

Your manager has had a meeting with Snowdon, a potential new client. Extracts from the memorandum prepared by your manager following the meeting, an inheritance tax computation prepared by Snowdon, and an email from your manager detailing the work you are required to do are set out below.

Extracts from the memorandum prepared by your manager — dated 6 June 2018

Snowdon is resident and domiciled in the UK. He requires advice in respect of a cottage he purchased from his sister, Coleen, and his unincorporated business, 'Siabod', which he started on 1 July 2009.

Purchase of the cottage from Coleen

Snowdon's sister, Coleen, died on 1 June 2018.

Coleen had sold a holiday cottage to Snowdon on 1 May 2014 for £225,000. At that time, the cottage was worth £260,000. Coleen had purchased the cottage for £165,000. The cottage qualified for capital gains tax gift relief and Snowdon and Coleen submitted a valid joint claim.

Coleen made a gift to a trust on 1 March 2010. This resulted in a gross chargeable transfer after all exemptions of £318,000.

Snowdon provided me with a computation he had prepared of the inheritance tax due as a result of Coleen's death in respect of the cottage. Snowdon is aware that he is not an expert when it comes to inheritance tax, such that this computation is unlikely to be totally accurate.

Siabod business

Budgeted figures relating to the unexpanded Siabod business for the year ending 30 June 2019 are:

	£
Turnover	255,000
Tax adjusted trading profit	85,000
Income tax on £85,000 using current rates	22,700
Class 4 national insurance contributions on £85,000 using current rates	4,115

The Siabod business is partially exempt for the purposes of value added tax (VAT). Snowdon's budgeted input tax for the unexpanded business for the year ending 30 June 2019 was £18,000. He would have been able to recover the whole of this amount because the business would have been below the de m/n/mis limits.

Since the above figures were prepared, Snowdon has decided to expand the Siabod business and increase its budgeted turnover for the year ending 30 June 2019 from £255,000 to £435,000. In order to carry out this expansion, Snowdon will adopt either strategy A or strategy B. Whichever strategy is adopted, the partial exemption percentage of the business will continue to be 76% (recoverable).

Strategy A

Under this strategy Snowdon will recruit an additional employee with an annual salary of £48,000.

Strategy B

Under this strategy Snowdon will appoint a sub-contractor, Tor Ltd, which will carry out the work required for the expansion. Tor Ltd will charge fees of £90,000 plus VAT each year.

Budgeted costs of expanding the business

	Strategy A £	Strategy B £
Salary of additional employee	48,000	N/A
Other expenditure relating to the expansion, net of VAT at 20%:		
Overheads	38,000	N/A
Advertising	2,000	2,000
Fees payable to Tor Ltd, net of VAT at 20%	N/A	90,000

Extracts from the memorandum prepared by your manager — dated 6 June 2018 (continued)

Additional information

- Prior to the expansion of the Siabod business, Snowdon's liability to employer's class 1 national insurance contributions for the year exceeded £3,000.
- Apart from the profits of the Siabod business, Snowdon's only income is £740 of bank interest each year.

Inheritance tax computation prepared by Snowdon — dated 6 June 2018

Inheritance tax due in respect of the cottage

	£
Value of the cottage as at 1 May 2014 (no annual exemption on death)	260,000
Less: taper relief (£260,000 x 40%) (between four and five years)	<u>(104,000)</u>
	156,000
Nil rate band	325,000
Less: gifts in the seven years prior to death	<u>nil</u>
Available nil rate band	<u>325,000</u>
Inheritance tax (the gift is fully covered by the available nil rate band)	<u>nil</u>

Email from your manager — dated 7 June 2018

Please prepare a memorandum for Snowdon's client file covering the following:

(i) Purchase of the cottage from Coleen

- Identification and explanation of the errors in the inheritance tax (IHT) computation prepared by Snowdon, and a calculation of the correct amount of IHT due.
I have already established that the cottage did not qualify for business property relief.
- The capital gains tax gift relief claimed by Coleen in respect of the cottage and Snowdon's base cost for the purposes of a future disposal by him.

(ii) Expansion of the Siabod business

- Calculations to show which of the two strategies is the most financially advantageous, i.e. the one which is expected to generate the most additional tax adjusted trading profit for the year ending 30 June 2019.
- A calculation of the additional budgeted post-tax income for the tax year 2019/20 which is expected to be generated by the most financially advantageous strategy.

(iii) Procedures we should follow before we agree to become Snowdon's tax advisers

A summary of the procedures we should follow before we agree to become Snowdon's tax advisers.

Tax manager

Required:

Prepare the memorandum as requested in the email from your manager. The following marks are available:

(i) Purchase of the cottage from Coleen. (9 marks)

Professional marks will be awarded for the approach taken to problem solving, the clarity of the explanations and calculations, the effectiveness with which the information is communicated, and the overall presentation and style of the memorandum. (4 marks)