



THE LAW SOCIETY OF SCOTLAND EXAMINATIONS

TAXATION

Thursday 9 SEPTEMBER 2004

**0900 – 1200
(Three Hours)**

**Candidates should attempt THREE questions in
each of Sections A and B**

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All questions are of equal value

SECTION A

1. Adam is the owner of a factory which makes industrial components. He operates as a sole trader. **EXPLAIN** the tax consequences for Adam of the following, mentioning alternatives where appropriate:-
 - (a) Adam pays wages to four employees. The payments are almost all for work done in the factory, but in one month Adam gets one of the employees to spend about two weeks completely refurbishing a car belonging to Adam's wife (the car is not used in the business).
 - (b) In order to carry out this work, Adam allows the employee to use a number of components taken from stock. The components are normally sold as retail supplies, with Adam's business making a profit on their sale. Adam makes no payment for the components he takes.
 - (c) Adam builds an extension on the factory. This is to be used as a showroom. As well as considerable costs of building this showroom, Adam spends a great deal on fitting it out, with special lighting systems and wall decorations being particularly expensive.
 - (d) To open the new showroom, Adam hosts a party for a number of customers and his staff. He entertains lavishly, with free food and drink all night. He holds a raffle, in which the star prize is a £5,000 holiday, which is won by one of his staff.

2. Bernice is a successful saleswoman employed by a large company. The work that she does involves incurring considerable expenses. **DISCUSS** whether she will obtain any tax deductions for such expenses and any alternatives which might be available:-
 - (a) Bernice does a great deal of paperwork at home. She does this in a bedroom which is fitted out with a desk and computer (both of which she bought herself). In doing this work, she obviously incurs normal household expenses such as heat and light. In addition, she has computer connection charges. She uses her normal household telephone line for the connection. This telephone is used for business and personal calls.

- (b) Bernice uses her own car (she recently bought a new one) for her work; and this is taken into account in the a round sum paid to her by her employers. The car is used for travelling to Bernice's office in her employer's premises; for travelling from there to clients' premises; and on occasions for travelling direct from home to clients' premises.
- (c) Bernice believes in being smartly turned out and has a regular weekly hairdressing appointment, as well as more occasional manicures and pedicures.

3. EXPLAIN the tax rules affecting and the tax advantages available to an individual in making investments in:-

- (a) an Individual Savings account; and
- (b) an Enterprise Investment Scheme company.

4. EXPLAIN, with examples, how the legislature and the courts have developed their treatment of schemes with no purpose other than tax avoidance.

END OF SECTION A

SECTION B

1. Charles is a farmer, who has been forced in recent years to diversify his activities. These now include a golf course (run as a business); and the letting of a large number of surplus houses on the farms which he owns, both for holiday lets and on a long-term basis.

Charles has a large number of stock exchange investments; and a reasonable amount in cash and other assets. The value of his farming interests is over £500,000; the golf course is worth £300,000; the letting properties are worth £400,000; his stock exchange investments are worth £350,000 and his cash and other assets some £250,000.

Charles is contemplating giving his farm and the letting businesses to his son; and (probably only on his death) the remainder of his assets to his daughter.

EXPLAIN the inheritance tax consequences which would arise if he made these gifts to his son and his daughter, dealing particularly with the availability of agricultural property relief and business property relief; what would happen if the son sold the farms between receiving them and his father's death; and the importance of Charles's survival for particular periods of time after making the lifetime gifts.

2. A limited company commercial developer has acquired a large area of land. It did not pay VAT on the purchase. It is contemplating building either a block of residential apartments, to be sold to individual owners; or an office block, to be sold to a single investor after letting the offices. It hopes to make a considerable profit on the development.

- (a) EXPLAIN briefly how that profit will be taxed in the company and what happens when amounts are paid out as dividends to individual investors in the company; AND
- (b) Outline the VAT consequences of the transactions undertaken and contemplated by the company.

3. A married couple bought a large house, with the intention of using it as their main residence. However, things do not turn out as planned and they have to let the house out for a number of years while they live elsewhere. When eventually they do move back in, they build a new garage. Even when they are living in the house, they have to rent out a number of rooms within the house for some years and the new garage is included in the parts let out. They move out again to a smaller flat; and two years after doing so eventually sell the large house.

They make a considerable gain on the sale of the house, compared to what they originally paid for it. EXPLAIN to them the basis on which they

will or may be charged to capital gains tax, taking account of all of the above facts and any reliefs and exemptions available to them.

4. EXPLAIN the meaning and significance in tax terms of the following expressions:-

- (a) market value for inheritance tax and capital gains tax;
- (b) settlement for income tax;
- (c) interest in possession for inheritance tax; and
- (d) disposal for capital gains tax.

END OF SECTION B AND OF PAPER