Question 4

Using your recent work experience, describe two situations where you have used your technical knowledge and/or practical experience to develop advice.

EXAMPLE ANSWER

ADVISING ON SEIS CLAIM TAX EFFICIENCY, BASED ON PREVIOUS KNOWLEDGE

During January 2020, I was asked to complete Mr B's 2018/19 personal tax return. Mr B mentioned that he had made several investments under the Seed Enterprise Investment Scheme (SEIS) and required further tax advice in relation to these investments to ensure appropriate reliefs were claimed.

Throughout 2018-2019 I had the opportunity to work alongside C Ltd, a software development company, who were in the process of developing a new cutting-edge compliance software product. The project required substantial funding to complete the development and bring the product to market. To encourage investment, it was proposed that investors would receive shares which qualify under the SEIS. To ensure the investments would qualify under the scheme, I was responsible for submitting the Advanced Assurance Application to HMRC.

C Ltd went on to obtain funding from several investors. Each time that shares were issued I had the task to draw up the necessary paperwork and make the appropriate filings with Companies House. To ensure that the investors could obtain the relevant tax relief, I had to submit SEIS1 Compliance Statement to HMRC to confirm that the company had met the conditions for the shares to qualify under SEIS. Once approved by HMRC, I then issued the SEIS3 certificates to C Ltd to forward onto investors for them to claim the tax relief on their investments made in C Ltd.

Throughout the whole process, I carried out research by reading HMRC guidance and attending CPD events so that I could provide appropriate advice to C Ltd. Consequently, as a result of my involvement with C Ltd, I have a sound understanding of the tax relief available to investors. This knowledge enabled me to be in a good position to provide advice to Mr B on how best to utilise the tax relief on his investments.

After ascertaining that Mr B had made qualifying investments over the last eighteen months, I advised that he could claim tax relief on shares issued in either tax year 2018/19 or 2019/20. This is because of the 'carry back' rule. This rule allows that shares acquired in one tax year can be carried back to the previous tax year. I explained that income tax relief would be 50% of the investment value on investments up to £100K. As Mr B had made a number of investments, it was important that his personal tax liability was assessed so that SEIS reliefs could be aligned accordingly and mitigate the risk of any reliefs being wasted. I advised that priority should be given to older investments first as the new investments could be claimed on the subsequent year's tax return. At the same time I was able to provide an outline of the tax reliefs available on the subsequent disposal of the shares.

Mr B understood the advice I was able to give him and provided a list of all investments made to be included on his tax return. I reviewed the list whilst preparing his tax return to ensure that claims were made in the most tax efficient order.

EXAMPLE ANSWER

TAX PLANNING: ADVISING A FARMING BUSINESS ON DIVERSIFICATION AND THE IHT IMPLICATIONS

Mr Lang, another TCA member, recently inherited a family farm and wanted to diversify. He had little interest in farming. His plan was to reduce the agricultural activities by letting some of his land on a farm business tenancy (FBT) and to diversify into the hospitality industry. He suggested operating as a wedding venue with cottages let to wedding guests. The concept was to allow the guests to bring in their own caterers, entertainment etc and Mr Lang merely supplies the venue. He was concerned about inheritance tax (IHT) implications. In 2017, I was responsible in giving him tax advice on his proposal on diversification.

The starting point was that the properties would no longer qualify for agricultural property relief (APR) once assets were taken away from agricultural use. Therefore, APR could be limited to the land retained for the FBT, and the site used for the wedding business would lose APR. The challenge of securing business property relief (BPR) for the wedding business was that Mr Lang would need to ensure there would be sufficient trading activities to meet the relevant qualifying conditions under section 105 of the inheritance Tax Act (IHTA) 1984.

Having gained a detailed understanding of Mr Lang's proposal and read his business plan, I was of the option that he could claim BPR under Inland Revenue Commissioners v George (2003) All ER (D) 102. A claim for BPR was upheld in that case as the owners devoted significant time to the 'management activities' (i.e. day to day maintenance of the exterior and the common areas, and 'policing' the common areas to ensure that tenants complied with the terms of their leases). The situation was not dissimilar to Mr Lang's proposal. Once his business was in full operation, he would be spending a lot of time in practice conducting the same management activities as in George.

However, in my advice I highlighted the risk of him adopting a phased-in-strategy. Before the wedding business could take off, I noted that I thought he may be using the cottages as furnished holiday lets (FHLs), and that from a BPR perspective, this could fall on the wrong side of the equation. Mr Lang commented that I was very astute to pick up this point even though he had not written it down in his business plan. We concluded that given his age, this was not necessarily a serious problem for the time being, but he should keep this under regular review. I also advised him that an alternative strategy was to consider running a shared farming or contract farming arrangement, instead of granting a FBT, so as to secure the BPR for the farmland. Depending on the turnover from the contract farming, he may also benefit from the Balfour principle by arguing that he runs a farming business predominantly, thereby securing BPR on all his properties.

EXAMPLE ANSWER

DEVELOPING CLIENT ADVICE ON IMPROVING THEIR CURRENT COST ACCOUNTING SYSTEM

My firm (Sands) was approached by AAA Engineering & Steel Mills Ltd, a single member company (or SMC), to study their cost accounting system and suggest improvements to the same. AAA Engineering was losing sales and market share due to more competitively priced products. Consequently, they decided to seek professional advice from my firm.

From the study of AAA Engineering's cost accounting system I found that the company had a process costing system in place that used the average costing method to account for finished and work-in-process inventories. Factory costs were analysed by cost elements (direct materials, direct labour and overheads) and departments (coke ovens, blast furnacing, sintering, pelletising, oxygen furnacing, vacuum degassing, alloy injecting, continuous casting, and rolling mills). A review of their factory overhead control account and its subsidiary ledgers revealed to me that a blanket predetermined factory overhead rate was used based on machine hours.

The study revealed to me that AAA Engineering's cost accounting system had some fundamental flaws. Further analysis of the system clearly indicated that an improved costing system was needed that could address all of the aforementioned shortcomings present in the system. To address these flaws I decided to prepare a report for the management on the findings gleaned from the study of their costing system with advice on how to design and implement an improved costing system.

In reporting on the current costing system I observed that the costing system was not linked to the product, customer and service rationalisation steps taken by the management to control costs. Secondly, it was not linked to managements' strategy initiatives making it ineffective to support their future decision-making (e.g. new product offerings, change in market dynamics, change in production method etc). Both of these flaws existed due to the usage of a classic or traditional costing system. Thirdly, it focussed on the sub-division of cost elements rather than trace costs to the cost drivers influencing them. Fourthly, it was limited to allocating only the total manufacturing costs as opposed to other costs that are involved in the entire value chain (consisting of activities in different departments) like quality costs, R&D costs, distribution costs and customer service costs.

I emphasised to management that in order for AAA Engineering to achieve its critical success factors, it needed to better understand the entire value chain that consisted of various cross functional activities that drove costs (or cost drivers) needed to provide the goods and services to the ultimate customer. The current costing system did not link these activities and their costs to the final product resulting in incorrect costing and pricing of final products. I therefore, advised management to implement an ABC (Activity-based costing) costing system in order to address the problem of costing its products competitively. I explained how to identify activities, cost drivers, create cost pools, relate activities to cost pools using cost drivers and allocate costs to products depending on the amount of activities they consumed. I explained the practical usage of ABC by constructing different matrices namely the Resource Identification Matrix, Activities Identification Matrix, Resource-Activity Matrix, Product-Activity Matrix and the Resource-Product Matrix that would be used for cost allocation to products.

Using a real-world example (from a previous assignment that I had done for another client) I contrasted the product costs resulting from the use of process costing with that of ABC costing method, proving that the current system was inadequate at capturing and reflecting the costs consumed by the products. I further proved through this example that ABC costing would result in a truer picture of product costs and relate them to the entire chain of activities that were involved in providing the end product to the consumer.

Through this advice (provided in the form of a report) AAA Engineering & Steel Mills were able to not only correctly cost their products and bring product-costing in line with their strategy but also price the product competitively.