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# Answers

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Section C

Marks

1 Paul

Business run as a limited company

- (1) Palu Ltd's corporation tax liability for the year ended 5 April 2021 will be:

|                                  | £              |   |
|----------------------------------|----------------|---|
| Trading profit                   | 175,000        | ½ |
| Director's remuneration          | (8,000)        | ½ |
| Taxable total profits            | <u>167,000</u> |   |
| Corporation tax (167,000 at 19%) | <u>31,730</u>  | ½ |

**Tutorial note:** Equivalent marks will be awarded if the corporation tax liability is alternatively calculated as  $175,000 - 8,000 - 135,270 = £31,730$ .

- (2) Paul's income tax liability for 2020–21 will be:

|                         | £              |   |
|-------------------------|----------------|---|
| Director's remuneration | 8,000          | ½ |
| Dividend income         | <u>135,270</u> | ½ |
|                         | 143,270        |   |
| Personal allowance      | <u>0</u>       | ½ |
| Taxable income          | <u>143,270</u> |   |

Income tax

|                                             | £              |   |
|---------------------------------------------|----------------|---|
| 8,000 at 20%                                | 1,600          | ½ |
| 2,000 at 0%                                 | 0              | ½ |
| 27,500 (37,500 – 8,000 – 2,000) at 7·5%     | 2,063          | ½ |
| 105,770 (135,270 – 2,000 – 27,500) at 32·5% | <u>34,375</u>  | ½ |
|                                             | <u>143,270</u> |   |
| Income tax liability                        | <u>38,038</u>  |   |

- (3) There will be no class 1 NICs because the earnings of £8,000 are below the NIC lower threshold. ½

Business run as a sole trader

- (1) Paul's income tax liability for 2020–21 will be:

|                    | £              |   |
|--------------------|----------------|---|
| Trading profit     | 175,000        |   |
| Personal allowance | <u>0</u>       |   |
| Taxable income     | <u>175,000</u> | ½ |

Income tax

|                      | £              |   |
|----------------------|----------------|---|
| 37,500 at 20%        | 7,500          | ½ |
| 112,500 at 40%       | 45,000         | ½ |
| 25,000 at 45%        | <u>11,250</u>  | ½ |
|                      | <u>175,000</u> |   |
| Income tax liability | <u>63,750</u>  |   |

- (2) Class 2 national insurance contributions (NICs) for 2020–21 will be £159 (52 x 3·05). ½

- (3) Class 4 NICs for 2020–21 will be:

|                                  | £            |   |
|----------------------------------|--------------|---|
| 40,500 (50,000 – 9,500) at 9%    | 3,645        |   |
| 125,000 (175,000 – 50,000) at 2% | <u>2,500</u> |   |
| Class 4 NICs                     | <u>6,145</u> | 1 |

**Conclusion**

If Paul runs his business as a sole trader, then overall tax and NIC will be £286 more compared to running the business as a limited company:

|                                    |            |                  |
|------------------------------------|------------|------------------|
|                                    | £          |                  |
| Limited company (31,730 + 38,038)  | 69,768     |                  |
| Sole trader (63,750 + 159 + 6,145) | (70,054)   |                  |
| Tax increase                       | <u>286</u> | <u>1</u>         |
|                                    |            | <b><u>10</u></b> |

**2 Alfred and Amaia****(a) Alfred – Tax adjusted trading loss for the seven month period ended 31 March 2021**

|                                         |                 |   |
|-----------------------------------------|-----------------|---|
|                                         | £               |   |
| Trading profit                          | 63,000          |   |
| Pre-trading expenditure                 | (5,000)         | ½ |
| Deduction for lease premium (working 1) | (1,435)         |   |
| Client entertaining                     | 0               | ½ |
| Capital allowances (working 2)          | (118,520)       |   |
| Trading loss                            | <u>(61,955)</u> |   |

**Working 1 – Deduction for lease premium**

|                              |                |    |
|------------------------------|----------------|----|
|                              | £              |    |
| Premium paid                 | 30,000         | ½  |
| Less: 30,000 x 2% x (10 – 1) | <u>(5,400)</u> | ½  |
|                              | <u>24,600</u>  |    |
| Deduction 24,600/10 x 7/12   | <u>1,435</u>   | 1½ |

**Working 2 – Capital allowances**

|                                                               | £                | Main pool<br>£ | Allowances<br>£ |          |
|---------------------------------------------------------------|------------------|----------------|-----------------|----------|
| Addition qualifying for the annual investment allowance (AIA) |                  |                |                 |          |
| Plant and machinery                                           | 116,000          |                |                 | ½        |
| AIA – 100%                                                    | <u>(116,000)</u> |                | 116,000         | ½        |
| Motor car                                                     |                  | 24,000         |                 | ½        |
| WDA – 18% x 7/12                                              |                  | <u>(2,520)</u> | 2,520           | 1        |
| WDV carried forward                                           |                  | <u>21,480</u>  |                 |          |
| Total allowances                                              |                  |                | <u>118,520</u>  | <u>6</u> |

**Tutorial notes:**

- (1) The cost of the marketing campaign is deductible because it was incurred in the seven years prior to the commencement of Alfred's trade and it would be deductible under general principles.
- (2) The motor car has CO<sub>2</sub> emissions between 51 and 110 grams per kilometre, and therefore qualifies for writing down allowances at the rate of 18%.

**Marks****(b) Amaia – Income tax payable for the tax year 2020–21**

|                                 | £             |    |
|---------------------------------|---------------|----|
| Employment income               |               |    |
| Salary                          | 80,000        | ½  |
| Motor car (25,000 x 13% x 3/12) | 813           | 1½ |
| Job-related accommodation       | 0             | 1  |
| Property income (working)       | 14,350        |    |
|                                 | <u>95,163</u> |    |
| Personal allowance              | (12,500)      | ½  |
| Taxable income                  | <u>82,663</u> |    |
| 37,500 at 20%                   | 7,500         | ½  |
| 45,163 (82,663 – 37,500) at 40% | 18,065        | ½  |
|                                 | <u>25,565</u> |    |
| Interest relief (2,600 at 20%)  | (520)         | 1  |
| Income tax liability            | <u>25,045</u> |    |
| PAYE                            | (19,240)      | ½  |
| Income tax payable              | <u>5,805</u>  |    |

**Working – Property income**

|                            | £             |           |
|----------------------------|---------------|-----------|
| Rent received (1,200 x 13) | 15,600        | 1         |
| Insurance                  | (1,250)       | 1         |
| Mortgage interest          | 0             | 1         |
| Property income            | <u>14,350</u> | 9         |
|                            |               | <u>15</u> |

**3 Mooncake Ltd**

- (a) (1) The timing and cash flow in relation to the relief obtained, with an earlier claim generally being preferable. 1
- (2) The extent to which relief for qualifying charitable donations will be lost. 1
- 2

**(b) Mooncake Ltd – Trading loss for the year ended 31 March 2021**

|                                  | £               |   |
|----------------------------------|-----------------|---|
| Operating loss                   | (93,820)        |   |
| Depreciation                     | 7,230           | ½ |
| Lease of office equipment        | 0               | ½ |
| Lease of motor car (3,400 x 15%) | 510             | 1 |
| Entertaining staff               | 0               | ½ |
| Entertaining overseas customers  | 8,720           | ½ |
| Qualifying charitable donations  | 1,600           | ½ |
| Capital allowances (working)     | (3,240)         | W |
| Trading loss                     | <u>(79,000)</u> |   |

**Marks**

**Working – Capital allowances**

|                         | <b>Main pool<br/>£</b> | <b>Allowances<br/>£</b> |          |
|-------------------------|------------------------|-------------------------|----------|
| WDV brought forward     | 43,200                 |                         | ½        |
| Proceeds – Delivery van | (11,800)               |                         | ½        |
| – Motor car [1]         | (8,100)                |                         | 1        |
| – Motor car [2]         | (5,300)                |                         | 1        |
|                         | <u>18,000</u>          |                         |          |
| WDA – 18%               | (3,240)                | 3,240                   | ½        |
| WDV carried forward     | <u>14,760</u>          |                         |          |
| Total allowances        |                        | <u>3,240</u>            | <u>7</u> |

**(c) (i) Corporation tax liabilities for the years ended 31 March 2020 and 2021**

|                                 | <b>Year ended<br/>31 March 2020<br/>£</b> | <b>Year ended<br/>31 March 2021<br/>£</b> |          |
|---------------------------------|-------------------------------------------|-------------------------------------------|----------|
| Trading profit                  | 138,200                                   | 0                                         | ½        |
| Property business income        | 23,700                                    | 0                                         | ½        |
| Chargeable gain                 | <u>0</u>                                  | <u>0</u>                                  | 1        |
|                                 | 161,900                                   | 0                                         |          |
| Trading loss                    | (79,000)                                  | 0                                         | 1        |
| Qualifying charitable donations | <u>(1,400)</u>                            | <u>0</u>                                  | ½        |
| Taxable total profits           | <u>81,500</u>                             | <u>0</u>                                  |          |
| Corporation tax at 19%          | <u>15,485</u>                             | <u>0</u>                                  | ½        |
|                                 |                                           |                                           | <u>4</u> |

**Tutorial note:** There is no chargeable gain for the year ended 31 March 2021 because the indexation allowance of £6,700 exceeds the gain of £3,700.

**(ii) Carry forward to the year ending 31 March 2022**

|                                 | <b>£</b> |                  |
|---------------------------------|----------|------------------|
| Trading loss                    | 0        | ½                |
| Property business loss          | 4,400    | ½                |
| Capital loss                    | 4,900    | ½                |
| Qualifying charitable donations | <u>0</u> | ½                |
|                                 |          | <u>2</u>         |
|                                 |          | <b><u>15</u></b> |

**Tutorial note:** Indexation allowance cannot be used to create a capital loss.