The Chartered Tax Adviser Examination

May 2010

Taxation of Owner-Managed Businesses

Advisory Paper

Suggested Answers without marks

Question 1

Part 1

Further to the recent meeting with Albert and Brian the various tax issues and tax implications that need to be considered before proceeding with the proposed transactions and the various alternative options can be detailed as follows:

(i) **Potential sale of shares in subsidiary companies**

The structure of the group would appear to be that of a dormant holding company owning the entire issued share capital of its three trading subsidiaries. The first option that can be considered therefore is a disposal of the shares in the subsidiary companies, George Brothers (NE) Ltd ("NE") and George Brothers (NW) Ltd ("NW") by George Brothers (Holdings) Ltd ("Holdings").

A disposal of shares by Holdings would result in a chargeable gain arising equal to the sale proceeds less the original cost of the share capital in each company. However, it would appear that this gain may be exempt under the substantial shareholding provisions, contained at s.192A TCGA 1992 and Schedule 7AC thereto. The exemption applies if a gain accrues to a company, the investing company, on a disposal of shares in another company, the investee company and:

- The investing company held a substantial shareholding (a 10% or greater test) in the investee company throughout any continuous period of twelve months beginning not more than two years prior to the disposal
- The investing company is the member of a trading group throughout the period beginning with the twelve month period and ending with the time of disposal and it must be a trading group after the time of the disposal
- The investee company similarly satisfies these conditions as regards trading status
- A trading group is defined as a group of companies whose activities taken together do not to any substantial extent include any non-trading activities
- The exemption is automatic and does not require the making of any claim.

It would appear from the details given that these conditions will be satisfied and that any chargeable gain arising on the disposal of shares will be exempt.

(ii) **Potential sale of trades/assets by individual companies**

Each company would be liable to corporation tax on the disposal of any chargeable assets, goodwill and properties in particular, subject to any possible exemptions/claims. There are minor differences between each of the two companies.

(a) **NW**

The disposal of the property will give rise to a chargeable gain/loss based on the difference between original cost of £200,000 plus indexation and consideration allocated to the property. It is possible however that roll-over relief, see below, may be available on a subsequent property acquisition by SW.

The original goodwill acquisition was prior to 1 April 2002, when the intangibles regime was introduced, and its disposal will give rise to a chargeable gain. As at 31 December 2009 it would have been amortised over nine years at 10% per annum and therefore will have a £10,000 book cost. However, its base cost for tax purposes will remain £100,000 original cost as the amortisation in previous years would have been added back for tax purposes. A disposal therefore will give rise to a chargeable gain/loss based on the difference between original cost plus indexation and consideration allocated to goodwill.

It is not possible to claim roll over relief on a subsequent acquisition of a tangible asset. However, reinvestment under the intangibles regime is available to reinvest the excess of proceeds over cost into the acquisition of new intangibles.

(b) NE

The tax position as regards a disposal of the property will be exactly the same as for NW.

However, the position as regards the goodwill will be different. As the goodwill was acquired after 1 April 2002 from an unconnected person it would fall to be treated under the intangibles regime.

The amortisation over the periods since acquisition would have been allowable as a deduction against trading profits. As at 31 December 2009 therefore the tax base cost after amortisation will be £90,000 after seven years of 10% amortisation. If the goodwill is sold for an amount in excess of this the gain would be taxable as trading income. Similarly any loss would be treated as an allowable trading loss.

It is possible however to defer the tax on any profit by reinvesting in newly acquired intangibles. The amount available for relief is the amount by which the lesser of the proceeds on realising the old asset and the cost of new assets acquired exceeds the cost of the new asset. The relief is given by reducing both the proceeds on realisation and the cost of the assets acquired.

(iii) Purchase of shares in new companies/ purchase of businesses and assets

There would be no immediate relief for investment in shares in new companies as no form of roll over relief exists for re-investment in share capital. However, where a controlling interest is acquired in a company holding intangible assets it is treated as acquiring the intangible assets indirectly. The amount of the expenditure so allocated is the lower of the tax written down value of the intangible asset and the consideration paid for acquiring the shares.

Any acquisition of goodwill will fall to be treated under the intangibles regime provided it is not acquired from any related parties in relation to a pre 1/4/02 business. As a result amortisation would be a tax deductible expense against trading income. In addition the gains potentially arising on the capital disposals discussed above could be re-invested as noted above.

In addition roll over relief would be available on the purchase of new properties deferring the gains on the properties discussed above. To the extent that the proceeds on the sale of premises are reinvested into new premises the gain can be rolled over against the later acquisition. To the extent that proceeds are not reinvested the gain remains chargeable. In addition the reinvestment can be made in any group company provided that the disposing company was a member of the group at the time of disposal and the acquiring company is a member of the group at the time of acquisition.

Part 2

Where the accounting carrying value of an intangible fixed asset is increased on a revaluation, a credit is brought into account for tax purposes of the lesser of:

- The increase in value for tax purposes; and
- The net aggregate amount of relevant tax debits previously brought into account. [s.723 CTA 2009]

The increase in value for tax purposes is:

I x [WDV/AV]

Where:

I	= the amount of increase in accounting value
WDV	= the written down value immediately before the revaluation
AV	= the accounting value immediately before the revaluation

Alternatively if there is a change of accounting policy in preparing a company's accounts from one period of account to the next and if there is a difference between the closing value in the earlier period and the opening value in the later period, a corresponding debit or credit is to be brought into account. This is restricted to:

Accounting difference x [tax written down value/accounting value]

Whilst the goodwill of SW was acquired from connected persons it still falls to be treated under the intangibles regime as the business itself had commenced after 1/4/02.

Question 2

The following describes the rules on the disclosure of tax avoidance schemes as they may apply to Tulip Ltd, We have been told that Tulip Ltd has been approached by a firm of tax advisers based in Jersey which is offering a scheme which may reduce the corporation tax charge for Tulip Ltd.

The main legislation relating to the disclosure of tax avoidance schemes is contained in FA 2004 (ss.306 to 319). The legislation came into effect on 1 August 2004 and originally applied only to schemes connected with employment or involving financial products. Since then the provisions have been extended by s.108 FA 2007 and s.116 and Sch. 38 FA 2008 to cover the whole of income tax, capital gains tax and corporation tax as well as national insurance contributions.

The legislation imposes obligations on promoters of certain tax avoidance schemes to disclose such schemes to HM Revenue and Customs (HMRC).

The arrangements which require disclosure are known as “notifiable arrangements” and are arrangements which:

- Fall within any description prescribed by Treasury regulations;
- Enable, or might be expected to enable, any person to obtain an advantage in relation to any tax that is so prescribed in relation to arrangements of that description;
- Are such that the main benefit, or one of the main benefits, that might be expected to arise from the arrangements is the obtaining of that advantage; and
- Bear one or more hallmarks.

The hallmarks are as follows:

1. Confidentiality in cases involving a promoter
2. Confidentiality in cases not involving a promoter
3. Premium fee
4. Off market terms
5. Standardised tax products
6. Loss schemes
7. Leasing arrangements

The term “advantage” in relation to a tax means

(a) relief or increased relief from, or repayment or increased repayment of that tax, or, the avoidance or reduction of a charge to that tax or an assessment to that tax, or the avoidance of a possible assessment to that tax;

(b) deferral of any payment of tax or the advancement of any repayment of tax; or

(c) avoidance of any obligation to deduct or account for any tax.

A promoter is a person if in the course of ‘relevant business’ (that is, any trade, profession or business which involved the provision to other persons of taxation services) he is responsible for the design, organisation or management of the proposed arrangements, or the marketing or promotion of schemes designed by someone else.

It would appear that the firm of tax advisers based in Jersey which is offering a scheme will be classified as a promoter under the legislation. However, as it is based in Jersey it is a non-UK promoter.

Usually, the scheme promoter must make the disclosure within five business days after it makes the proposal available for implementation by any person. However, in this case, where the promoter is a non-UK promoter, it will be the responsibility of Tulip Ltd to provide HMRC with the specified information relating to the scheme arrangements within five business days after entering the transaction. This obligation is discharged if the promoter makes disclosure of the scheme arrangements in question.

Disclosure can be made online via HMRC’s website or by post using specific forms depending on the type of scheme to be disclosed. Certain basic information must be given, for example the name and address of the promoter, and a summary of the scheme, in sufficient detail for HMRC to understand how a tax advantage arises.

HMRC registers all disclosed schemes and gives each one a reference number. The promoter must provide to its clients this number together with information specified in regulations. A company which is party to notifiable arrangements giving rise to a corporation tax or capital gains tax advantage must quote the reference number in its company tax return for the accounting period in which the company is notified of the number (or, if earlier, the accounting period in which the tax advantage is expected to arise) or, on or after 1 November 2008, on a specified disclosure form (Form AAG4).

HMRC has powers to enquire into reasons why a promoter may have failed to disclose a scheme, enforce disclosure where appropriate and require further information when disclosure is thought to be incomplete.

There are penalties for failing to disclose a notifiable scheme. A person who fails to comply shall be liable to a penalty not exceeding £5,000, and if the failure continues to a further penalty not exceeding £600 for each day on which the failure continues after the day on which the first penalty was imposed

There are also penalties for failing to notify HMRC of the allocated reference number, while not a criminal offence, renders the offender liable to a financial penalty. The penalty is £100 for the first such failure, £500 for the second failure within the previous 36 months, and £1,000 for the third and subsequent failures within the previous 36 months.

Question 3

Part 1

(1) A limited liability partnership is taxed like any other partnership. The rules relating to training of a proprietor are different to the rules relating to the training of an employee.

The expenses of a training course for the proprietor of a business are normally allowed as a trade deduction under general principles only where the training is undertaken for the purposes of the trade and relate to the updating of existing expertise rather than the acquisition of new skills. The Masters Degree that Carl is taking is not in the area of law that he is currently working in. He is learning new skills in order to set up a new department within the firm. This means that it is unlikely that the firm will obtain an income tax deduction for the costs incurred of £3,000.

This is because s. 33 ITTOIA 2005 states that no deduction is allowed for items of a capital nature. The cost of the degree course is of a capital nature because it is bringing into existence an intangible asset (new skills, knowledge and expertise) that will be of enduring benefit to the business. In addition, Carl will obtain a new qualification at the end of the course.

This follows the judgment given by Viscount Cave LC in British Insulated and Helsby Cables Ltd v Atherton [1926] *10 TC 155* to illustrate the character of capital expenditure where he said that where expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, it should be treated as properly attributable not to revenue but to capital.

(2) (a) The new lighting system in the reception area will qualify for capital allowances as an integral feature, so it will be eligible for a 10% writing down allowance and pooled into a special rate pool. However, taxpayers are entitled to choose what items of plant and machinery qualify for the annual investment allowance (AIA) of £50,000, so it would be sensible to allocate the AIA to the lighting system first as it would otherwise only qualify for the 10% allowance.

(b) The filing cabinets will qualify for capital allowances as plant and machinery, as will the cost of reinforcing the floor as it is part of the installation of the filing cabinets under s. 25 CAA 2001. The AIA provides 100% relief for the first £50,000 of qualifying expenditure which has not already been utilised, eg against the lighting system. Any remaining expenditure is eligible for a first year allowance at 40% as it is main pool expenditure incurred in 2009/10. The balance of the expenditure will go into the main pool, where it will attract writing down allowances in future years at the rate of 20% per annum.

(c) The offices will not qualify for capital allowances as plant and machinery as they will be treated as part of the building, see s.21 CAA 2001. If the dividing walls are moveable and are intended to be moved during the course of the trade then they may qualify as plant and machinery in accordance with the decision in the case of Jarrold v John Good & Sons Ltd 40 TC 681.

(d) Replacement of the broken kitchen units will be treated as a repair and be deductible as a trading expense if this was a like for like replacement which restored the units to their original condition. If however the replacements involved an element of improvement then this would be treated as a capital addition qualifying for capital allowances.

(e) Repairing the air conditioning system may qualify as revenue expenditure. However, not all repairs to an integral feature are necessarily classified as revenue expenditure. Where:

- repair expenditure incurred within 12 months of initial expenditure on an integral feature
- which together with the initial expenditure totals more than 50% of how much it would cost to replace that feature,
- the repair expenditure will only qualify for the 10% writing down allowance rather than a full revenue deduction in the period.

Further information is required to assess whether this expenditure qualifies as a repair.

In addition, it may be appropriate to consider the case of Odeon Associated Theatres Ltd v Jones 48 TC 257, where it was held that expenditure on repairing a number of dilapidated cinemas over a period of time was revenue expenditure because the cinemas remained usable over that time. By contrast the case of Law Shipping v CIR 12 TC 621 in which the cost of repairs to ships attributable to their use before acquisition, was held capital

(f) The cost of demolishing the old garage will not qualify for capital allowances as it is not being replaced and in any case it is unlikely to have qualified as plant and machinery when first constructed. It is capital expenditure so will not be deductible against trading profits in accordance with s. 96 ITTOIA 2005.

(3) It may be possible to describe the expenditure as advertising, but this does not in itself distinguish between payments of a capital nature and payments of a revenue nature.

In order therefore to decide if the expenditure of £1,500 incurred in updating the website is allowable, it will be necessary to consider if the costs are revenue or capital costs. As mentioned in 1) above, the costs of bringing into existence an asset or advantage of enduring benefit to the trade are capital.

Following the case of Anglo-Persian Oil v Dale [1931] 16 TC 253 a lump sum payment will be a revenue item, and (if paid wholly and exclusively for the purposes of the trade) deductible in computing the profit of the accounting period in which it is paid, if it relates to the trading arrangements of the business or does not relate to or enhance the value of, or create, a capital asset.

The question to ask is whether the website has the lifetime normally expected of a capital asset**.** The regular update costs of the site are likely to be revenue expenses and the original cost of creation, capital.

As the website is being updated as a result of the relocation, it will be necessary to look at how fundamental the update is and whether it is more than merely updating the original site, and is instead bringing into existence a new website.

If the expenditure is deemed to be capital in nature, then it should be possible to claim capital allowances, either through the annual investment allowance or writing down allowances as appropriate.

(4) Income tax is charged on the profits of a trade, profession or vocation under s.5 ITTOIA 2005. Section 96 ITTOIA 2005 states that items of a capital nature must not be brought into account as receipts in calculating the profits of a trade. There is no further explanation in the legislation regarding what is considered to be a capital receipt and what is considered to be a revenue receipt.

Therefore the same principles should be applied to determine whether a receipt is capital as are applied to determine whether an expense is capital.

The fact that the receipt of £10,000 compensation is a lump sum does not necessarily mean that it is capital in nature. But the fact that it is a lump sum, with little or no possibility of it recurring, points to its being a capital item, though this test is not of itself conclusive. A persuasive test is whether the lump sum was received in consideration of the recipient's surrendering an asset which was wholly or mainly the foundation of his source of income. If the cancellation, variation or breach of a trading agreement either destroys or materially affects the recipient's profit-making structure and character, compensation or damages may be capital in nature.

An important case is Van den Berghs Ltd v Clark 19 TC 390 in which a receipt on the termination of a profit-sharing arrangement was held to be capital because the arrangement related to the whole structure of the recipient's trade, forming the "fixed framework within which its circulating capital operated."

In Barr, Crombie & Co Ltd v IRC 1945 SC 271, a receipt was held to be capital where it related to compensation for the loss of an agency by a ship-managing company, which derived almost all of its receipts from the agency. However, in contrast, in the case of Kelsall Parsons & Co v IRC [1938] SC 238 compensation received on the termination of an agency agreement by a company having a number of such agreements was held to be income.

It could be argued that the receipt is to compensate Smith and Carter LLP for the loss of income which would have been derived from their retention of those clients, and so the compensation is taxable as income. The compensation has been awarded to Smith and Carter LLP as a result of its former employee taking three clients' business away from it. This principle has been applied in cases involving compensation on the cancellation of contracts receipts from which, if completed, would have been trading receipts.

Martin Jones has poached three clients. It is likely that this is not a significant number out of the total number of clients that the firm has, so it would be difficult to argue that the loss of those clients destroyed or materially affected the firm's profit making structure. It is therefore likely that the receipt of £10,000 will be taxable as income in the hands of Smith and Carter LLP.

Part 2

It does not necessarily follow that the tax treatment of a payment will mirror the tax treatment of the receipt in the recipient's hands.

For it to be trading expenditure, it must have been incurred wholly and exclusively for the purposes of the trade under s.34 ITTOIA 2005.

The costs of civil damages arising as a result of normal trading operations are generally allowable.

In this case, Martin Jones has been found to be in breach of his contract of employment with Smith and Carter LLP, and the damages have been awarded as a result. It could therefore be argued that the defence of the action relates to his previous employment and not to his current trading activity, so that the damages are not deductible under s. 34.

Question 4

Part 1

East Devonish Couriers Ltd

Note **Capital Allowances Computation**

1. **Year ended 30 November 2009**

Note		Main Pool	Integral Features	Exp Car	Special Rate Pool	Allowances
		£	£	£	£	£
	Plant and Equipment	10,000				
	Fixtures and fittings	5,000				
	Integral features		20,000			
2.	Professional Costs Pro-rata		1,000			
3.	New Van	9,000				
4.	Used Van	4,000				
5.	Motor Cycle	6,000				
6.	Car acquired 1/1/09			13,500		
7.	Car acquired 1/5/09				20,000	
8.	Car acquired 1/8/09	19,000				
		53,000	21,000	13,500	20,000	
	Sale Proceeds	(6,000)	0	0	0	
9.	AIA	(24,000)	(21,000)		0	45,000
		23,000		13,500	20,000	
10.	WDA @ 20%	(4,600)		(2,700)	0	7,300
	WDA @ 10%	0	0	0	(2,000)	2,000
						£54,300
	Pool c/fwd	£18,400	£0	£10,800	£18,000	

5 month period to 30 April 2010

Note		Main Pool	Integral Features	Exp Car	Special Rate Pool	Allowances
11.	New Car	14,000				
12.	New Motor Cycle	4,000				
	Plant and Equipment	15,000				
		51,400	0	10,800	18,000	
13.	Sale Proceeds	0	0	0	(12,000)	
14.	AIA	(19,000)	0	0	0	19,000
		32,400	0	10,800	6,000	
15.	WDA @ 20%*5/12	(2,700)		(900)		3,600
	WDA @ 10%*5/12				(250)	250
						£22,850
		£29,700	£0	£9,900	£5,750	

Notes to the computations:

1. The capital allowances computations will be split into two periods, the twelve months from commencement of the trade (not from incorporation) and the remaining five month period.
2. In addition to the integral features the professional fees should be allocated pro-rata between the qualifying (10%) and non-qualifying element (90%).
3. Where a qualifying asset is acquired prior to the commencement of the trade the expenditure is deemed to be acquired on the first day of trading. As a van it is allocated to the main pool.
4. As the van had previously been used by a connected party for another purpose it is still allocated to the main pool but the Annual Investment Allowance (AIA) see below is not available against the cost. [s.217 CAA 2001]
5. For acquisitions prior to 1 April 2009 a motor cycle is classed as a car for capital allowance purposes and as a result an AIA cannot be claimed against the cost although as cost is less than £12,000 it is allocated to the main pool.
6. As the car was acquired prior to 1 April 2009 it falls to be treated under the old rules even though the emissions are not greater than 160g/km and as a result it is put into its own separate expensive car pool for tax purposes.
7. As the car was acquired on or after 1 April 2009 it falls under the new regime and as emissions are greater than 160g/km is put into the new special rate pool. AIA cannot be allocated.
8. This car has emissions not exceeding 160g/km and is therefore allocated to main pool although AIA not available against cost.
9. The AIA is first allocated against integral fixtures as otherwise they would only qualify for 10% WDA. The only other assets qualifying for AIA are plant and machinery (£10,000), fixtures (£5,000) and the new van (£9,000) not the used van, motor cycle or car.
10. WDA is 20% for main pool balance and lower of £3,000 or 20% of cost for the car.
11. Car allocated to main pool but no AIA see below
12. Under new regime a motor cycle is not classified as a car and AIA is available
13. Even though the car is sold in the period there is no balancing allowance as the 10% pool continues.
14. The only assets qualifying for AIA are motor cycle and plant which is less the £50,000 pro rata limit of £20,833
15. WDA restricted to 20% or 10% * 5/12 as appropriate

(marks are also available for presentation etc and summary calculations of allowances and accuracy of calculations)

Part 2

Capital expenditure is generally treated as incurred for capital allowance purposes as soon as there is an unconditional obligation to pay it, even if all or part of it is not required to be paid for until some later date.

However, expenditure is treated as incurred on a later date if:

- Any part of the expenditure is not required to be paid until a later date more than four months after the date as above – it is then treated as incurred when it is required to be paid.

  or

- The obligation to pay becomes unconditional earlier than in accordance with normal commercial usage with the sole or main benefit likely to be bringing forward the chargeable period in which the expenditure would otherwise be treated as being incurred – it is then treated as incurred on the due date of payment.

Where the asset becomes the purchaser's property during a chargeable period, but the obligation to pay becomes unconditional within one month after the end of the chargeable period, the expenditure is treated as incurred immediately before the end of the chargeable period.

Where an asset is acquired under a hire-purchase contract, the person incurring the expenditure under the contract is treated for capital allowance purposes to be the owner. As soon as the asset is brought into use for the purposes of the qualifying expenditure the full outstanding cost attracts capital allowances immediately.

Under an operating lease the allowances generally rest with the lessor and the lessee can claim relief for the hire payments as and when they fall due. Under the new regime for cars these hire payments are allowable in full provided the car has emissions of 160g/km or less. If they are more than this only 85% of the lease costs are allowable expenses for corporation tax purposes.

Each of the arrangements/agreement the company has made will need to be reviewed taking into account these rules.

Question 5

MEMORANDUM

TO: Tax Partner

CLIENT: Alan Jackson

SUBJECT: Utilisation of losses arising in the year ended 5 April 2010

The loss arising in the year ended 5 April 2010 can be utilised in a variety of ways all of which will have different consequences both in terms of the timing of relief and also the amount of such relief. These alternatives can be summarised as follows:

Carry forward trade loss relief (s.83 ITA 2007)

The simplest method of relieving the loss will be to carry it forward under the provisions of s.83 ITA 2007. The losses will then carry forward against the first available profits from the same trade. It would appear however from the notes of the meeting that further losses are expected in the current year to 5 April 2011 and as a result relief would not be obtained until at the earliest the year to 5 April 2012. On the basis however that substantial profits are expected the relief could be at the highest possible tax rate. As an alternative to waiting for the relief, consideration should be given to offsetting the losses sooner by using the other forms of relief available.

Trading loss relief against general income and gains (ss.64 & 71 ITA 2007)

The first alternative would be to obtain relief for the loss under the provisions of s.64(2) ITA 2007. Under these provisions relief for the loss can be claimed:

- Under s. 64(2)(a) against other income of the tax year of the loss, i.e. 2009/10; or
- Under s. 64(2)(b) against other income of the previous tax year, i.e.2008/09; or
- Under s. 64(2)(c) against other income of both tax years, i.e.2008/09 and 2009/10.

In this way tax refunds can be generated now rather than waiting for later relief. A claim for relief in respect of a 2009/10 loss must be made on or before 31 January 2012, being the first anniversary of 31 January following the year in which the loss was incurred.

However, this would mean that the personal allowance was not used as this claim is against total income before the personal allowance. In addition this could result in the loss being relieved at the basic rate rather than the higher rate.

I also note that Alan made a capital gain in 2009/10 on the disposal of his shareholding in Bella Communications Ltd. Where a claim has been made under s.64(2) ITA 2007 it is then possible to extend the relief to offset any remaining losses against capital gains in the year under s.261B TCGA 1992.

I have attached a computation of the gain arising and a capital gains tax liability is unlikely to arise in any event on the basis that entrepreneurs' relief is available, the annual capital gains tax exemption is unused and the availability of capital losses brought forward. In fact losses of £3,100 will still remain to carry forward. If a claim under s.261B were made this would merely increase the capital losses remaining to carry forward.

Losses in the early years of trade (s.72 ITA 2007)

As Alan only commenced to trade on 6 April 2006 a further relief is available under the provisions of s.72 ITA 2007. Where an individual sustains a loss in any of the first four years of assessment he may claim relief against other income of the three years preceding the year of the loss on a FIFO basis i.e. relief is given against the earlier years first.

As 2009/10 is the fourth year of assessment, this relief is available. If claimed, the losses would be offset against total income arising in 2006/07 followed by 2007/08 and then finally 2008/09. This raises the same issue as for relief under s.64 discussed above, with loss of personal allowances and also relief at basic rather than higher rates. In fact the position could be that losses could effectively be offset against non-taxable dividend income. The time limit for any claim is the same as for s.64(2) ITA 2007.

Extended losses carry back (s.23 FA 2009)

The final available relief is under the provisions of Sch 6 paras 1 and 2 Finance Act 2009. Under these provisions a trade loss incurred in 2008/09 or 2009/10 can be carried back for three years against trading income**.**

The amount that can be carried back for more than one year is limited to £50,000 and a claim is only possible when a claim under s.64 ITA 2007 as detailed above has already been made.

It is important to note however that there is no requirement to have set the losses against general income for both possible years under s.64. It is sufficient only that a claim against one year or the other has been made. Relief for the losses carried back under Sch 6 is given against later profits first (i.e. a LIFO basis).

If therefore a claim is made to offset the loss against other income of 2009/10 then the extended carry back claim could be made against profits of 2008/09 and the two years prior to that. This claim may help to protect the personal allowance for such earlier years. The time limit for claims under these provisions is the same as for s.64 ITA 2007. In this case as the loss arises in 2009/10, the deadline is 31 January 2012.

Conclusion

Any combination of the above reliefs can be made and in this regard the attached calculations show the total income before relief for losses or personal allowances as a base to compare the alternatives. The subsequent calculations then examine the most likely methods of claim.

(i) Relief for losses under s.72 in totality (losses in the early years of trade)

(ii) Relief under s.64(2)(c) and then s.72 with remainder (CY and PY and then relief for losses in the early years of trade)

(iii) Relief under s.64(2)(a) and then Sch 6 Finance Act 2009 (CY and then extended carry back)

There are of course various other scenarios.

When comparing these particular three scenarios, they all reduce total income by £80,000 from £187,000 to £107,000 however there are differences in terms of the spread of income and wasted personal allowances. In addition, to the extent that dividends fall in the basic rate band the use of losses generates no savings. Option (ii) in particular will result in two wasted allowances for 2009/10 and 2008/09 whilst the other two do not. Detailed calculations would be required for (i) and (ii) to calculate the highest levels of refund arising.

It is also important to note that the rules for losses for National Insurance purposes are different than for Income Tax. In particular where losses have been offset against other income they are not deemed to have been utilised for NIC purposes and are therefore available to carry forward. The losses for NIC purposes are as noted.

<u>Total income before personal allowance or relief for losses</u>

	TOTAL	**2009/10**	**2008/09**	**2007/08**	**2006/07**
Trading income	90,000	-	20,000	40,000	30,000
less: loss relief	-	-	-	-	-
dividends	40,000	5,000	5,000	20,000	10,000
salary	57,000	5,000	22,000	20,000	10,000
	187,000	10,000	47,000	80,000	50,000
less: loss relief	-	-	-	-	-
	187,000	10,000	47,000	80,000	50,000

(i) Total income before personal allowances if relief
for loss claimed under s.72 ITA 2007 - early years trading

	TOTAL	2009/10	2008/09	2007/08	2006/07
Trading income	90,000	-	20,000	40,000	30,000
less: loss relief	-	-	-	-	-
dividends	40,000	5,000	5,000	20,000	10,000
salary	57,000	5,000	22,000	20,000	10,000
	187,000	10,000	47,000	80,000	50,000
less: loss relief	(80,000)	-	-	(30,000)	(50,000)
	107,000	10,000	47,000	50,000	-

Unused losses to carry forward for NIC purposes = £20,000 as £20,000 of loss relief in 2006/07 was set against dividends and salary (i.e. non-trading income).

(ii) Total income before personal allowances if relief
for loss claimed under s.64(2)(c)ITA 2007 and then s.72 ITA 2007

	TOTAL	2009/10	2008/09	2007/08	2006/07
Trading income	90,000	-	20,000	40,000	30,000
less: loss relief	-	-	-	-	-
dividends	40,000	5,000	5,000	20,000	10,000
salary	57,000	5,000	22,000	20,000	10,000
	187,000	10,000	47,000	80,000	50,000
less: loss relief	(80,000)	(10,000)	(47,000)	-	(23,000)
	107,000	-	-	80,000	27,000

Unused losses to carry forward for NIC purposes = £37,000 as £10,000 of loss in 2009/10 and £27,000 of loss in 2008/09 set against dividends and salary (i.e. non-trade income).

(iii) Total income before personal allowances relief
for loss claimed under s.64(2)(a) ITA 2007 and then s.23 FA 2009

	TOTAL	2009/10	2008/09	2007/08	2006/07
Trading income	90,000	-	20,000	40,000	30,000
less: loss relief	(70,000)	-	(20,000)	(40,000)	(10,000)
dividends	40,000	5,000	5,000	20,000	10,000
salary	57,000	5,000	22,000	20,000	10,000
	117,000	10,000	27,000	40,000	40,000
less: loss relief	(10,000)	(10,000)	-	-	-
	107,000	-	27,000	40,000	40,000

Unused losses to carry forward for NIC purposes = £10,000 as £10,000 of loss relief in 2009/10 was set against dividends and salary (i.e. non-trading income).

Capital Gains Tax Computation

		£
Share of proceeds - £2.5m * 5%		125,000
Less: Cost		(80,000)
		45,000
Less: Entrepreneurs' relief		(20,000)
		25,000
Less losses b/fwd	18,000	
Restrict to preserve AEA	(3,100)	
		(14,900)
		10,100
Less AEA		(10,100)
Taxable gain		nil

Question 6

Part 1

Mrs Gwen Mayflower

Director, so annual earnings period

Class 1 (primary) contributions payable by Gwen

Class 1 (secondary) contributions payable by Mayflower Ltd

Annual salary £4,000 x 12 = £48,000

Plus personal bill £500 paid October 2009 (settlement of pecuniary liability)

Total income = £48,500

No National Insurance on dividends

Although the write off of the loan account is treated as a distribution for income tax purposes, it is likely that HMRC will wish to argue that it is subject to Class 1 National Insurance Contributions. This is certainly their published view. The following computation has been computed on that basis.

Class 1				Primary		Secondary
		£		£		£
To LEL		4,940				
To ET		775				
To UAP		34,325	9.4%	3,227	11.4%	3,913
To UEL		3,835	11%	422	12.8%	491
Above UEL		6,625	1%	66	12.8%	848
		50,500		3,715		5,252
Employee's rebate						
LEL to ET	£775 x 1.6%			(12)		
Employer's rebate						
LEL to ET	£775 x 1.4%					(11)
				3,683		4,985

Mr Jim Jones

Normal monthly earnings period

Class 1 (primary) contributions payable by Jim

Class 1 (secondary) contributions payable by Mayflower Ltd

Monthly salary = £26,400 /12 = £2,200

Class 1			Primary		Secondary
	£		£		£
To LEL	412				
To ET	64				
Balance	1,724	9.4%	162	11.4%	197
	2,200		162		197
Annual total					
(£162/£197 x 12)			1,944		2,364
On bonus of £1,500 (March 2010)					
To UAP	1,137	9.4%	107	11.4%	130
(£3,337 - £2,200)					
Balance	363	11.0%	40	12.8%	46
	1,500		147		176
On mobile phone bill (less business calls) £57 (March 2010)					
Balance (UAP)	57	11%	6	12.8%	7
Employee's rebate					
LEL to ET	£64 x 1.6% x 12		(12)		
Employer's rebate					
LEL to ET	£64 x 1.4% x 12				(11)
Annual total			2,085		2,536

Miss Eve Long

Normal monthly earnings period

Class 1 (primary) contributions payable by Eve

Class 1 (secondary) contributions payable by Mayflower Ltd

On annual salary of £17,400 between 1 August 2009 and 31 October 2009

£17,400 /12 = £1,450

Class 1			Primary		Secondary
	£		£		£
To LEL	412				
To ET	64				
Balance	974	11%	107	12.8%	125
	1,450		107		125
Three month total					
(£107/£125 x 3)			321		375

On annual salary of £18,000 between 1 November 2009 and 5 April 2010

£18,000 /12 = £1,500

Class 1			Primary		Secondary
	£		£		£
To LEL	412				
To ET	64				
Balance	1,024	11%	113	12.8%	131
	1,500		113		131
Five month total (£113/£131 x 5)			565		655
Annual total			886		1,030

No rebate is available for Mayflower. Instead the rebate is paid directly to Eve's personal pension scheme provider.

ALTERNATIVE ANSWER LAYOUT FOR EVE

Normal monthly earnings period

Class 1 (primary) contributions payable by Eve

Annual total

On annual salary of £17,400 between 1 August 2009 and 31 October 2009

£17,400 /12 = £1,450

On annual salary of £18,000 between 1 November 2009 and 5 April 2010

£18,000 /12 = £1,500

Class 1				Primary		Secondary
		£		£		£
To LEL		412				
To ET		64				
Balance	1.8.09 - 31.10.09	974	11%	107	12.8%	125
	1.11.09 - 5.4.10	1,024	11%	113	12.8%	131
		2,474				
Three month total (£107/£125 x 3)				321		375
Five month total (£113/£131 x 5)				565		655
Annual total				886		1,030

No rebate is available for Mayflower. Instead the rebate is paid directly to Eve's personal pension scheme provider.

Part 2

The current arrangement means that the company is settling a pecuniary liability on behalf of its employee, Jim. In other words, it is settling the employee’s personal debt. The mobile telephone contract is between Jim and the telephone provider, and the company is not party to the contract. This gives rise to both a primary and secondary liability to Class 1 NI contributions (see above). If the company provides Jim with a mobile telephone (but without the transfer of property) directly then the company is contracting with the mobile telephone provider. This means that the provision of the mobile telephone is exempt from NIC under the provisions of s.319 ITEPA 2003.

Part 3

There is an exemption from Income Tax and NIC of up to £55 per week in respect of childcare provided by means of vouchers. This covers children for whom the employee has parental responsibility and covers only childcare which is properly registered or approved under the relevant legislation. A person is regarded as a child up to 1 September following their 15th birthday.

The company could provide childcare vouchers to Eve by way of a salary sacrifice scheme. This would be attractive to Gwen as she has said that she would be interested in providing vouchers provided it was at no additional cost to the company. The salary sacrifice arrangement would mean that Eve would give up an equivalent amount of salary in return for childcare vouchers.

Structured in the right way, this will save the company secondary Class 1 NIC and will also save Eve primary Class 1 NIC. It is important to note however that the scheme must be open to all employees not only Eve.

If the company provides Eve with vouchers worth £55 per week this could save the company secondary Class 1 NIC contributions of approximately £366 a year based on current rates.