	Set off against income of current year(½)
30 June 2020	6,000	Set off against income(½) and gains (½)of later year(½)
Unrelieved non-trading deficit	3,000	(½) carry forward
	15,000	

Maximum 4 marks

7. Delimp Ltd

	Year ended 31 May 2019	4 months ended 30 September 2019	Year ended 30 September 2020
	£	£	£
Trade profits (loss)	11,000	3,000	
Chargeable gain	-	1,000	5,000
UK property business income	7,000	2,500	8,000
Current year loss set against other income			(13,000)
Loss carried back to previous 12 months	(12,000)	(6,500)	

Set -off :	£	
30 September 2020	13,000	Current year (½) chargeable gain and UK property (½)
30 September 2019	6,500	Carry back to previous 12 months (4 month period) (½) all income and gains (½)
31 May 2019	12,000	Restricted to 8 months(½) proportion of all income and gains (½)
Carried forward	4,500	(½)
	36,000	

Donations to charity unrelieved (½) for 4 m/e 30 September 2019 and y/e 30 September 2020.

Maximum 4 marks

8. Fyshwin Ltd – capital loss

	£	£	
Chattel – deemed proceeds		6,000	(½)
Less: Cost	8,000		
Cost of sale	600	(8,600)	(½)
		(2,600)	(½)
Gain February 2020		16,500	
Loss		(2,600)	(½)
		13,900	(½)
Corporation tax @ 19%		2,641	(½)
Proceeds (£34,500 + £4,000)		38,500	(½)
Net proceeds available for reinvestment		35,859	(½)

Maximum 4 marks

9. Invoice 1

This is not a valid VAT invoice so the input VAT will not be recoverable. (½)

The invoice does not contain an invoice number. (½)

There is no VAT registration number on the invoice. (½)

The rate of VAT is not shown on the invoice. (½)

Invoice 2

This is a retailer's invoice for less than £250 and contains the required information. (½)

It is a valid VAT invoice so the input VAT will be recoverable. (½)

Maximum 3 marks

10.

		£	
Materials	£350 (½) x 20%(½)	70	
Fuel	£600 (½) x 1/6 (½)	100	
Other goods	£1,000 (½) x 90% = 900 (½)		
	900 x 20% (½)	180	
		350	(½)

Maximum 4 marks

11. Permanent differences arise where certain items of income and/or expenditure are included in the accounts **(½)** but are not in the tax computation as either the income is not taxable or the expenditure is not an allowable deduction. **(½)**

For example, business entertaining is included as a business expense but is not allowable as a deduction in the tax computation. (½)

Timing differences arise where certain types of income and expenditure are recognised in different periods when comparing the accounts with the tax computations. (½)

For example, when an asset is purchased, a proportion of that cost is written off in the accounts as depreciation but a different proportion is written off in the tax computation as capital allowances. (½) Over the life time of the asset the same amount will be charged in the accounts and the tax computation but in any particular accounting period the two amounts will differ. (½)

Maximum 3 marks

12.

Email

To: manager

From: ATT candidate

DATE

Mrs Pooch (format 1)

She has asked a question about her 'hobby'. It seems she has been grooming dogs for payment and from the information she gave it seems she may be turning over around £28,000 per year. (£35 x40 x20) (1) This sounds like rather more than a hobby.

I looked at the badges of trade and have the following comments:

Various of the badges of trade are irrelevant because this is a service being provided rather than goods. (1/2)

Profit seeking motive (1/2)

While this may not have been the case at the start, by advertising and buying better equipment, it sounds like there is a motive to make profit. (1/2)

Existence of sales organisation (1/2)

She has advertised both on social media and in a local paper so this points towards trading. (1/2)

Frequency of transactions (1/2)

Mrs Pooch is grooming around 20 dogs a week, so again this points towards trading. (1/2)

[marks will be awarded for other relevant points]

Administration points

This may well have started as a hobby but we need to determine when trade actually started. It would be useful to obtain from her a note of when she began advertising, for example. (1/2) She should have registered for tax and National Insurance when she commenced trading. For both income tax and NIC purposes she should have registered by 5 October following the end of the tax year in which she began trading. (1) She could be charged a penalty for failure to notify, but as she would be making an unprompted disclosure (1/2), the penalty would be a maximum of 30% (1/2) of the potential lost revenue (1/2).

Max (8)

Accounting and expenses

Given that her turnover is relatively modest, it may make sense to use cash accounting (1/2) as this would simplify her record keeping. She would be able to deduct the full cost of her clippers as an expense. (1/2)

As far as her travelling costs are concerned, it would be easier for her to use flat rate costs (1/2), with 45p per mile on the first 10,000 business miles and 25p per mile thereafter. (1/2) In addition Mrs Pooch may be able to get a flat rate allowance to cover the costs of using her own home for the business (1/2). Of course, she says she has few expenses and it may make sense to use the trading allowance rather than claim her other expenses. (1/2) Max (2)

National Insurance

As a self-employed person Mrs Pooch will pay both Class 2 and Class 4 NIC, depending on her profits as follows:

- the rate of Class 2 NIC is £3.05 per week, (1/2) and
- Class 4 is calculated on the trading profit figure for the tax year at 9% between the lower profits limit and her trading income or £50,000 (whichever is lower), and 2% on trading profits above £50,000 (1/2)

Class 2 NIC is due by 31 January following the end of the tax year. (1/2) Class 4 NIC is generally due in two instalments (31 January during the tax year and 31 July following the end of the tax year) with any balance due by 31 January following the end of the tax year. (1)

Mrs Pooch will also pay Class 1 NIC on her salary and that will be deducted by her employer each pay day under PAYE. (1/2)

There is an annual maximum amount payable for NIC but it seems unlikely she will approach that level of earnings. (1/2) Max (3)

Ethical considerations

We have already filed Mrs Pooch's tax return for the year to 5 April 2021. If it turns out that trading income should have been included, then that form is incorrect. (1/2) The same may be true for previous periods as we are not sure when trading commenced. (1/2)

We need to establish the facts as soon as possible and ask Mrs Pooch's permission to disclose this income to HMRC. (1/2) We owe her a duty of confidentiality (1/2). We should check the engagement letter to see if this includes permission to disclose to HMRC (1/2). If not, we should write to her to urge her to disclose. (1/2) If she refuses, then we need to cease to act (1/2). We would need to advise HMRC that we are ceasing to act (1/2) and consider whether we need to make a report to our Money Laundering Officer. (1/2)

Max (3)

[marks will be awarded for other relevant points]

If you need any further information, let me know.

Kind regards

ATT candidate. Total (16)

13.

1)

Capital allowances for AP ended 30 June 2020

	FYA £	AIA £	General Pool £	Special rate Pool £	Allowances claimed £	
b/f			25,000	6,000		
Additions:						
New plant		50,000				(1/2)
Preparing floor		12,000				(1/2)
Disposal:						
Plant			(5,000)			(1/2)
Air conditioning system		250,000				
AIA		(312,000)			312,000	(1)
Low emission car	25,000					(1/2)
FYA 100%	(25,000)		0		25,000	(1/2)
			20,000			
WDA						
18%			(3,600)		3,600	(1/2)
6%				(360)	360	(1/2)
WDV c/f			£16,400	£5,640		
Total allowances claimed					£340,960	

Capital allowances for period to 31 October 2020

	General Pool £	AIA £	Special rate Pool £	Allowances claimed £	
b/f	16,400		5,640		
Addition:					
New cold water supply		15,000			(1/2)
AIA		(15,000)		15,000	(1/2)
WDA 18% x 4/12	984			984	(1/2)
WDA 6% x 4/12			113	113	(1/2)
WDV c/f	£15,416		£5,527		
Total allowances claimed				£16,097	

Adjustment of profits

	£	£		
Profit per draft accounts		390,000		
Add back:				
Depreciation	50,000			(1/2)
Repainting	-		True repair	(1/2)
Preparing factory floor	12,000		Eligible for capital allowances	(1/2)
Creating new paved area	7,500		Capital expenditure; no SBA as work started before 29 October 2018	(1/2) (1/2)
New double glazing	-		Treated as repair	(1/2)
Extending cold water system	15,000		Eligible for capital allowances	(1/2)
Overdraft interest	-		Trading loan relationship	(1/2)
Interest paid to director	6,000		Non-trading loan relationship	(1/2)
		90,500		
		480,500		
Less: profit on sale		(5,000)		(1/2)
Trading profits before capital allowances		475,500		

Corporation tax computation

	Year to 30 June 2020	Period to 31 October 2020	Total	
	£	£	£	
Trading profits before capital allowances	356,625	118,875	475,500	(1/2)
Less: capital allowances	(340,960)	(16,097)		(1/2)
Trading profits	15,665	102,778		
Less: non-trading loan relationship	(4,500)	(1,500)		(1)
Total Taxable Profits	11,165	101,278		
Corporation tax at 19%	2,121	19,243		(1/2)
				(14)

2)

The tax for the year to 30 June 2020 was due by 1 April 2021. (1/2)

The tax for the period to 31 October 2020 is due by 1 August 2021. (1/2) (1)

3)

Note on company's Articles.

These govern the running of the company, (1/2) including such matters as:

- How and when shares may be issued; (1/2)
- The rights of shareholders; (1/2)
- The declaration and payment of dividends; (1/2)
- The conduct of meetings; (1/2) and

- The role and powers of directors. (1/2)

They can only be changed at a meeting of the shareholders. (1/2). A notice period of 14 days is required for the meeting to vote on a change to the company's Articles of Association (1/2).

The Articles may then be changed by special resolution (1/2) Such a resolution requires 75% of the votes cast to be in favour for a change to occur. (1/2) – each shareholder normally has one vote for each share held. (1/2)

Max (5)

Total (20)

14.

1) Sale by company

		£	£	
Sales proceeds			320,000	(1/2)
Less: legal fees			(15,000)	(1/2)
Net sales proceeds			305,000	
Cost		180,000		(1/2)
Legal costs at purchase		12,500		(1/2)
Extension		40,000		(1/2)
Architect's fees		12,000		(1/2)
Total costs			(244,500)	
Unindexed gain			60,500	
Indexation allowance on original cost	(278.1 – 250.0) x 192,500 / 250.0 [0.112 x 192,500]		(21,560)	(1) Factors of indexation (1) correct cost
Gain			£38,940	

Net sales proceeds in December 2020 are £305,000. It is preferable to use rollover relief rather than holdover relief (1/2). [if not stated explicitly, mark will be awarded if calculation demonstrates the point]

Gain to be rolled over into each asset may be calculated as:

	New property £	**New fixed plant £**	**Total £**	
Proceeds reinvested	250,000	190,000	440,000	
Gain allocated	(38,940)	0	(38,940)	(1)
Base cost for future disposal	211,060	190,000	401,060	(1)

(7)

2)

Re capital gains tax reliefs that may be available to Mr Bench:

- For the investment into his friend's company he could use EIS deferral relief by subscribing (1/2) in cash (1/2) for qualifying EIS shares (1/2) within one year before (1/2) and three years after the disposal that gave rise to the gain. (1/2) To fully defer the gain he must subscribe for shares at least equal to the amount of the gain, not the whole sales proceeds. (1/2) The EIS company must be carrying on a qualifying trade (1/2) and the funds must be used for a qualifying business activity. (1/2)
- He could subscribe for qualifying SEIS shares in his niece's company by subscribing in cash for shares up to a value of £100,000. (1/2) Half the amount subscribed is available to exempt any gain (1/2) but he can only claim SEIS reinvestment relief in the tax year in which income tax relief is claimed. (1/2)

[marks will be awarded for other relevant points]

Max (5)

Total (12)

15.

1)

Allocate profits/losses

30 June 2017

Each partner had profits of £120,000. (1/2)

30 June 2018

Each partner had profits of £100,000. (1/2)

30 June 2019

Alf (£)	Bob (£)	Dan (£)	Total (£)	
15,000	15,000	20,000	50,000	(1)
30,000	30,000	30,000	90,000	(1/2)
45,000	45,000	50,000	140,000	

30 June 2020

Alf (£)	Bob (£)	Dan (£)	Total (£)	
15,000	15,000	20,000	50,000	
(150,000)	(150,000)	(150,000)	(450,000)	(1)
(135,000)	(135,000)	(130,000)	(400,000)	

Total terminal loss available:

	£	
Loss per final accounts	130,000	
Overlap profits brought forward	35,000	(1)
Total loss	165,000	

Dan's trade ceased in 2020/21 and the terminal loss is carried back to the three earlier tax years, latest year first. (1/2)

Loss relief is allocated:

Tax year	Original result £	Loss used £	Taxable profit £	
2020/21	-	-	-	(1/2)
2019/20	50,000	50,000	-	(1/2)
2018/19	100,000	100,000	-	(1/2)
2017/18	120,000	15,000	105,000	(1/2)

(7)

2)

Bob has various options for using his loss relief.

Against net income
He can claim the loss against other income of the same tax year (1/2) or the previous tax year. (1/2) He can claim the loss against the net income of both of those tax years (1/2) and can choose which of these two tax years uses the loss first. (1/2) This sideways loss relief is restricted to the greater (1/2) of £50,000 or 25% of his adjusted total income. (1/2)

Against gains
He can extend the loss relief against capital gains for either or both of those tax years, but only after it has been used against net income in the relevant year. (1/2) The claim is 'all or nothing' and cannot be restricted to preserve personal allowances. (1/2)

Carry forward
If he makes no other claim, it is automatically carried forward (1/2) against future profits of the same trade. (1/2)

(5)

Total (12)