Tolley® Exam Training

CTA ADVANCED TECHNICAL PAPER

TAXATION OF MAJOR CORPORATES

PRE REVISION QUESTION BANK

FA 2020

May and November 2021 Sittings

PQ923

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INTRODUCTION

This Pre Revision Question Bank for the Advanced Technical TOMC paper contains 15 exam standard questions (all with answers updated to Finance Act 2020).

Using this question bank

All the CTA exams, with the exception of the Awareness paper, are **3.5 hours** in length.

We recommend you **allocate 1.9 minutes per mark** which allows for 10 minutes initial reading time and a further 10 mins in total for final reviews (best done as you finish each question).

10 mark question = 19 minutes
15 mark question = 28.5 minutes
20 mark question = 38 minutes

You should attempt each question as if you were in the real exam. Try to **avoid just reading the answers** to **questions** – it is all too easy to nod as you read our answer saying "yes I know that point, yes I understand that advice given" – the test is would you have actually put those points in your answer? You won't find this out unless you **type up the answers** yourself.

Doing "proper" answers also gives you a good idea of how long an exam standard answer will take you to type.

Reviewing your answers

It is essential to read through your answer when you have finished typing it. We thought it might be useful at this stage to pass on some tips about how to review your answers effectively – **before** you look at our model answer.

Remember the first thing the marker will do is read your answer through as a whole – what overall impression are you giving of your ability? Have you put the marker in a good mood as soon as they see your script or are they going to be dreading marking what you have handed in?

Key **presentation considerations** include spacing your answer out, cross referencing your workings and using subheadings and short paragraphs.

You may be able to make some small corrections at this review stage – you can use the spell check function to correct any spelling mistakes and you may find you have missed out a vital word such as "not" or you may at this stage think of another point or two to add while reading through your answer. This approach could increase your marks much more effectively than carrying on with the point you were making before you stopped to do this final review.

The presentation and higher skills (PHS) marks are given for "clarity of explanation" so consider giving your answer to somebody else to read to see whether they can understand the points you are trying to make as a test of your PHS skills. A good question to ask yourself is would the reader pay money for your advice?

Reviewing the model answer

In the advanced technical papers, it is quite likely that there is no single right answer. The model answer is only one possible solution. You may well have included valid points which are not included in the model answer. Review critically both your answer and the model answer. Are there points in the model answer which you could have included in your answer to get extra marks? Are there points you have included which, with the benefit of hindsight, you should have left out?

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INCOME TAX - RATES AND THRESHOLDS

	2020/21	2019/20
Rates	%	%
Starting rate for savings income only	0	0
Basic rate for non-savings and savings income only	20	20
Higher rate for non-savings and savings income only	40	40
Additional and trust rate for non-savings and savings income	45	45
Dividend ordinary rate	7.5	7.5
Dividend upper rate	32.5	32.5
Dividend additional rate and trust rate for dividends	38.1	38.1
Thresholds	£	£
Savings income starting rate band	1 – 5,000	1 – 5,000
Basic rate band	1 – 37,500	1 – 37,500
Higher rate band	37,501 – 150,000	37,501– 150,000
Dividend allowance	2,000	2,000
Personal Savings Allowance		
– Taxpayer with basic rate income	1,000	1,000
– Taxpayer with higher rate income	500	500
– Taxpayer with additional rate income	Nil	Nil
Standard rate band for trusts	1,000	1,000
Scottish Tax Rates(1)	%	%
Starter rate	19	19
Scottish basic rate	20	20
Intermediate rate	21	21
Higher rate	41	41
Top rate	46	46
Scottish Tax Thresholds(1)	£	£
Starter rate	1 – 2,085	1 – 2,049
Scottish basic rate	2,086 – 12,658	2,050 – 12,444
Intermediate rate	12,659 – 30,930	12,445 – 30,930
Higher rate	30,931 – 150,000	30,931 – 150,000
Top rate	150,000 +	150,000 +

INCOME TAX - RELIEFS

	2020/21	2019/20
	£	£
Personal allowance(2)	12,500	12,500
Married couple's allowance(3)	9,075	8,915
– Maximum income before abatement of relief - £1 for £2	30,200	29,600
– Minimum allowance	3,510	3,450
Transferable Tax allowance for married couples and civil partners(4)	1,250	1,250
Blind person's allowance	2,500	2,450
Enterprise investment scheme relief limit(5)	1,000,000	1,000,000
Venture capital trust relief limit	200,000	200,000
Seed enterprise investment scheme relief limit	100,000	100,000
Social investment relief	1,000,000	1,000,000

Notes:
(1) Scottish taxpayers pay Scottish income tax on non-savings income.
(2) The personal allowance of any individual with adjusted net income above £100,000 is reduced by £1 for every £2 of adjusted net income above the £100,000 limit.
(3) Only available where at least one partner was born before 6 April 1935. Relief restricted to 10%.
(4) The recipient must not be liable to tax above the basic rate. The recipient is eligible for a tax reduction of 20% of the transferred amount.
(5) The limit is £2 million, where over £1 million is invested in knowledge intensive companies.

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ISA limits	**2020/21**	**2019/20**
Maximum subscription:	£	£
'Adult' ISAs	20,000	20,000
Junior ISAs	9,000	4,368

Pension contributions

	Annual allowance[(1)]	**Lifetime allowance**	**Minimum pension age**
	£	£	
2019/20	40,000	1,055,000	55
2020/21	40,000	1,073,100	55

Basic amount qualifying for tax relief £3,600

Note: (1) The annual allowance is tapered by £1 for every £2 of adjusted income above £240,000 (2019/20: £150,000) for individuals with threshold income above £200,000 (2019/20: £110,000). It cannot be reduced below £4,000 (2019/20: £10,000).

Employer Supported Childcare

Exemption – basic rate taxpayer[(1)]	£55 per week	£55 per week

Note: (1) For schemes joined on or after 6 April 2011 the exempt childcare amounts for higher and additional rate taxpayers (based on the employer's earning assessment only) are £28 and £25 respectively.

ITEPA mileage rates

Car or van[(1)]	First 10,000 business miles	45p
	Additional business miles	25p
Motorcycles		24p
Bicycles		20p
Passenger payments		5p

Note: (1) For NIC purposes, a rate of 45p applies irrespective of mileage.

INCOME TAX - BENEFITS

Car benefits – 2020/21

Emissions	**Electric range (miles)**	**Car benefit %[(1)] Pre 6 April 2020 registration**	**Car benefit %[(1)] On/after 6 April 2020 registration**	
0g/km	N/A	0%	0%	
1-50g/km	>130	2%	0%	
1-50g/km	70-129	5%	3%	
1-50g/km	40-69	8%	6%	
1-50g/km	30-39	12%	10%	
1-50g/km	<30	14%	12%	
51-54g/km		15%	13%	
55-59g/km		16%	14%	
60-64g/km		17%	15%	
65-69g/km		18%	16%	
70-74g/km		19%	17%	
75g/km or more		20%	18%	+ 1% for every additional whole 5g/km above 75g/km
160g/km or more		37%		
170g/km or more			37%	

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Car benefits – 2019/20

Emissions	**Car benefit %[1]**
0 – 50 g/km	16%
51 – 75 g/km	19%
76 – 94 g/km	22%
95 g/km or more	23% + 1% for every additional whole 5g/km above threshold
165 g/km or more	37%

Note: (1) 4% supplement for diesel cars excluding those that meet the Real Driving Emissions Step 2 (RDE2) standard (not to exceed maximum of 37%).

Fuel benefit base figure	**2020/21**	**2019/20**
	£	£
	24,500	24,100

Van benefits	**2020/21**	**2019/20**
	£	£
No CO_2 emissions	2,792	2,058
CO_2 emissions > 0g/km	3,490	3,430
Fuel benefit for vans	666	655

INCOME TAX - CHARGES

Child benefit charge	**Withdrawal rate**
Adjusted net income >£50,000	1% of benefit per £100 of income between £50,000 and £60,000
Adjusted net income >£60,000	Full child benefit amount assessable in that tax year

	2020/21	**2019/20**
Official rate of interest	2.25%	2.5%

INCOME TAX - SIMPLIFICATION MEASURES

Allowances

	2020/21	**2019/20**
	£	£
'Rent-a-room' limit	7,500	7,500
Property allowance/Trading allowance	1,000	1,000

Flat Rate Expenses for Unincorporated Businesses

Motoring expenses	First 10,000 business miles		45p per mile
	Additional business miles		25p per mile
Business use of home	25 – 50 hours use		£10 per month
	51 – 100 hours use		£18 per month
	101+ hours use		£26 per month
Private use of business premises	No of persons living there:	1	£350 per month
		2	£500 per month
		3+	£650 per month

Cash Basis for Unincorporated Businesses	£
Turnover threshold to join scheme	150,000
Turnover threshold to leave scheme	300,000

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CAPITAL ALLOWANCES

Annual investment allowance for plant and machinery (AIA)[1]	100%
WDA on plant and machinery in main pool[2]	18%
WDA on plant and machinery in special rate pool[3]	6%
WDA on patent rights and know-how	25%
WDA on structures and buildings (SBA) [4]	3%

Notes: (1) On first £1,000,000 of investment in plant & machinery (not cars) from 1 January 2019 to 31 December 2020 (£200,000 from 1 January 2021) (£200,000 before 1 January 2019).
(2) The main pool rate applies to cars with CO_2 emissions of not more than 110 g/km (from April 2021 not more than 50g/km).
(3) The special pool rate applies to cars with CO_2 emissions greater than 110 g/km (from April 2021 greater than 50g/km). The special pool rate was 8% before 6 April 2019 (1 April 2019 for companies).
(4) The SBA rate was 2% prior to April 2020.

100% First year allowances available to all businesses
1) Capital expenditure incurred by a person on research and development.
2) New zero-emission goods vehicles (until April 2025).
3) New cars if the car either emits not more than 50 g/km of CO_2 (0 g/km of CO_2 from April 2021) or it is electrically propelled (until April 2025).
4) Electric vehicle charging points (until April 2023).

NATIONAL INSURANCE CONTRIBUTIONS

Class 1 limits		**2020/21**			**2019/20**	
	Annual	**Monthly**	**Weekly**	**Annual**	**Monthly**	**Weekly**
Lower earnings limit (LEL)	£6,240	£520	£120	£6,136	£512	£118
Primary threshold (PT)	£9,500	£792	£183	£8,632	£719	£166
Secondary threshold (ST)	£8,788	£732	£169	£8,632	£719	£166
Upper earnings limit (UEL)/ Upper secondary threshold for under 21 (UST)[1] Apprentice upper secondary threshold for under 25 (AUST)[2]	£50,000	£4,167	£962	£50,000	£4,167	£962

Class 1 primary contribution rates		
Earnings between PT and UEL	12%	12%
Earnings above UEL	2%	2%
Class 1 secondary contribution rates		
Earnings above ST [1][2]	13.8%	13.8%

Notes: (1) Rate of secondary NICs for employees < age 21 on earnings between ST&UST is 0%.
(2) Rate of secondary NICs for apprentices < age 25 on earnings between ST&AUST is 0%.

	2020/21	**2019/20**
Employment allowance		
Per year, per employer	£4,000	£3,000
Class 1A contributions	13.8%	13.8%
Class 1B contributions	13.8%	13.8%
Class 2 contributions		
Normal rate	£3.05 pw	£3.00 pw
Small profits threshold	£6,475 pa	£6,365 pa
Class 3 contributions	£15.30 pw	£15.00 pw
Class 4 contributions		
Annual lower profits limit (LPL)	£9,500	£8,632
Annual upper profits limit (UPL)	£50,000	£50,000
Percentage rate between LPL and UPL	9%	9%
Percentage rate above UPL	2%	2%

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OTHER PAYROLL INFORMATION

Statutory maternity/adoption pay		First 6 weeks @ 90% of AWE Next 33 weeks @ the lower of £151.20 and 90% of AWE
Statutory shared parental pay /paternity pay/parental bereavement pay		For each qualifying week, the lower of 90% of AWE and £151.20
Statutory sick pay		£95.85 per week
Student Loan	Plan 1:	9% of earnings exceeding £19,390 per year (£1,615.83 per month/ £372.88 per week)
	Plan 2:	9% of earnings exceeding £26,575 per year (£2,214.58 per month /£511.05 per week)
Postgraduate Loan		6% of earnings exceeding £21,000 per year (£1,750 per month/£403.88 per week)

National living/minimum wage (April 2020 onwards)

Category of Worker	Rate per hour £	Category of Worker	Rate per hour £
Workers aged 25 and over	8.72	18–20 year olds	6.45
21–24 year olds	8.20	16–17 year olds	4.55
Accommodation Offset	£8.20 per day		
		Apprentices	4.15

HMRC INTEREST RATES

Late payment interest	2.6%
Underpaid corporation tax instalments interest	1.1%
Repayment interest	0.5%
Credit interest	0.5%

CAPITAL GAINS TAX

	2020/21	2019/20
Annual exempt amount for individuals	£12,300	£12,000

CGT rates for individuals, trusts and estates

Gains qualifying for business asset disposal(1)/investors' relief	10%	10%
Gains for individuals falling within remaining basic rate band(2)	10%	10%
Gains for individuals exceeding basic rate band and gains for trusts and estates(3)	20%	20%

Notes: (1) Formerly called entrepreneurs' relief
(2) The rate is 18% if the gain is in respect of a residential property
(3) The rate is 28% if the gain is in respect of a residential property

Business Asset Disposal(1) relief	**2020/21**	**2019/20**
Relevant gains (lifetime maximum) (2)	£1 million	£10 million

Investors' relief

Relevant gains (lifetime maximum)	£10 million	£10 million

Note: (1) Formerly called entrepreneurs' relief
(2) For qualifying disposals made before 11 March 2020 the lifetime limit was £10 million.

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Retail Prices Index

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
1982	–	–	79.44	81.04	81.62	81.85	81.88	81.90	81.85	82.26	82.66	82.51
1983	82.61	82.97	83.12	84.28	84.64	84.84	85.30	85.68	86.06	86.36	86.67	86.89
1984	86.84	87.20	87.48	88.64	88.97	89.20	89.10	89.94	90.11	90.67	90.95	90.87
1985	91.20	91.94	92.80	94.78	95.21	95.41	95.23	95.49	95.44	95.59	95.92	96.05
1986	96.25	96.60	96.73	97.67	97.85	97.79	97.52	97.82	98.30	98.45	99.29	99.62
1987	100.0	100.4	100.6	101.8	101.9	101.9	101.8	102.1	102.4	102.9	103.4	103.3
1988	103.3	103.7	104.1	105.8	106.2	106.6	106.7	107.9	108.4	109.5	110.0	110.3
1989	111.0	111.8	112.3	114.3	115.0	115.4	115.5	115.8	116.6	117.5	118.5	118.8
1990	119.5	120.2	121.4	125.1	126.2	126.7	126.8	128.1	129.3	130.3	130.0	129.9
1991	130.2	130.9	131.4	133.1	133.5	134.1	133.8	134.1	134.6	135.1	135.6	135.7
1992	135.6	136.3	136.7	138.8	139.3	139.3	138.8	138.9	139.4	139.9	139.7	139.2
1993	137.9	138.8	139.3	140.6	141.1	141.0	140.7	141.3	141.9	141.8	141.6	141.9
1994	141.3	142.1	142.5	144.2	144.7	144.7	144.0	144.7	145.0	145.2	145.3	146.0
1995	146.0	146.9	147.5	149.0	149.6	149.8	149.1	149.9	150.6	149.8	149.8	150.7
1996	150.2	150.9	151.5	152.6	152.9	153.0	152.4	153.1	153.8	153.8	153.9	154.4
1997	154.4	155.0	155.4	156.3	156.9	157.5	157.5	158.5	159.3	159.5	159.6	160.0
1998	159.5	160.3	160.8	162.6	163.5	163.4	163.0	163.7	164.4	164.5	164.4	164.4
1999	163.4	163.7	164.1	165.2	165.6	165.6	165.1	165.5	166.2	166.5	166.7	167.3
2000	166.6	167.5	168.4	170.1	170.7	171.1	170.5	170.5	171.7	171.6	172.1	172.2
2001	171.1	172.0	172.2	173.1	174.2	174.4	173.3	174.0	174.6	174.3	173.6	173.4
2002	173.3	173.8	174.5	175.7	176.2	176.2	175.9	176.4	177.6	177.9	178.2	178.5
2003	178.4	179.3	179.9	181.2	181.5	181.3	181.3	181.6	182.5	182.6	182.7	183.5
2004	183.1	183.8	184.6	185.7	186.5	186.8	186.8	187.4	188.1	188.6	189.0	189.9
2005	188.9	189.6	190.5	191.6	192.0	192.2	192.2	192.6	193.1	193.3	193.6	194.1
2006	193.4	194.2	195.0	196.5	197.7	198.5	198.5	199.2	200.1	200.4	201.1	202.7
2007	201.6	203.1	204.4	205.4	206.2	207.3	206.1	207.3	208.0	208.9	209.7	210.9
2008	209.8	211.4	212.1	214.0	215.1	216.8	216.5	217.2	218.4	217.7	216.0	212.9
2009	210.1	211.4	211.3	211.5	212.8	213.4	213.4	214.4	215.3	216.0	216.6	218.0
2010	217.9	219.2	220.7	222.8	223.6	224.1	223.6	224.5	225.3	225.8	226.8	228.4
2011	229.0	231.3	232.5	234.4	235.2	235.2	234.7	236.1	237.9	238.0	238.5	239.4
2012	238.0	239.9	240.8	242.5	242.4	241.8	242.1	243.0	244.2	245.6	245.6	246.8
2013	245.8	247.6	248.7	249.5	250.0	249.7	249.7	251.0	251.9	251.9	252.1	253.4
2014	252.6	254.2	254.8	255.7	255.9	256.3	256.0	257.0	257.6	257.7	257.1	257.5
2015	255.4	256.7	257.1	258.0	258.5	258.9	258.6	259.8	259.6	259.5	259.8	260.6
2016	258.8	260.0	261.1	261.4	262.1	263.1	263.4	264.4	264.9	264.8	265.5	267.1
2017	265.5	268.4	269.3	270.6	271.7	272.3	272.9	274.7	275.1	275.3	275.8	278.1

Lease percentage table

Years	Percentage	Years	Percentage	Years	Percentage	Years	Percentage
50+	100.000	37	93.497	24	79.622	11	50.038
49	99.657	36	92.761	23	78.055	10	46.695
48	99.289	35	91.981	22	76.399	9	43.154
47	98.902	34	91.156	21	74.635	8	39.399
46	98.490	33	90.280	20	72.770	7	35.414
45	98.059	32	89.354	19	70.791	6	31.195
44	97.595	31	88.371	18	68.697	5	26.722
43	97.107	30	87.330	17	66.470	4	21.983
42	96.593	29	86.226	16	64.116	3	16.959
41	96.041	28	85.053	15	61.617	2	11.629
40	95.457	27	83.816	14	58.971	1	5.983
39	94.842	26	82.496	13	56.167	0	0.000
38	94.189	25	81.100	12	53.191		

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CORPORATION TAX

Financial year	**2020**	**2019**	**2018**
Main rate	19%	19%	19%

EU definition of small and medium sized enterprises

	Small [2]	Medium [2]	Extended definition for R&D expenditure
Employees[1]	< 50	< 250	<500
Turnover[1]	≤ €10m	≤ €50m	≤ €100m
Balance sheet assets[1]	≤ €10m	≤ €43m	≤ €86m

Notes: (1) Must meet employees criteria and either turnover or balance sheet assets criteria.
(2) Thresholds apply for transfer pricing and distributions received by small companies.

VALUE ADDED TAX

	Standard rate	**VAT fraction**
Rate	20%	1/6

Limits	**From 1.4.20**	**From 1.4.19**
	£	£
Annual registration limit	85,000	85,000
De-registration limit	83,000	83,000

Thresholds	**Cash accounting**	**Annual accounting**
	£	£
Turnover threshold to join scheme	1,350,000	1,350,000
Turnover threshold to leave scheme	1,600,000	1,600,000

ADVISORY FUEL RATES (as at 1 June 2020)

Engine size	**Petrol**	**LPG**	**Engine size**	**Diesel**
1400cc or less	10p	6p	1600cc or less	8p
1401cc to 2000cc	12p	8p	1601cc to 2000cc	9p
Over 2000cc	17p	11p	Over 2000cc	12p

Electricity rate 4p

OTHER INDIRECT TAXES

	2020/21	**2019/20**
Insurance premium tax[1]		
Standard rate	12%	12%
Higher rate	20%	20%

Tobacco products duty	**From 11.3.20**	**From 29.10.18**
Cigarettes	16.5% x retail price + £237.34 per thousand cigarettes (or £305.23 per thousand cigarettes [2])	16.5% x retail price + £228.29 per thousand cigarettes (or £293.95 per thousand cigarettes [2])
Cigars	£296.04 per kg	£284.76 per kg
Hand-rolling tobacco	£253.33 per kg	£234.65 per kg
Other smoking/chewing tobacco	£130.16 per kg	£125.20 per kg
Tobacco for heating	£243.95 per kg	£234.65 per kg[3]

Notes: (1) Premium is tax inclusive ($^3/_{28}$ for 12% rate and $^1/_6$ for 20% rate).
(2) The £305.23/£293.95 per thousand cigarettes is a minimum excise duty (if higher than the first calculation).
(3) From 1.7.19.

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INHERITANCE TAX

Death rate	40%[1]	**Lifetime rate**	20%

Note: (1) 36% rate applies where 10% or more of the deceased person's net chargeable estate is left to charity.

Nil rate bands

6 April 1996 – 5 April 1997	£200,000	6 April 2003 – 5 April 2004	£255,000
6 April 1997 – 5 April 1998	£215,000	6 April 2004 – 5 April 2005	£263,000
6 April 1998 – 5 April 1999	£223,000	6 April 2005 – 5 April 2006	£275,000
6 April 1999 – 5 April 2000	£231,000	6 April 2006 – 5 April 2007	£285,000
6 April 2000 – 5 April 2001	£234,000	6 April 2007 – 5 April 2008	£300,000
6 April 2001 – 5 April 2002	£242,000	6 April 2008 – 5 April 2009	£312,000
6 April 2002 – 5 April 2003	£250,000	6 April 2009 – 5 April 2021	£325,000

Residence nil rate bands[2]

6 April 2017 – 5 April 2018	£100,000	6 April 2019 – 5 April 2020	£150,000
6 April 2018 – 5 April 2019	£125,000	6 April 2020 – 5 April 2021	£175,000

Note: (2) An additional nil rate band is available where a main residence is passed on death to a direct descendant. Tapered withdrawal for estates > £2million.

Taper relief		
Death within 3 years of gift		Nil%
Between 3 and 4 years		20%
Between 4 and 5 years		40%
Between 5 and 6 years		60%
Between 6 and 7 years		80%
Quick Succession relief		
Period between transfers less than one year		100%
Between 1 and 2 years		80%
Between 2 and 3 years		60%
Between 3 and 4 years		40%
Between 4 and 5 years		20%
Lifetime exemptions		
Annual exemption		£3,000
Small gifts		£250
Wedding gifts	Child	£5,000
	Grandchild or remoter issue or other party to marriage	£2,500
	Other	£1,000

ANNUAL TAX ON ENVELOPED DWELLINGS (ATED)

Residential property value	**From 1.4.20**	**From 1.4.19**
>£0.5m - ≤ 1m	£3,700	£3,650
> £1m - ≤ 2m	£7,500	£7,400
> £2m – ≤ 5m	£25,200	£24,800
> £5m – ≤ 10m	£58,850	£57,900
> £10m – ≤ 20m	£118,050	£116,100
> £20m	£236,250	£232,350

STAMP DUTY/SDRT

Stamp duty[1]	- On shares transferred by physical stock transfer form	0.5%
Stamp duty reserve tax[1]	- On agreements to transfer shares[2]	0.5%
	- On shares transferred to depositary receipt schemes	1.5%

Notes: (1) Does not apply to UK securities traded on a recognised growth market (eg AIM).
(2) Does not apply to units in UK unit trust schemes or shares in UK OEICS bought from fund managers.

CTA EXAMINATIONS

2021

TAX TABLES

STAMP DUTY LAND TAX

Stamp Duty Land Tax on purchase price / lease premium / transfer value – England & NI

Basic Rate %(1)(2)(3)	Higher Rate %(1)(2)	Residential(1)(2)(3)	Non-Residential
0	3	£0 - £125,000	£0 - £150,000
2	5	£125,001 - £250,000	£150,001 - £250,000
5	8	£250,001 - £925,000	£250,001 +
10	13	£925,001 - £1,500,000	N/A
12	15	£1,500,001 +	N/A

Notes: (1) The basic rates are increased by 3% where the purchase is of an additional residential property for individuals (see column 2 for the rates that apply). Companies and trusts pay the additional 3% on all purchases of residential properties, subject to note 2 below.

(2) Companies (and certain other entities) pay 15% on purchases of residential property valued > £500,000.

(3) First-time buyers purchasing a single dwelling as their only or main residence may benefit from a reduced rate. (This includes qualifying shared ownership properties.) SDLT will not be due on properties up to £300,000. For homes up to £500,000, SDLT will be payable on £200,000 at 5%. Homes bought for more than £500,000 will incur the rates as per column 1 of the table above.

New leases – Stamp Duty Land Tax on lease rentals – England & NI

Rate (%)	Net present value of rent	
	Residential	**Non-residential**
Zero	Up to £125,000	Up to £150,000
1%	Excess over £125,000	£150,001-£5m
2%		Over £5m

Land and Buildings Transaction Tax (LBTT) on purchase price – Scotland

Basic Rate %(1)(2)(3)	Residential	Rate %(1)	Non-Residential
0	up to £145,000	0	£0 - £150,000
2	£145,001 - £250,000	1	£150,001 - £250,000
5	£250,001 - £325,000	5	£250,001 +
10	£325,001 - £750,000		
12	£750,001 +		

Notes: (1) Rates are charged on the portion of consideration that falls in each band. The same tax is payable for a premium granted for a land transaction, except for residential leases which are generally exempt. Special rules apply to a premium for non-residential property where the rent exceeds £1,000 a year.

(2) An additional amount of tax equal to 4% of the relevant consideration applies broadly to purchases of an additional dwelling by individuals and trusts (over which the beneficiary has substantial rights) and to purchases of a dwelling by certain businesses, companies and other trusts.

(3) There is a relief for first-time buyers where a 0% rate is applied to the first £175,000 of the purchase consideration.

New leases – Land and Buildings Transaction Tax (LBTT) on lease rentals - Scotland

Rate (%)	Net present value of rent(1)
	Non-residential
Zero	Up to £150,000
1%	£150,001 to £2,000,000
2%	£2,000,001+

Note: (1) Residential leases are generally exempt

QUESTIONS

1. Swan Ltd is a manufacturer of fishing tackle, and has two wholly owned subsidiaries, Duck Ltd and Pelican Ltd. Swan Ltd makes premium fly fishing rods and reels and Pelican Ltd holds various items of intellectual property as investments. Swan Ltd also owns a 58% interest in the shares of Goose Ltd which makes waterproof clothing for anglers. The remaining 42% is owned by three individuals, all of whom are unconnected with Swan Ltd. All three companies are UK tax resident and have a year end of 30 September.

   The group is proposing to undertake the following transactions:

   1) Goose Ltd is selling a freehold building, Stone House, which was bought on 1 May 2009 for £250,000. Until 31 December 2012, it was rented out to a neighbouring business. From 2013 to the present time, it has been used as a factory by Goose Ltd, except for the top storey, which represents 15% of the floor space, and has never been used in the trade. An offer for the building has been received for £600,000 from an unconnected buyer. The exchange of contracts (Scots Law – conclusion of missives) is likely to take place on 31 December 2021.

   2) Goose Ltd is planning to purchase a freehold building, Bear House, for £620,000 in March 2022. Proceeds from the sale of Stone House will be used to fund the purchase. On acquisition of Bear House, Goose Ltd will refurbish the building and may then rent it out for a year before using it in its trade.

   3) Swan Ltd purchased the freehold interest of a warehouse, Wyvern House, on 1 April 2016 for £500,000. The warehouse has been used continuously in Swan Ltd's trade since acquisition but was recently put up for sale. An offer has been received from an unconnected buyer for £600,000 and the exchange of contracts is likely to take place on 31 December 2021.

   4) Duck Ltd is considering buying a leasehold building, Sword House, for £560,000 for use in its trade. The purchase will be funded by the proceeds from the sale of Wyvern House. The lease has 54 years remaining.

   5) There is a possibility that Swan Ltd may sell all the shares of Pelican Ltd in the next two years. Swan Ltd purchased fly reel patents on 1 October 2015 for £100,000. They were transferred to Pelican Ltd on 30 September 2019 at the patents' net book value. The patents were amortised at a rate of 10% of the purchase price per annum on a straight line basis. The market value at the time of transfer was £150,000. The current market value of the patents is £200,000. Assume that the sale will take place on 30 September 2022.

   Requirement:

   Explain and advise on the Corporation Tax consequences of the above proposals. Ignore indexation allowance. Assume it is May 2021. (20)

2. White Ltd is planning to reduce the number of companies in its group. The first two companies being considered are Blue Ltd and Green Ltd. Both are wholly owned subsidiaries of White Ltd. It is anticipated that the balance sheets of both entities will be “cleaned up” and thereafter the entities will be liquidated.

All three companies are incorporated and tax resident in the UK.

Blue Ltd

This company has been dormant for many years. The balance sheet at 31 December 2020 was as follows:

	£
Bank	10,000
Intra-group creditor – loan from White Ltd	(300,000)
Intra-group creditor – other amounts due to White Ltd	(110,000)
	(400,000)
Share capital	10,000
Profit and loss account – distributable reserves	(410,000)
Capital and reserves	(400,000)

The ‘other amounts’ arose from trading expenses incurred by Blue Ltd when it still actively traded.

It is proposed that the loan creditor and other amounts be formally waived. This will leave the balance sheet (post clean-up) as follows:

	£
Bank	10,000
	10,000
Share capital	10,000
Profit and loss account – reserves	0
Capital and reserves	10,000

Thereafter the company will be liquidated.

Green Ltd

This company was trading but ceased during 2020 and has been dormant since then. The balance sheet at 31 December 2020 was as follows:

	£
Bank	310,000
	310,000
Share capital	10,000
Share premium account	500,000
Profit and loss account	(200,000)
Capital and reserves	310,000

It is proposed to perform a capital reduction. The share premium account will be reduced to nil and transferred to distributable reserves. A dividend of £300,000 will be paid leaving the balance sheet (post clean-up) as follows:

	£
Bank	10,000
	10,000
Share capital	10,000
Profit and loss account – reserves	0
Capital and reserves	10,000

Thereafter the company will be liquidated.

Requirement:

Advise on the Corporation Tax consequences of the proposed transactions and the liquidation of the dormant subsidiaries as outlined above. (15)

3. Organic Fruit plc is a UK resident holding company with five wholly owned subsidiaries, each based in a different part of the UK. All group companies have an accounting year-end of 30 September.

Four of the subsidiaries have traded for over five years. The fifth, Sweet Fruit Ltd, was incorporated in June 2020 with a fully paid up share capital of £500,000. Legal fees of £5,000 were incurred by Organic Fruit plc on the incorporation of Sweet Fruit Ltd.

Each subsidiary owns and manages a packing and distribution centre, distributing fruit to well-known supermarkets within its local area. Sweet Fruit Ltd did not initially trade. In September 2020, it purchased the freehold of a warehouse for £2 million from another subsidiary, Sour Fruits Ltd, which had been holding the warehouse as an investment. The other subsidiary had acquired the warehouse in December 2014 from a third party for £2 million. At the time of the purchase by Sweet Fruit Ltd, the market value of the warehouse was £5 million.

After purchasing the warehouse, Sweet Fruit Ltd started purchasing equipment, acquiring stock and hiring employees. It formally opened its packing and distribution centre on 1 October 2020 but has been loss making since then.

Recently a competitor, Cool Bananas plc, made an unsolicited offer of £10 million cash for the entire share capital of Sweet Fruit Ltd.

If Organic Fruit plc accepts the offer, the sale is likely to complete in July 2021.

Requirement:

Explain the Corporation Tax consequences for the Organic Fruit plc group of the sale of the shares of Sweet Fruit Ltd to Cool Bananas plc. (15)

4. Marylebone plc, a listed company, reports under IFRS and has an accounting reference date of 31 March.

The finance director is considering a number of changes to the remuneration packages of the senior management team to improve motivation. The alternatives that he is considering are:

1) Introducing a bonus scheme whereby a bonus is paid on 1 September each year, based on the company's results for the year ended 31 March.

2) Making significant one off payments into the company pension scheme for 20 key employees.

3) Introducing an unapproved share scheme.

The following additional details relate to the possible unapproved share scheme. It is intended that a total of 50,000 unapproved options over new shares in Marylebone plc would be granted to five key employees on 1 April 2022 and will vest on 31 March 2025. The employees may exercise the options on 31 March 2026 to purchase shares in Marylebone plc at £2 per share, which is anticipated to represent a significant discount on market value.

It is estimated that the accounting charge arising in connection with the share scheme in the year ending 31 March 2023 will be £150,000.

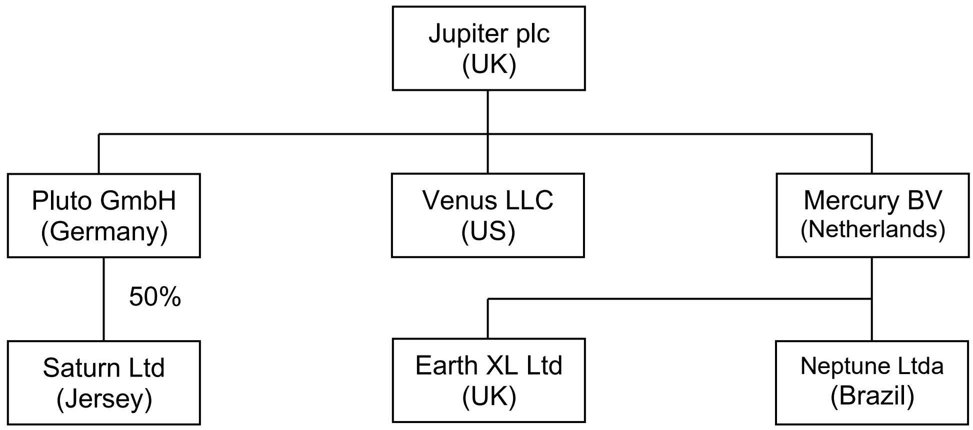
Requirement:

1) Explain the Corporation Tax implications of the various alternatives. (9)

2) Explain the deferred tax implications of the alternatives including, for the share scheme, the calculation of the deferred tax balance for the year ending 31 March 2023, on the assumption that tax relief will be available and that the share price at the balance sheet date is £7. Assume that the rate of corporation tax remains at 19% throughout. (6)

Total (15)

5. The Jupiter group specialises in the production of chemicals and natural resources. The group structure is set out below, with the jurisdiction of incorporation and tax residence of each company stated. All subsidiaries, except for Saturn Ltd, are wholly owned.



All companies in the group have a 31 December year-end and the following background information is available:

1) Jupiter plc and Mercury BV are both holding companies and do not carry on a trade or hold any investments other than in subsidiary companies.

2) Pluto GmbH is a holding company that does not carry on a trade but has a portfolio of investment properties.

3) Saturn Ltd manufactures and sells chemicals in Jersey and is owned jointly with an unrelated third party investor.

4) Venus LLC produces natural gas in the US and is currently valued at £60 million. It also holds a number of investments connected with the gas industry. The company was incorporated and commenced trading on 1 November 2020.

5) Earth XL Ltd and Neptune Ltda are both trading companies with the former producing shale gas in the UK and the latter undertaking oil and gas exploration in Brazil.

<u>Proposed transaction</u>

On 31 December 2021, Jupiter plc will transfer its entire shareholding in Venus LLC to Mercury BV in exchange for the issue of 1,000 ordinary shares by Mercury BV. This transaction is to be undertaken urgently to facilitate the issue of a convertible loan note by Mercury BV in January 2022. Following discussion with potential investors, it is a condition of issuing the convertible loan note that Mercury BV will hold all of the group's oil and gas assets at the time of issue. With regard to the UK tax status of Venus LLC there are three presumed alternatives:

1) Venus LLC may be regarded as a body corporate with issued share capital

2) Venus LLC may be regarded as a body corporate without issued share capital

3) Venus LLC may be regarded as a branch of Jupiter plc

Requirement:

Explain the UK Corporation Tax implications of the proposed transaction and how any potential tax charge may be mitigated assuming each alternative may represent the UK tax status of Venus LLC. (20)

6. Crawl Ltd is a wholly-owned UK resident subsidiary of Paddle plc.

Crawl Ltd, a manufacturer of gym equipment, has been loss-making for the past three years. After a number of unsuccessful attempts to improve profitability, the Board of Directors of Paddle plc has agreed to place the company into a members' voluntary liquidation. The Board plans to appoint the liquidator within the next few weeks and the liquidation process is expected to last around nine months.

The Board has not decided whether Crawl Ltd should cease trading now or wait until after the appointment of the liquidator. Although Crawl Ltd is currently solvent and still able to trade, the Board are aware that this may not be the case for long, and they may be forced to cease trading before the appointment.

Crawl Ltd has one subsidiary: a wholly-owned UK resident trading company, Butterfly Ltd, which was acquired four years ago for £15 million. Butterfly Ltd has also been loss-making recently, but the Board wishes to retain ownership of this shareholding. The current market value of the shares is estimated to be £8 million.

Crawl Ltd and Butterfly Ltd have no brought forward losses; current year losses in both companies have always been surrendered in full to other UK companies in the group.

The draft step plan for the winding up of Crawl Ltd after it has both ceased trading and gone into liquidation is as follows:

1) The land and buildings, which were acquired 11 years ago for £25 million, will be sold to a third party at their market value of £35 million.

2) The shares in Butterfly Ltd, all plant and machinery, and all stock will be transferred to Splashing Ltd, another wholly-owned UK resident subsidiary of Paddle plc, at net book value (which is equal to their market value).

3) Trade receivables will either be collected or written off and trade payables will be settled.

4) The excess cash will be paid up to Paddle plc as a single distribution.

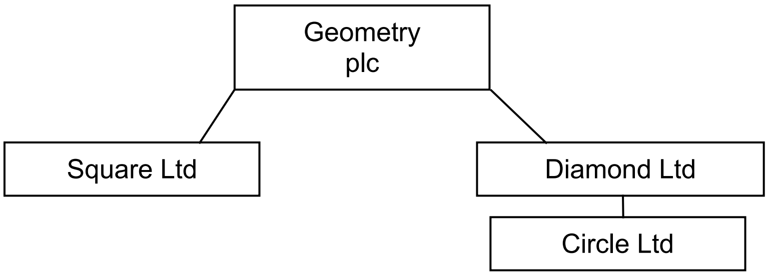
Crawl Ltd will then be dissolved.

Requirement:

Explain the Corporation Tax consequences of the above matters including whether it matters if Crawl Ltd ceases to trade before or after the appointment of the liquidator. Make any relevant recommendations. Calculations are NOT required and do NOT discuss any general legal aspects of the proposals. (15)

7. Geometry plc is proposing to sell Diamond Ltd, one of its subsidiaries.

Part of the Geometry group structure, which has been unchanged for the past five years, is set out below.



1) Geometry plc is a holding company incorporated and tax resident in the UK. All of its subsidiaries are wholly owned trading companies. All companies make up their accounts to 31 December.

2) Diamond Ltd was incorporated in the Republic of Ireland but had been centrally managed and controlled from the UK until it migrated from the UK by transferring its place of central management and control, as well as much of its trading activity, to the Republic of Ireland on 1 September 2019. After migration some existing trading activity remained in a UK permanent establishment of Diamond Ltd which was carried out in the factory located in the UK.

At the time of migrating, Diamond Ltd had the following assets, which would have realised profits or losses if sold at market value, as set out below:

Asset	Profit/(loss) £
Investment property located in the UK	125,000
Factory located in the UK	150,000
Trademark registered in the Republic of Ireland	750,000
IT equipment remaining in the UK	(300,000)
IT equipment transferred to Ireland	(250,000)
Net profit	475,000

The IT equipment comprises individual items of computer hardware none of which has a value in excess of £6,000. On 1 February 2021, Diamond Ltd sold the investment property located in the UK and IT equipment which had been physically transferred to the company's operations in Ireland.

3) Both Square Ltd and Circle Ltd are UK incorporated and tax resident. On 15 July 2019 Square Ltd transferred a property to Circle Ltd. The property has continued to appreciate in value since that time.

4) The sale of all the Diamond Ltd shares is likely to take place in October 2021.

Requirement:

1) Explain the UK tax implications arising from the migration of Diamond Ltd and of the proposed sale of all the shares of Diamond Ltd. (18)

2) Explain how Geometry plc can protect itself from any future tax claims made under an indemnity or for breach of a warranty that the purchaser of Diamond Ltd may bring against Geometry plc after the sale of Diamond Ltd. (2)

Total (20)

8. Calke Ltd has two wholly owned UK tax resident subsidiaries. A review has taken place of the group's tax affairs and the following matters have come to light.

The following two matters relate to Calke Ltd's corporation tax return for the eight-month accounting period ended 31 January:

1) The previous Managing Director submitted a Research & Development claim for an enhanced deduction against the company's taxable profits. He had no tax knowledge of the subject but still decided to prepare the claim himself (after reading an article about the relief); Calke Ltd's previous tax advisers did not review the claim. The tax on the amount claimed is overstated by £42,000 and HMRC have been notified of this.

2) Calke Ltd entered into a tax avoidance scheme but the transactions were not implemented as planned. The previous Managing Director was aware of this and falsely amended the minutes of certain meetings. The Corporation Tax return was filed on the basis that the scheme was implemented as planned, thus saving the company £60,000 of Corporation Tax.

The following information relates to Melton Ltd, one of Calke Ltd's subsidiaries:

Melton Ltd started trading on 1 June 2018 and made up its first set of accounts to 31 May 2019. The company did not receive a notice to file a Corporation Tax return and did not notify HMRC of chargeability until 15 June 2021, when the company was contacted by HMRC. After originally denying that Melton Ltd had begun trading on 1 June 2018 and claiming that the company had a shortage of funds and could not pay any tax, the previous Managing Director did make a full disclosure, but after a five-month delay in providing the information.

Melton Ltd eventually filed its first Corporation Tax return on 1 November 2021 showing a Corporation Tax liability of £99,000. Corporation Tax of £12,000 was paid by the company on 1 June 2021 but no other payments have since been made.

Melton Ltd needs to add back £20,000 as a transfer pricing adjustment in its computation for the period ended 31 May 2019 in respect of services to Calke Ltd; no compensating adjustment has been claimed to date by Calke Ltd.

The group wishes to make a full disclosure immediately in respect of the above errors.

Requirement:

Explain the penalties which may be charged by HMRC (including calculations), and any mitigation that may be available. You are NOT required to comment on professional responsibilities or ethics. (15)

9. Spark Ltd is tax resident in the UK and is a specialist supplier of locks and ironmongery. It has two overseas permanent establishments (PE1 and PE2) located in Ruritania and Pangaea, respectively.

Spark Ltd also has a 5% interest in the share capital of Boltex Ltd, which is tax resident in Utopia. The remaining shares of Boltex Ltd are owned locally by Utopian residents.

Ruritania, Pangaea and Utopia do not have Double Taxation Agreements with the UK.

In the year ended 31 March 2021, summary turnover and costs were as follows:

	Spark Ltd UK Income (£'000)	PE1 Ruritania (£'000)	PE2 Pangaea (£'000)
Turnover	25,000	2,000	700
Direct costs	(5,000)	(700)	(800)
Indirect costs	(600)	(200)	(50)

Spark Ltd employed 100 staff worldwide during the year and has no other income or expenses other than those detailed above. None of the costs included above require adjustment for the purposes of calculating the company's tax liability.

Local Corporation Tax of 30% was applied by the Ruritanian tax authorities to the profit of PE1.

A withholding tax of 20% was applied by the Pangaean tax authorities to the turnover of PE2. Turnover is stated before the withholding tax is applied.

For the year ended 31 March 2021, Boltex Ltd paid one dividend totalling £1 million (gross) to all shareholders. A 10% withholding tax was applied to this by the Utopian tax authorities.

Spark Ltd is considering setting up two new overseas permanent establishments. Both are expected to be profitable from the start. One will be located in a country which does not levy Corporation Tax. The other will be located in a country with a rate of Corporation Tax similar to the UK.

Requirement:

Explain the UK Corporation Tax implications of the above information, including a calculation of the UK Corporation Tax liability of Spark Ltd for the year ended 31 March 2021. (15)

10. The Spey group of companies consists of three companies: the holding company, Spey Ltd; and two wholly owned trading subsidiaries, Don Ltd and Burnawn Ltd. The group is proposing a demerger.

Spey Ltd is jointly owned by two shareholder/directors, Mr Loudoun and Mr Clyde. Mr Loudoun and Mr Clyde have fallen out irreconcilably and have therefore decided to break the group up via a capital reduction demerger. This will result in Mr Loudoun owning Don Ltd and Mr Clyde owning Burnawn Ltd, each held through intermediate holding companies.

Proposed transactions

Step 1: The share capital of Spey Ltd will be re-designated into A and B shares with separate rights attaching to Mr Loudoun and Mr Clyde, respectively.

Step 2: A new holding company, Tay Ltd, will be incorporated. Tay Ltd will also have both A and B shares only.

Step 3: Mr Loudoun will exchange his A shares in Spey Ltd for A shares in Tay Ltd. Mr Clyde will exchange his B shares in Spey Ltd for B shares in Tay Ltd. From Tay Ltd's perspective, for accounting purposes, its investment in Spey Ltd is booked at market value. Any difference between the market value and the nominal value of the shares issued in Tay Ltd will be taken to a merger reserve.

Step 4: Spey Ltd will then sell its shareholding in Burnawn Ltd to Tay Ltd at market value, leaving the consideration on an intra-group loan account. Burnawn Ltd will declare a dividend to Tay Ltd to equalise the value of the investments held by Tay Ltd in Spey Ltd and Burnawn Ltd.

Step 5: Mr Clyde will incorporate a new holding company, Tweed Ltd.

Step 6: Tay Ltd will reduce its capital by special resolution supported by a solvency statement as allowed by the Companies Act 2006, cancelling the B shares. Part of the merger reserve (mentioned at step 4 above) will be used for this process.

Step 7: The investment in Burnawn Ltd will then be transferred to Tweed Ltd at book value as part of the reduction in capital arrangement. Tweed Ltd in turn will issue shares to Mr Clyde.

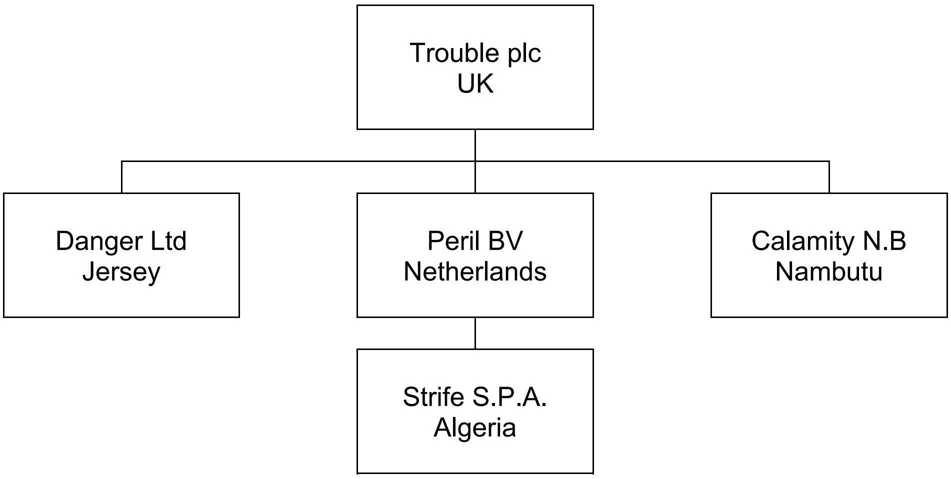
Post transaction, 100% of Tay Ltd (which owns Spey Ltd which in turn owns Don Ltd) will be owned by Mr Loudoun and 100% of Tweed Ltd (which owns Burnawn Ltd) will be owned by Mr Clyde.

Requirement:

Explain the Corporation Tax and Stamp Duty consequences of each of the steps in the proposed demerger.

(15)

11. Trouble plc is the parent company of an international group specialising in the design and sale of luxury cars. The structure of the group is set out below with companies incorporated and tax resident in the jurisdictions stated. All subsidiaries are wholly owned.



The following information is available in respect of the year ending 31 December 2021:

1) Trouble plc sells cars in the UK market. It plans to issue an interest-bearing corporate bond to secure funding from a wide range of investors. It will use the proceeds raised to subscribe for additional ordinary shares in Danger Ltd, currently a dormant company. The directors of Danger Ltd and its registered office are provided by a trust company based in Jersey. Danger Ltd will use the funds to issue a loan to Calamity N.B. with a market rate of interest, to enable Calamity N.B. to fund ongoing business activities.

2) Calamity N.B. sells cars in Nambutu and is due to pay a gross dividend of £10 million in 2021 to Trouble plc in respect of profits realised during the year ended 31 December 2020. The dividend will be paid net of a 10% withholding tax. Calamity N.B. paid corporate tax of £5 million in respect of the profits. A corporate tax deduction will be available for the company in respect of the distribution in Nambutu.

3) Peril BV is a holding company and its only source of income is a £22.8 million annual patent royalty from Strife S.P.A. for the use of patents, received net of a 24% Algerian withholding tax. The royalty income is taxed at a rate of 5% in the Netherlands. The patents have never been held in the UK. On 1 March 2021, Peril BV disposed of an investment property for £50 million having purchased the property for £20 million on 15 April 2007.

4) Strife S.P.A. is a manufacturing company with all its income derived from its trade. The company is subject to corporate tax at a rate of 23% and is expected to realise accounting profits of £400,000.

Requirement:

Explain the UK Corporation Tax implications of the above. Do NOT discuss the corporate interest restriction regime. (15)

12. On 1 October 2019, United Kingdom Electricity plc acquired Faraday plc, along with its wholly owned subsidiary, Faraday Consulting Ltd. The income statements and relevant notes for Faraday plc and Faraday Consulting Ltd for the year ended 30 September 2020 are set out below.

Faraday plc

Income Statement for the year ended 30 September 2020	Notes	£'000
Turnover		
Rental income	(2)	2,000
Patent income	(3)	4,000
Operating costs		
Audit and tax fees		(90)
Legal and professional fees – building disposal	(2)	(220)
Other income		
Fair value movement on investment property	(2)	180
Profit before tax		5,870

Notes:

1) United Kingdom Electricity plc has excess losses of £60 million for the year ended 30 September 2020 which could potentially be surrendered as group relief to Faraday plc and Faraday Consulting Ltd.

2) On 31 March 2020 Faraday plc sold a freehold building to a third party for £12 million. Prior to the disposal, the building had been rented to Faraday Consulting Ltd. It had been treated in the accounts as an investment property and recognised at fair value on the balance sheet, with changes in valuation recognised through profit or loss. The building had been acquired on 31 March 1992 for £3.4 million.

3) The company holds the patents for a particular design of wind turbine, which it has been licensing to third parties. During the year it recognised £4 million of royalty income. Faraday Consulting Ltd developed the intellectual property as part of its consultancy business.

Faraday Consulting Ltd

Income Statement for the year ended 30 September 2020	Notes	UK	Ireland	Total
		£'000	£'000	£'000
Turnover		55,000	11,000	66,000
Cost of sales				
Staff costs – salary		(30,000)	(5,500)	(35,500)
Staff costs – social security costs		(3,200)	(700)	(3,900)
Staff costs – bonus	(2)	(2,500)	(1,000)	(3,500)
Operating costs				
Office rental	(3)	(6,000)	(1,200)	(7,200)
Lease premium	(3)	(200)		(200)
Depreciation – leased equipment	(4)	(2,500)	(500)	(3,000)
Car rental	(5)	(120)	(40)	(160)
Bad debt	(6)		(600)	(600)
Travel costs	(7)		(100)	(100)
Fine	(8)	(20)		(20)
Entertainment	(9)	(500)	(350)	(850)
Charitable donation	(10)	(100)		(100)
Interest and other financing costs				
Bank loan	(11)	(1,000)		(1,000)
Finance cost – leased equipment	(4)	(400)	(80)	(480)
Profit before tax		8,460	930	9,390

Notes

1) Faraday Consulting Ltd provides consultancy advice for the design of new wind generators. Its main business is in the UK following the expansion of renewable energy over the last decade. It also operates from an office in Ireland to provide consultancy advice in that country.

2) Staff bonuses are paid 12 months after the end of the period. The bonuses for the year ended 30 September 2019 were £2 million in total, of which £800,000 related to the Irish office.

3) On 1 October 2019 it signed a new 10-year lease and paid a lease premium of £2 million.

4) The only fixed assets are computers, which are rented under a four-year finance lease arrangement entered into on 1 October 2018.

5) The car rental costs include £5,000 for the Managing Director's car, which has CO_2 emissions of 219g/km. All of the other leased cars have CO_2 emissions of less than 110g/km. All the leases were entered into three years ago.

6) The Irish office has a debt where the customer is in financial difficulty, for which the accounts recognise an impairment loss of £600,000. The company has not written the balance off and is still chasing for payment.

7) Travel costs include £2,000 in respect of flights and hotel costs for the family of one of the company's employees who has been seconded to the Irish office.

8) The company incurred a fine for breach of health and safety rules.

9) Entertainment costs are broken down as follows:

	UK	Ireland
	£	£
Client entertainment	450,000	280,000
Staff entertainment	50,000	70,000

10) The company paid a donation of £100,000 to a UK charity which seeks to assist persons in overseas countries adversely affected by weather-related disasters.

11) The company has a bank loan, which covers the working capital requirements of the business, in particular to fund staff costs ahead of being paid by customers. The UK office is responsible for negotiating the terms of the loan with the bank.

12) The Irish office operates autonomously and has a Euro functional currency. An exchange gain of £4 million arose on the year-end retranslation of the foreign operation's balance sheet and has been recognised in other comprehensive income (rather than in profit or loss).

13) The accounting records of the company estimated the Irish tax to be €150,000 for the year. The company paid €140,000 on 30 April 2021, which was based on the submitted tax computations for the Irish branch.

14) The relevant exchange rates are:

30 September 2020: £1 = €1.10
30 April 2021: £1 = €1.05
Average rate of the year to 30 September 2020: £1 = €1.18

15) The company has not made an election under s.18A CTA 2009.

Requirement:

Prepare a computation of total taxable profits for Faraday plc and Faraday Consulting Ltd for the year ended 30 September 2020, with supporting explanations. (20)

13. Cicely plc is a company incorporated and tax resident in the United Kingdom, and the head of a global trading group.

The following is a summary of the estimated UK Corporation Tax position for the group, for the year ending 31 March 2021:

	Amount (£)
Profit before tax	5,000,000
Depreciation	1,000,000
Legal and professional fees	250,000
Client entertaining	350,000
Capital allowances	(500,000)
Less non-trading loan relationship income	(250,000)
Taxable trading profit before losses	5,850,000
Trading losses brought forward	(500,000)
Taxable trading profit after losses	5,350,000
Non-trading loan relationship profit	250,000
Total taxable profits	5,600,000

The 'Profit Before Tax' figure shown above includes the following finance income and costs:

	Amount (£)
Finance lease interest expense	(300,000)
Foreign exchange loss on trading loan relationship	(240,000)
Loan interest expense	(3,000,000)
Bank interest received	250,000

The draft consolidated accounts of the worldwide group for the year ending 31 March 2021 contain the following information:

	Amount (£)
Finance lease interest expense	(1,500,000)
Bank loan interest expense	(4,000,000)
Bank interest received	1,000,000

Requirement:

1) **Provide a brief description of the UK Corporate Interest Restriction rules, and how these interact with the thin capitalisation rules.** (4)

2) **Calculate the group's potential disallowance under the Corporate Interest Restriction rules for the year ending 31 March 2021, using the fixed ratio method. Assume that ANGIE is £4,500,000** (10)

3) **Describe the way in which the group ratio method operates, and in what circumstances this may be beneficial. You are not required to calculate the disallowance under the group ratio method.** (3)

4) **List the administrative requirements relevant to the group under the Corporate Interest Restriction.** (3)

Total (20)

14. Spot Ltd is a UK tax resident supplier of hygiene equipment. The company has three non-UK subsidiaries. All of these companies are wholly owned and all will make up accounts for the year to 31 March 2022.

1) Dalmatian Ltd. This company is tax resident in Lilliput. It is a trading company with some investments. This company is forecast to have taxable trading profits of £290,000, interest receivable of £25,000 and dividends receivable of £22,000.

2) Mark Ltd. This company is tax resident in Laputia. It is a soap manufacturing company, selling entirely in Laputia and adjacent territories. It has no activities whatsoever in the UK and is staffed by local employees. UK supervision is limited to occasional visits by directors of Spot Ltd and the receipt of annual performance data from Mark Ltd. Trading profits are forecast to be £700,000 for the year to 31 March 2022.

3) In the year ended 31 March 2020, Spot Ltd subscribed £500,000 for additional new share capital in Mark Ltd. This was invested entirely in long dated Laputia government bonds with no redemptions permitted for 10 years. Interest receivable for the year to 31 March 2022 is expected to be £80,000.

4) Blemish Ltd. This company is also tax resident in Laputia and is a trading company. Its accounting profits are forecast to be £600,000 for the year to 31 March 2022. Relevant operating expenditure is forecast to be £8,500,000. The company will pay no interest during the year and purchase no goods, except as will be used in Laputia in its trade.

5) Mark Ltd and Blemish Ltd were set up because Laputia was seen as a promising market and the Laputian authorities require the establishment of a local company in order to provide goods or services to their country.

6) Neither Lilliput nor Laputia is included on the 'Excluded Territories' list. Neither country has a Double Taxation Treaty with the UK, nor do they withhold or charge tax of any kind on company profits.

7) The rate of Corporation Tax for FY 2022 is 19%.

Requirement:

Comment on the UK CFC implications of the above information. (20)

15. Teacups Group Ltd is a privately owned UK tax resident company. Teacups Group Ltd has two wholly owned UK tax resident subsidiaries: Teacups Ltd and Saucers Ltd. All three companies prepare accounts under FRS 102. The following information is relevant to deferred taxation.

Teacups Ltd is a long-standing, profitable company. The draft accounts show the following for tangible fixed assets as at 31 March 2021:

	Cost	Accumulated Depreciation	Net book value
	£	£	£
Plant and machinery	2,345,000	(909,000)	1,436,000

All of the plant and machinery qualifies for capital allowances. The draft tax computations for the year ended 31 March 2021 show the following:

	£
Tax written down value brought forward	768,000
Qualifying expenditure	140,000
Capital allowances claimed	Nil
Tax written down value carried forward	908,000

Teacups Ltd has £200,000 of directors' bonuses that are deferred for 12 months that have been disallowed in the tax computations. The company has client entertaining expenditure of £90,000 that has been disallowed in the tax computations.

Saucers Ltd was set up in 2020 and is currently loss making.

The draft accounts show the following for tangible fixed assets as at 31 March 2021:

	Cost	Accumulated Depreciation	Net book value
	£	£	£
Plant and machinery	70,000	(14,000)	56,000

All of the plant and machinery qualifies for capital allowances. The draft tax computations for the year ended 31 March 2021 show the following:

	£
Tax written down value brought forward	Nil
Qualifying expenditure	70,000
Capital allowances claimed	Nil
Tax written down value carried forward	70,000

The tax computations show that as at 31 March 2021, and after group relief surrenders, Saucers Ltd has unrelieved trading losses carried forward of £434,000.

Requirement:

1) **Explain the basis for calculating deferred tax under FRS 102.** (4)

2) **Set out the deferred tax balance sheet figures for Teacups Ltd and Saucers Ltd for inclusion in the group consolidated accounts for the year ended 31 March 2021, with supporting explanations.** (6)

Total (10)

ANSWERS

1. SWAN LTD

Disposal of Stone House

A chargeable gain arises, calculated as the difference between the disposal proceeds and acquisition cost, so £350,000 (£600,000 - £250,000).

Rollover relief may be available to defer the gain where certain conditions are met:

1) A person carrying on a trade,

2) Disposes of assets used only for the purposes of the trade throughout the period of ownership, and

3) The consideration resulting from the sale is used to acquire other assets, which on acquisition are taken into use and used only for the purposes of the trade.

4) The acquisition takes place within one year before and up to three years after the sale of the old asset, or such longer period as HMRC may allow.

5) The old assets and the new assets are within the classes of assets listed in the legislation (which includes buildings).

Goose Ltd is carrying on a trade so 1) is met.

Regarding 2), relief is available since the assets disposed of were used (albeit partly) for the trade during their period of ownership (again albeit partly). However, the amount of relief is restricted by reference to the non-trade use of the assets (see Appendix 1).

Regarding 3), the whole consideration from the sale is being applied to the acquisition of the new asset. However, Bear House is not going to be taken into use on acquisition and so on the face of it, the conditions for rollover relief are not met. However, HMRC will, by concession (ESC D24), allow relief in these circumstances where further conditions are met:

a) The owner proposes to incur capital expenditure for the purposes of enhancing its value;

b) Any work begins as soon as possible after acquisition and is completed in a reasonable time;

c) Whereupon the asset is taken into use for the purposes of the trade and for no other purpose; and

d) The asset is not let or used for any non-trading purpose in the period between acquisition and the time it is taken into use for the purposes of the trade.

If Goose Ltd lets out Bear House, rollover relief will not be available due to condition d) above, so Bear House should instead be used for the purposes of Goose Ltd's trade as soon as the refurbishment has concluded.

Goose Ltd intends to buy Bear House in March 2022, which is within three years of the sale of the old building, so condition 4) is met.

Freehold land and buildings are listed as qualifying assets within the legislation so condition 5) is met.

The rollover relief available is restricted for:

- The period, 44 months, for which the building was not in use for the trade; and
- The upper storey which was never in use in the trade.

Appendix 1 contains a calculation of the gain rolled over and chargeable gain. If the building is not let out, the rollover relief is £211,382 and the chargeable gain taxable now is £138,618.

Disposal of Wyvern House

Since Duck Ltd is a wholly owned subsidiary of Swan Ltd, they form a chargeable gains group for tax purposes. Group rollover relief may apply where one company sells a qualifying asset and a qualifying asset is acquired by another group company. The tax effect is that the company selling the asset may benefit from rollover relief just as if it acquired the replacement asset itself.

The gain on Wyvern House cannot be rolled over in relation to the acquisition of Bear House, as Goose Ltd is not a member of the Swan Ltd group, as the shareholding is not 75%.

Rollover relief is restricted to the extent that not all of the sale proceeds are reinvested. The group could look to reinvest the proceeds from Wyvern House into Sword House. However, on the basis that £40,000 (£600,000 minus £560,000) would not be reinvested, this amount would be chargeable to Corporation Tax at the time of disposal.

The lease on Sword House has 54 years left and so is a depreciating asset as it has a predictable life of less than sixty years. Thus the chargeable gain on disposal of Wyvern House would not be deducted from the cost of Sword House. Instead, that gain would be held over, ie deferred, and would become chargeable on occurrence of the first of the following events:

1) Ten years from the time of acquisition of Sword House;

2) Disposal of Sword House;

3) When Sword House ceases to be used in the trade of the Swan Ltd / Duck Ltd group.

Transfer of fly reel patents

Patents purchased after April 2002 are intangible fixed assets and chargeable intangible assets for the purposes of Corporation Tax. Swan Ltd and Pelican Ltd form a group for the purposes of the intangible assets legislation since one is a wholly owned subsidiary of the other. The transfer of the patents to Pelican Ltd would have been a tax neutral transfer and no Corporation Tax charge would have arisen on the transfer.

If Pelican Ltd is sold within six years of the date the patents were transferred, whilst it still holds the patents, a de-grouping charge will arise. This is because the sale of Pelican Ltd's shares will not qualify for substantial shareholding exemption (the company not being a trading company). The de-grouping charge will be based on the market value of the patents at the time of transfer. Pelican Ltd will be treated as though it had realised and reacquired the assets for their market value, immediately after the assets were transferred to it.

The de-grouping charge is calculated by comparing the tax written down value of the patents at the time of sale with their market value at the time of transfer (£150,000).

The tax written down value is equal to the net book value of the patents and is calculated as the purchase price (£100,000) less four amounts of annual amortisation.

The annual amortisation charge is 100,000 x 10% = 10,000.

So, 100,000 – (4 x 10,000) = £60,000

So, 150,000 – 60,000 = £90,000 is prima facie the amount of the de-grouping charge

However, an adjustment is also made for the additional amount written off each year following the substitution of market value for the original acquisition cost at the time of the intra-group transfer (ie for three years from 1 October 2019 until 30 September 2022).

So (£10,000 x (150,000/60,000) - £10,000) x 3 years = £45,000 additional amortisation is available. This is included in the computation when Pelican Ltd is sold.

So the total de-grouping charge (after the adjustment for the additional amount of amoritsation) = £90,000 - £45,000 = £45,000.

Pelican Ltd may jointly elect with Swan Ltd that Swan Ltd pays the tax on the de-grouping charge instead of Pelican Ltd.

<u>APPENDIX 1</u>
<u>Calculation of gain on sale of Stone House</u>

	£
Proceeds	600,000
Cost	(250,000)
Chargeable gain	350,000
Less rollover relief	(211,382)
Amount chargeable now	138,618

<u>Rollover relief calculation</u>

Period of trading use of old asset	108 months	
Period of total ownership of old asset	152 months	
Restriction for non-use of top storey	15%	
Rollover relief =	211,382	(350,000 x 108/152 x 85%)

<u>Tutorial Note:</u>

Although not in the model answer, credit would also be given for discussion of the tax consequences of the sale of the shares in Duck Ltd, including consideration of whether SSE is available.

CIOT MARKING GUIDE

TOPIC	***MARKS***
Presentation and higher skills	*1*
<u>Stone House</u>:	
Conditions for roll-over relief	*2*
Which conditions are met by Goose Ltd	*2*
Discuss tax issues arising if building is not used on acquisition and ESC D24	*2*
Calculation of roll-over relief and explanation of restriction for assets partially used in the trade	*2*
<u>Wyvern House/Sword House</u>:	
Roll-over relief is available on disposals and acquisitions by different members of a gains group	*1*
Roll-over relief is reduced if proceeds are partially reinvested, amount of gain chargeable to tax now	*2*
Deferral of gains for depreciating assets	*2*
When deferral comes back into charge	*1*
<u>Transfer of patents:</u>	
Transfer of patents from Swan Ltd to Pelican Ltd is tax neutral	*1*
Degrouping charge that may arise on possible sale of Pelican Ltd and calculation	*3*
Election that allows charge to be transferred elsewhere in the group	*1*
TOTAL	***20***

Examiner's report:
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This question was about corporation tax on chargeable gains and rollover relief. Overall the question was well answered. Candidates were generally able to determine which companies were within a gains group and showed awareness that rollover relief was group-wide and gains could be rolled over into purchases by a company other than that which made the disposal.

Candidates showed a good knowledge of the conditions for rollover relief. They did not always, however, state whether or not the conditions were met.

Candidates showed a good awareness of the different type of rollover relief available for depreciating as opposed to non-depreciating assets. Most candidates commented in some detail on the availability of substantial shareholdings exemption for the disposal of Duck Ltd and credit was given for this.

Many candidates showed an awareness of the degrouping charge and its applicability in the context of an intra-group transfer of intellectual property. Candidates were aware that the charge was computed using market value at the time of transfer but were less comfortable about calculating the degrouping charge and in particular were uncertain about how to factor in to the calculation the increased amortisation of the IP. However, the impact on the overall marks that candidates scored was small.

2. WHITE LTD

White Ltd: Simplification of Group Structure

1) Pre-liquidation structuring

Steps will be taken to clean up the balance sheet of companies to be liquidated prior to commencement of the liquidation.

Blue Ltd's current balance sheet shows net liabilities of £400,000. To make the company solvent it should consider writing off intra-group balances prior to commencement of the liquidation.

The treatment of these balance waivers will differ for tax purposes dependent upon whether they fall under the loan relationship rules.

1.1) Loan relationship

Specific rules apply to the taxation of loan relationships. A loan relationship is any 'money debt', owed by a company, arising from a 'transaction for the lending of money'. A loan relationship will include any debt represented by a security, such as a bond. It is however important to recognise that there is a distinction between a debt and a loan relationship. It is important that intra-group loans are documented as accurately and contemporaneously as possible.

If the loan from White Ltd to Blue Ltd meets these criteria and constitutes a loan relationship it will be necessary to consider the connected party provisions. A company is connected with another for an accounting period if at any time in that period, one of the companies is under the control of the other, or both are under control of the same person.

Where the debtor company is connected with the creditor company and it is released from its obligation to pay all or part of an amount due under the terms of the loan relationship, the credit in the debtor company does not give rise to a taxable profit.

In consequence, since the loan in Blue Ltd is from its parent White Ltd it will fall within the connected party rules and its waiver will not give rise to a taxable credit.

1.2) Other intra-group balances

Certain money debts which do not arise from a loan relationship (such as trade debts) are nevertheless treated as payable under a loan relationship. This treatment applies to a money debt which falls into one of a number of categories specified as relevant non-lending relationships.

In the current scenario, the relevant category is a debt in respect of which a company has been entitled to relief for the underlying expense represented by the debt in calculating the profits of a trade.

Where a company has a relevant non-lending relationship, the loan relationship provisions apply as they would have to a loan relationship (see above).

The other creditor balance between Blue Ltd and White Ltd will meet these criteria if it has arisen from underlying trading transactions. As such there would be a connected party loan relationship and any waiver of the balance will not give rise to a taxable credit (as above).

1.3) Capital reduction

In the case of Green Ltd the route adopted is a capital reduction followed by a dividend. The capital reduction in Green Ltd will be treated as a reorganisation of share capital so that there will be no disposal/acquisition by White Ltd of Green Ltd's shares for UK corporate tax purposes.

1.4) Dividend

Where a dividend is paid from reserves which were created by a capital reduction, statutory provisions treat this as an income distribution for corporate tax purposes.

The basic rule is that dividends and other distributions received by a UK company are subject to Corporation Tax unless they fall within certain statutory exemptions.

CTA 2009 s.931E provides an exemption for dividends from controlled companies.

This exemption will apply to exempt dividends from both Green Ltd and Blue Ltd to White Ltd.

2) Liquidation

A number of important corporate tax consequences arise out of the appointment of the liquidator.

2.1) Consequences of the appointment of the liquidator

The appointment of a liquidator causes an accounting period to end and a new one to begin. Thereafter the accounting period will run to the earlier of 12 months or the conclusion of the winding up.

2.2) Liquidation distribution

Distributions made during liquidation are capital, not income, in nature. The shareholders are treated as having disposed of their shares in the company for an amount equal to the distribution.

As with income dividends (above), whilst a capital distribution may in theory give rise to a taxable capital gain or loss, corporate shareholders may find the gain / (loss) exempt for corporate tax purposes (see SSE below).

2.3) Capital gains treatment and exemption

As noted above a liquidation distribution will be treated as capital for tax purposes potentially giving rise to a capital gain or loss on the shares.

The Substantial Shareholding Exemption ("SSE") may apply to exempt any gain or loss on liquidation of the company.

In broad terms, for SSE to be available a main requirement is that the company invested in is a trading company.

Where the company being liquidated has ceased trading, this would on the face of it appear to preclude SSE. The so-called second subsidiary exemption does however operate to potentially extend the applicability of SSE in these situations. If the shares would have qualified for SSE if they had been disposed of within the last 2 years, they will qualify for SSE notwithstanding the fact that the investee company is no longer trading provided also in that 2-year period it was controlled by the company making the disposal.

In the case of Green Ltd, it ceased trading within the last year. If the liquidation is commenced and concluded within about a year, SSE may be available (dependent upon other conditions being satisfied).

In the case of Blue Ltd, it has been dormant for some time and SSE will therefore not be in point.

3) <u>Clearances</u>

Given the complexities involved, the group may choose to seek advance clearances from HMRC for matters such as SSE and anti-avoidance provisions such as Transactions in Securities.

CIOT MARKING GUIDE

TOPIC	***MARKS***
Presentation and higher skills	*1*
<u>Pre-liquidation structuring:</u>	
Waiver of loan relationship – connected party rules:	
Meaning of loan relationship including definition	*2*
Connected party rules:	
– connected parties	*1*
– consequence	*1*
Other balances: relevant non-lending relationships:	
– relevant non-lending relationships	*1*
– consequence	*1*
Reduction in share capital reorganisation/distribution	*1*
Intra-group dividend	*1*
<u>Liquidation:</u>	
Consequences of appointment of liquidator:	
Accounting period	*1*
Distributions on liquidation – distribution rules	*1½*
Substantial Shareholding Exemption	*1½*
SSE – Subsidiary exemption	*1*
Transaction in securities and other possible HMRC clearances	*1*
TOTAL	***15***

Examiner's report:
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This question addressed some core topics but in an unusual manner. Whilst this didn’t present an issue for many well-prepared candidates, others seemed to struggle.

The question tested the knowledge of connected party loan relationships, and most candidates were aware of the correct tax treatment. The treatment of the “other intra-group balances” was poorly answered with only a small proportion of candidates addressing the relevant non-lending relationship rules.

It also tested the knowledge of candidates on the difference between the treatment of income distributions pre-liquidation and capital distributions by the liquidator. This was poorly identified in many cases.

The question clearly asked candidates to address the Corporation Tax consequences of the liquidation of the dormant subsidiaries yet some candidates explained that dissolution was a cheaper option for professional fees and concentrated on the tax consequences of that route. Candidates must always read the question carefully and limit the answer to what has been requested.

3. ORGANIC FRUIT PLC

Corporation tax consequences of the sale of the shares in Sweet Fruit Ltd by Organic Fruit plc to Cool Bananas plc

Substantial shareholdings exemption ("SSE")

SSE automatically exempts gains on the sale of shares where two conditions are both met. These are, broadly:

- the investing company must have held at least 10% of the ordinary share capital of the investee company for a continuous period of at least 12 months in the six years preceding the disposal of its shares; and

- the investee company must be a trading company or holding company of a trading group throughout the last possible period during which the above 10% test was satisfied.

Here, although Organic Fruit plc will have held all the shares in Sweet Fruit Ltd for more than a year before July 2021, SSE will not be available as Sweet Fruit Ltd will not have traded for one year as at July 2021 when its shares are sold. Sweet Fruit Ltd became a trading company within the SSE definition when it started preparing to trade in September 2020. If commercially practicable, Organic Fruit plc could seek to defer the sale of Sweet Fruit Ltd to October 2021 in order for the shares in Sweet Fruit Ltd to qualify for SSE.

Gain on disposal of Sweet Fruit Ltd

Assuming sale proceeds of £10 million, a chargeable gain will arise:

	£	£
Proceeds on disposal		10,000,000
Less:		
Cost of shares	(500,000)	
Legal costs on investment	(5,000)	
		(505,000)
Gain on disposal of shares		9,495,000

Note that as Sweet Fruit Ltd was incorporated after December 2017, there will be no indexation allowance.

The Warehouse

All the subsidiaries of Organic Fruit plc are wholly-owned and therefore all the companies form a capital gains group. Therefore, the transfer of the warehouse from Sour Fruit Ltd to Sweet Fruit Ltd would have been at nil gain/nil loss for tax purposes.

On the sale to Cool Bananas plc, Sweet Fruit Ltd will leave the capital gains group whilst holding an asset it received under a nil gain/nil loss transfer in the last 6 years and therefore a de-grouping charge will arise. This is calculated as if Sweet Fruit Ltd had disposed of and reacquired the asset at market value immediately after the time it acquired the asset from Sour Fruit Ltd, with the cost of the asset being the cost to Sour Fruit Ltd plus indexation up to December 2017, as follows:

	£	£
Deemed proceeds on disposal		5,000,000
Less:		
Cost to Sour Fruit Limited	(2,000,000)	
Indexation to Sour Fruit Limited		
Dec 2014 – Dec 2017		
[(278.1-257.5)/257.5] = 0.080 x 2,000,000	(160,000)	
		(2,160,000)
De-grouping charge–capital gain on sale of Sweet Fruit Ltd		2,840,000

The de-grouping gain arising from the deemed disposal will be added to the consideration received by Organic Fruit plc for the shares in Sweet Fruit Ltd for the purposes of computing Organic Fruit plc's gain on sale of the shares.

However, at the time that Sweet Fruit Ltd purchased the warehouse, it acquired an asset worth £5 million for £2 million and therefore the value of Sweet Fruit Ltd rose by £3 million. This £3 million would effectively be subject to double taxation as part of the de-grouping charge and as part of the gain arising on the sale of the shares. As such, a claim can be made to reduce the de-grouping charge by a just and reasonable amount because all or some of the de-grouping charge has been reflected in the proceeds from disposal of the shares. As the £3 million subject to double taxation is greater than the de-grouping charge, a claim should be made to eliminate the de-grouping charge.

The claim should be made in the Corporation Tax computation for Organic Fruit plc for the accounting period in which the sale of Sweet Fruit Ltd shares occurred. This must be made within two years of the end of the accounting period, that is, by 30 September 2023 if the sale is made in July 2021.

If the sale of Sweet Fruit Ltd is delayed until October 2021 and qualifies for SSE, the de-grouping gain will also be exempt from tax.

Group relief

Prior to its sale to Cool Bananas plc, Sweet Fruit Ltd is part of the group relief group of Organic Fruit plc, since it is wholly owned and therefore within the 75% group.

Organic Fruit plc and its subsidiaries can utilise the trading losses of Sweet Fruit Ltd until the point where Sweet Fruit Ltd is no longer in the group relief group. This is when arrangements come into force for the sale of the shares in Sweet Fruit Ltd such as where an offer is accepted subject to contract or when shareholders' approval is obtained (if required).

Group relief is available for the period from 1 October 2020 (the day Sweet Fruit Ltd starting trading) to the day when the arrangements come into force for the sale of the shares. Both the profits and the losses of Organic Fruit plc/its subsidiaries and Sweet Fruit Ltd respectively will need to be apportioned based on the overlapping period. The maximum amount available for group relief would be the lower of the combined profits of Organic Fruit plc/its subsidiaries or the losses of Sweet Fruit Ltd for the overlapping period.

CIOT MARKING GUIDE

TOPIC	***MARKS***
Presentation and higher skills	*1*
Calculation of gain which would arise on sale of shares:	
Proceeds	*1*
Deduction of cost and fees	*1*
Indexation	*1*
Substantial shareholding exemption automatically exempts gain if conditions met	*1*
Summary of two tests that must be met	*1*
Investee company conditions not met	*1*
Consider delaying sale to October 2020	*½*
De-grouping:	
– Companies in a capital gains group	*1*
– Company leaving group in 6 years holding asset and therefore de-grouping charge arises	*1*
– Calculation of de-grouping charge	*1*
– De-grouping charge is added to the proceeds of sale of the shares	*1*
– Relief under s179ZA available	*1*
– Calculation of "just and reasonable" relief	*1*
– Gain exempt if SSE applies	*1*
Group relief:	
– In a group relief group	*1*
– Relief available until arrangements in place	*1*
– Time apportionment required	*½*
TOTAL (MAX)	***15***

Examiner's report:
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This question tested chargeable gains computation rules for a group of companies with some consideration of group relief. In general, candidates performed strongly on this question. The majority of candidates correctly identified that SSE would not apply to the sale of the shares and calculated the gain on the sale of the shares.

Almost all candidates identified that a de-grouping charge would arise and noted correctly that this would be added to the sale price of the shares. Only a handful of candidates recognised that a relief under s179ZA would be available if a claim was made to reduce the de-grouping charge. Instead a number of candidates suggested moving the de-grouping charge into another group company with very few of these candidates explaining in what circumstances this might be beneficial.

Only a small number of candidates discussed the fact the companies were also in a group relief group and that the sale would impact the use of these losses.

4. MARYLEBONE PLC

1) CORPORATION TAX IMPLICATIONS OF POSSIBLE CHANGES TO REMUNERATION PACKAGES

Payment of bonuses

Tax relief is available for remuneration paid to employees. The timing of the tax relief follows the accounts unless the remuneration remains unpaid 9 months after the period end.

As the bonuses are to be paid on 1 September, tax relief will be available in the year ending 31 March 2022 for the bonus payable on 1 September 2022 provided it was accrued in the accounts for the year ended 31 March 2022.

Additional pension contributions

Tax relief is available for pension contributions. The relief is available in the accounting period when the cash payment is made, rather than when the expense is accrued in the accounts.

In certain cases there is a further restriction on the deduction of pension contributions, resulting in the spreading of the contributions over a number of years. This occurs when there is a significant increase (over 210%) in the level of the contribution paid from one accounting period to the next. It is not clear from the information available whether this will be the case, but given that an additional contribution is being considered for 20 key employees, this legislation could apply.

Any excess contribution must be calculated and will be spread over a period of up to 4 years depending on the amount. There is no spreading if the excess contribution is less than £500,000.

Share schemes

No tax relief is available for the £150,000 accounting expense charged in connection with share option schemes. As a result the accounting expense calculated must be added back to the accounting result when calculating the taxable profits.

However, provided certain conditions are met, a statutory deduction is available for the difference between the market value of the shares and the consideration given by the employee on the exercise of an approved or unapproved share option. For Marylebone, this will be in the year ending 31 March 2026 as this is when the options are likely to be exercised.

The conditions for the statutory deduction to be available are:

- the shares must be part of the company's ordinary share capital,
- they must be fully paid up, non-redeemable shares, and
- they must be
  - shares of a class listed on a recognised stock exchange,
  - shares in a subsidiary of a listed company,
  - shares in a company which is not controlled by another company, or
  - shares that are within any of these 3 categories at the date the option was granted, where
    - the company was taken over on or after 17 July 2014,
    - the takeover is prior to exercise of the options,
    - as a direct result of the takeover the shares are no longer within any of these 3 categories, and
    - the options are exercised within 90 days of the takeover.

Any statutory deduction will be calculated as the number of options exercised, multiplied by the difference between the market value of the shares at the date of exercise and the consideration paid by the employees (ie the exercise price of £2).

No tax relief is available for the costs associated with setting up a share scheme as such costs are considered to be capital unless the scheme meets certain criteria allowing a statutory deduction.

2) DEFERRED TAX

IFRS requires a comparison of the tax base of an item and the carrying amount in accordance with IAS 12 to identify the 'temporary difference'.

Bonuses - There is no temporary difference associated with the bonuses as the tax relief will be obtained in the period in which the bonus is accrued in the accounts.

Pension contributions - A deferred tax asset will arise in connection with pension contributions to the extent that the tax relief is given in a later period than the accounting expense. This will be the case if the expense is accrued in the accounts or if an element of the contribution is spread for tax purposes.

Share options - No asset or liability is carried on the accounting balance sheet in respect of share options prior to exercise, hence the accounting base is nil.

The tax base is the future tax deduction. The tax deduction available is the difference between the market value of the shares and the exercise price at the date of exercise. This is available on exercise of the options, ie 31 March 2026, so the tax rate when the tax relief will be claimed should be based on this date.

IAS 12 requires that if the amount of the deduction is not known at the balance sheet date (which is the case as it relates to the future market value) it should be estimated based on information available at the end of the period. Hence the market value at balance sheet date should be used.

If the estimated tax deduction exceeds the amount of the related remuneration expense, this indicates that the tax deduction relates not only to remuneration expense but also to an equity item. The excess of deferred tax should unwind in the year ending 31 March 2026 as this is when the options are exercised

Year ended 31 March 2023

Expected future tax deduction on the basis of share price of £7:
50,000 x (£7-£2) x 1/3 = £83,333

(number of options x intrinsic value x proportion of vesting period passed)

Deferred tax asset:

£83,333 x 19% tax rate = £15,833

£15,833 is recognised as a credit in the income statement as this is less than the expense at the corporation tax rate (£150,000 x 19% = £28,500).

MARKING GUIDE

TOPIC	***MARKS***
Presentation and higher skills	*1*
Bonus deductible	*½*
Timing of relief	*½*
Pension contribution – paid basis	*1*
Possibility of spreading	*1*
Details on timing/quantum	*1*
Share options - Disallow accounting expense	*½*
Basis of calculation of statutory deduction	*1*
Relief March 2026	*½*
Conditions for statutory deduction	*1½*
Treatment of costs associated with scheme	*½*
Deferred tax	
Arises from temporary difference	*½*
Bonus – no deferred tax	*½*
Pension – potential asset if tax relief delayed	*½*
Relevant for accrual or spreading	*½*
Share options – carrying value	*½*
Tax base = future tax deduction	*½*
Market value compared with exercise price	*½*
Relate applicable rate to timing of relief	*½*
Balance sheet valuation for share price	*½*
Explain possibility of recognising amounts in equity	*½*
2023 calculation - future deduction	*½*
Associated asset	*½*
TOTAL	***15***

Examiner's report:
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Most candidates produced reasonable responses to the first part of this question which was to consider the tax implications of alternative forms of remuneration, although easy marks were lost by those who failed to explain the conditions for corporation tax relief in respect of share options. The second part of the question, which considered the deferred tax implications, was not answered so well. Whist the position relating to share options was relatively complex meaning that few candidates provided a comprehensive answer, it was disappointing that marks were lost by those candidates who failed to provide an appropriate explanation of deferred tax and to identify the potential for a deferred tax asset arising from the spreading of pension contributions.

5. JUPITER PLC

Corporation Tax implications of proposed transaction

a) Venus LLC treated as a body corporate with issued share capital:

It is possible that the transfer of the shares by Jupiter plc of Venus LLC in exchange for the issue of ordinary shares by Mercury BV will be exempt from tax by virtue of the Substantial Shareholdings Exemption ("SSE"). SSE applies automatically where the following conditions are satisfied:

1) The shares being disposed of qualify as "ordinary share capital" – this condition should be satisfied;

2) At least 10% of the shares in the investee company (Venus LLC) have been owned continuously for a period of 12 months out of the previous 6 years – this condition should be satisfied; and

3) The investee company (Venus LLC) qualifies as a trading company or a holding company of a trading group or subgroup throughout the latest 12 month period in which the 10% shareholding test is met and, where the sale is to a connected company (in this case, Mercury BV), immediately after the disposal.

Venus LLC will have traded in the 12-month period up to the proposed date of disposal and is expected to be trading immediately thereafter. However, it also holds a number of investments. A trading company is defined as a company carrying on trading activity whose activities do not include to a substantial extent non-trading activities.

HMRC has published guidance on the interpretation of "substantial" stating that in excess of 80% of the revenue, asset base and employees of the company should relate to trading activity. It is unclear whether this requirement is met in view of the investment activities of Venus LLC.

In summary, there is insufficient information to conclude on whether SSE will apply to the disposal and this should be further reviewed. If SSE does not apply to the disposal, it may still qualify as a tax-free reorganisation provided that it meets the following conditions.

1) The new shares issued by Mercury BV are in proportion to the shares previously issued by Venus LLC;

2) Mercury BV will hold in excess of 25% of the shares of Venus LLC; and

3) The transaction must be effected for bona fide commercial reasons and not form part of a scheme or arrangements of which the main purpose, or one of the main purposes, is avoidance of liability to Corporation Tax.

In the event that all conditions are satisfied, Jupiter plc will not be regarded as making a disposal of the shares in Venus LLC and acquiring a new shareholding in Mercury BV. Instead, the application of "share for share" relief means that the original shares in Venus LLC and the new shareholding in Mercury BV are treated as the same asset for Jupiter plc as acquired when the original shares in Venus LLC were acquired. As a consequence, any chargeable gain inherent in the shares of Venus LLC is effectively rolled into the new shareholding in Mercury BV.

It seems likely that these provisions would apply and therefore the transfer of the shares in Venus LLC by Jupiter plc to Mercury BV should not be treated as a chargeable disposal, rather the transaction should instead qualify as a tax free reorganisation on the basis that the corporate reorganisation is required in order to enable Mercury BV to raise external finance.

b) Venus LLC treated as a body corporate without issued share capital:

In this scenario, the disposal will not qualify for SSE (as Venus LLC does not have a share capital). However, the tax free reorganisation rules (as discussed above) apply even though Venus LLC does not have share capital. The interest which Jupiter plc has in Venus LLC is treated in the same way as if Jupiter plc owned shares in Venus LLC.

c) Venus LLC treated as an overseas branch of Jupiter plc

The sale of assets by Jupiter plc is a taxable transaction and it will be necessary to distinguish between different classes of asset, ordinarily being those falling in the chargeable gains rules, loan relationships and derivative contracts, intangible assets and assets qualifying for capital allowances.

Taxable gains and losses will broadly arise based on the difference between the market value of the assets at disposal and Jupiter plc's base cost for tax purposes in the assets. It should be possible, however, to claim holdover relief as the US branch is transferred to a non-UK company provided:

- The consideration for the transfer is wholly securities; and
- Jupiter plc owns more than 25% of the ordinary shares of Mercury BV.

This relief represents a deferral of any chargeable gains with gains crystallising on a subsequent disposal of shares in Mercury BV or any disposal of interests in the LLC by Mercury BV in the next six years.

Other considerations

In scenarios (a) and (b) there is a risk of a tax charge arising on the transaction subject to further analysis. In view of this, it may be preferable for Earth XL Ltd to acquire the interest in Venus LLC so that the no gain/no loss provisions can apply to prevent a chargeable gain arising. Similar provisions would also apply to prevent any clawback of capital allowances or relief in respect of intangible assets.

CIOT MARKING GUIDE

TOPIC	***MARKS***
Presentation and higher skills	*1*
<u>Transfer of Venus LLC to Mercury BV:</u>	
Body corporate with issued share capital:	
– Note that any chargeable gain or loss will be exempt if the Substantial Shareholdings Exemptions applies to the disposal	*½*
– Automatic if conditions satisfied	*½*
– Outline the conditions to be met in order for SSE to apply	*2½*
– Note that necessary to review the trading status of Venus LLC to determine whether Jupiter plitc meets the "investee" company requirement	*1*
– State additional condition for investee company where disposal is to a connected company	*½*
– Conclude that there is a risk SSE may not apply and further analysis to be undertaken	*½*
– Note that s.135 TCGA 1992 may apply to share for share exchange and state relevant conditions	*2½*
– Comment that relief likely applicable in view of rationale for transaction	*1*
Body corporate without issued share capital:	
– State that SSE cannot apply to transaction as no issued ordinary share capital	*1*
– Explain that s.135 TCGA 1995 may apply to a company without a share capital	*1*
<u>Overseas branch of Jupiter plc:</u>	
Note that taxable transaction and outline how any gains or loss to be computed	*2*
Note that s.140 TCGA 1992 may apply and relevant conditions	*1*
State conditions under which held over gain crystallize after claiming relief under s.140 TCGA 1992	*2*
<u>Other considerations:</u>	
Note that a transfer to Earth XL Ltd could be preferable in view of relief under s.171 TCGA 1992, s.941 CTA 2010 and s.775 CTA 2009	*2*
Presentation and higher skills	*2*
TOTAL (MAX)	***20***

Examiner's report:
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This question was about a proposed financing transaction but included consideration of the tax status of a LLC, which could have caused some candidates to panic although most of the marks available were for a plain vanilla company/permanent establishment.

Generally, candidates did reasonably well on the share-for-share aspects, the SSE and s135, but sometimes conclusions were lacking.

However, other aspects were not well dealt with. Many candidates discussed no gain no loss intra-group transfers while missing the subtlety of non-UK resident companies. There was too much discussion of CFCs, PEs and general rules for relieving losses, none of which were called for in the question.

6. CRAWL LTD

Corporation Tax consequences of the proposed cessation of trade and liquidation of Crawl Ltd

Cessation of trade

Cessation of trade causes an accounting period to end on the last day of trading, and a new period to commence the following day. An exception to this is that if Crawl Ltd is already in liquidation when it ceases to trade, the cessation of trade will not cause an accounting period to end.

All plant and machinery and inventory owned by Crawl Ltd is deemed to be sold at market value on the last day of trading, regardless of the actual date of transfer. The deemed disposal of plant and machinery will result in capital allowance balancing adjustments.

Post-cessation expenses are allowable if they would have been deductible as a trading expense had Crawl Ltd continued to trade. However, such expenses cannot be group relieved and can only be offset against post-cessation receipts, which are rare. It may therefore be difficult to obtain relief for these expenses. Expenses relating to the cessation are disallowed, except for statutory redundancy payments plus any non-statutory redundancy payments (which are not otherwise deductible) up to three times the gross statutory redundancy payment.

Liquidation

The appointment of a liquidator will cause an accounting period to end on the day before the appointment, and a new period to commence on the day of appointment. As the liquidation is only expected to last nine months, this new period would therefore be the final accounting period of the company.

The liquidator will become responsible for fulfilling Crawl Ltd’s Corporation Tax obligations, such as the filing of returns and payment of tax.

The appointment of the liquidator will cause Crawl Ltd to lose beneficial ownership of its assets. One effect of this is to break the group relief group between Crawl Ltd and Butterfly Ltd. This would mean the losses generated by Butterfly Ltd would not be able to be surrendered to other Paddle group companies. Once the shares have been transferred to Splashing Ltd, however, group relief can operate again as before.

The liquidator’s fees will be allowable, either as a trading expense or a post-cessation expense, but any other costs associated with winding up the company are unlikely to be tax-deductible.

Other points arising from the plan

The disposal of the land and buildings will crystallise a chargeable gain of £10 million less indexation allowance. This gain can be offset by current period trading losses but not by post-cessation expenses.

The transfer of the shareholding to Splashing Ltd will be done on a “nil gain nil loss” basis as the two companies are in the same capital gains group, even during liquidation.

Any expense arising from the write-off of trade receivables will be allowable as a trading expense or a post-cessation expense, as appropriate.

There should be no Corporation Tax consequences on Crawl Ltd of settling trade payables or paying up a distribution.

Recommendations

If it is legal and practicable, Crawl Ltd should continue to trade until after liquidation has commenced. This would prevent the subsequent cessation of trade from ending an accounting period. The main benefits of this are that the trading losses arising in the post-liquidation period can be used to reduce or eliminate the chargeable gain on sale of land and buildings, and any excess trading losses in the post-liquidation period can be group relieved to the Paddle group.

If for whatever reason it is not possible for Crawl Ltd to continue trading until after liquidation has commenced, it is recommended that provisions are made (in accordance with relevant accounting standards) for any expenses that are expected to arise during liquidation, eg the liquidator’s fees and any trade receivable impairments. This will reduce the amount of post-cessation expenses arising.

It is also recommended that the transfer of the shares in Butterfly Ltd is done as soon as possible after liquidation has commenced to reduce the group relief restriction caused by the liquidation. Alternatively, the shares could be transferred before the appointment of the liquidator to avoid the restriction completely.

CIOT MARKING GUIDE

TOPIC	***MARKS***
Presentation and higher skills	*½*
<u>Cessation of trade</u>	
– Cessation causes an accounting period to end	*½*
– Rule doesn't apply if company is already in liquidation	*½*
– Plant and machinery and inventory deemed to be sold at market value on last day of trading, CA balancing adjustments arise	*1½*
– Relevant comments relating to post-cessation expenses and receipts	*1½*
<u>Liquidation</u>	
– Appointment causes accounting period to end, and final accounting period will end at end of liquidation	*1*
– Crawl Ltd loses beneficial ownership of assets	*½*
– Group relief group broken – Butterfly Ltd losses cannot be surrendered	*1*
– Liquidator's fees allowable, but costs associated with winding up not allowable	*1*
<u>Other step plan points</u>	
– Disposal of land and buildings crystallises £10m chargeable gain, offset by trading losses but not post-cessation expenses	*1*
– Capital gains group not broken, so transfer of shareholding done at "nil gain nil loss"	*1*
– Treatment of bad debt expenses	*½*
– No Corporation Tax consequences on Crawl of other steps	*½*
<u>Recommendations</u>	
– Continue to trade until after liquidator appointed, with explanation of benefits	*1½*
– If can't continue to trade, ensure provisions are made for potential post-cessation expenses, with explanation of benefit	*1*
– Transfer Butterfly Ltd shares as soon as possible to reduce/avoid group relief restriction	*1*
Presentation and higher skills	*1*
TOTAL (MAX)	***15***

Examiner's report:
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This question, which tested candidates' knowledge of the impact of a company ceasing to trade and going into liquidation, was answered poorly. Almost all failed to keep their comments relevant and in line with the requirement of the question. Most explained the tax consequences on Paddle plc (e.g. applicability of SSE to the liquidation and the tax treatment of distributions received from Crawl Ltd) despite the question asking for the tax consequences on Crawl Ltd.

Most correctly stated some of the rules for accounting periods on cessation/liquidation, but then struggled to name any other consequences. Many wrongly stated that plant and machinery could be transferred at tax written down value under the 'transfer of trade' provisions, even though the question stated the transfer would take place after cessation of trade.

Hardly anyone appreciated that the group relief grouping broken on liquidation was between Crawl Ltd and Butterfly Ltd, not between Paddle plc and Crawl Ltd, and hence that it was Butterfly Ltd's losses that could not be group relieved for the period between liquidation and transfer to Splashing Ltd.

7. GEOMETRY PLC

Geometry plc – Migration to Republic of Ireland and sale of Diamond Ltd

Exit charge upon migration of Diamond Ltd

When Diamond Ltd migrated from the UK to the Republic of Ireland, thus ceasing to be UK tax resident, it was deemed to dispose of, and immediately reacquire, certain of its chargeable assets and intangible fixed assets at their market value at that time.

At the time a migration occurs, there are no deemed disposals of UK assets if they are used at any time thereafter in a trade carried on in the UK through a permanent establishment ('PE'). Therefore, there was therefore no deemed disposal by Diamond Ltd of the factory located in the UK but this may later be subject to a tax charge at the earlier of the PE's trade ceasing or the disposal of the asset.

None of the IT equipment was a chargeable asset so only the following were immediately subject to an exit charge:

Asset	Taxable gain/(loss)
	£
Investment property located in the UK	125,000
Trademark registered in the Republic of Ireland	750,000

As the migration occurred before 1 January 2020, the exit charge of £750,000 in respect of the trademark could be postponed because Diamond Ltd is a 75% subsidiary of a UK company, but only if a joint election is made by Diamond Ltd and Geometry plc within two years of migration, so by 31 August 2021.

The postponed gain will be brought into charge in Geometry plc if:

1) Within six years of migration, Diamond Ltd disposes of the asset; or

2) Diamond Ltd ceases to be a 75% subsidiary of Geometry plc; or

3) Geometry plc ceases to be UK tax resident.

Sale of UK investment property - 1 February 2021

The chargeable gain of £125,000 arising as an exit charge would have been payable by Diamond Ltd upon migrating from the UK. This exit charge would not have been eligible for postponement as it arises in respect of a UK asset that was not used within the trade of the UK PE. As a consequence of this, any gain arising after this date would not be taxable in the UK.

Sale of IT equipment transferred to Ireland - 1 February 2021

No UK tax would arise as a result of this sale because none of the IT equipment is a chargeable asset.

Sale of Diamond Ltd

When Diamond Ltd ceases to be a 75% subsidiary of Geometry plc, the postponed gain of £750,000 will be brought into charge in Geometry plc. This may be reduced by any allowable losses that Diamond Ltd has accrued up to the date of migration provided that they have not been taken into account in computing the postponed gain, and provided the joint election is made within two years of the disposal of the shares. If Diamond Ltd makes allowable losses after the date of migration, for example, on assets of its UK PE, an election may include these losses (provided they are unused).

As none of the IT equipment is a chargeable asset, the losses arising on disposal of the IT equipment will not be allowable losses for these purposes.

<u>Substantial shareholdings exemption ('SSE')</u>

Any gain on the disposal of Diamond Ltd's shares by Geometry plc would be a chargeable gain unless the SSE applies.

The SSE should apply because:

1) Diamond Ltd is a trading company; and

2) Geometry plc owns 100% of Diamond Ltd and has done so for more than 12 months in the past six years.

<u>Property transfer from Square Ltd to Circle Ltd</u>

Chargeable gain

No chargeable gain should have arisen on the transfer of property on 15 July 2019 from Square Ltd to Circle Ltd because both were within a capital gains group headed up by Geometry plc and so the transfer took place at nil gain/nil loss.

Upon the sale of Diamond Ltd, Circle Ltd will leave that capital gains group. If the sale takes place in October 2021, this will be within 6 years of the original transfer, triggering a de-grouping charge, which deems that a disposal at market value was made by Circle Ltd on 15 July 2019. This charge is added to the proceeds arising on the sale of shares of Diamond Ltd but will be covered by SSE.

SDLT

Geometry plc, Square Ltd and Circle Ltd form a SDLT group, so group relief should have been claimed on the transfer of the property from Square Ltd to Circle Ltd, resulting in no SDLT payable at the time of the transfer.

If Circle Ltd leaves the SDLT group within 3 years of the transfer of the property, which it will do if the sale of Diamond Ltd takes place in October 2021, the exemption from SDLT will no longer apply, meaning SDLT will be payable on the market value of the property at the time of the intra-group transfer. The SDLT is payable by Circle Ltd and a SDLT return will need to be made by Circle Ltd within 30 days of it leaving the Geometry plc group.

<u>Limitations on seller's liability</u>

Limitations to and exclusions from warranties and indemnities or covenants should be included in the sale agreement, which should include time limits for claims.

If Geometry plc prepares a 'disclosure letter' pre-completion that identifies information disclosed to the purchaser and reveals all pertinent matters, this may prevent the purchaser making certain claims under the tax warranties. Geometry plc could also negotiate specific exclusions from liability under a tax indemnity or covenant in respect of such matters, as disclosure against the indemnity or covenant is not usually permitted. Any known and expected tax liabilities should be dealt with through an appropriate adjustment to the purchase price for the shares.

MARKING GUIDE

TOPIC	***MARKS***
Presentation and higher skills	*1*
<u>Exit charge:</u>	
Explanation	*1*
PE carve out	*1*
But later charge	*1*
No charge on IT equipment	*1*
Actual exit charge	*1*
Postponement possible	*1*
Joint election	*1*
Triggers	*1*
Sale of investment property	*1½*
Sale of IT equipment	*½*
Proposed sale of Diamond Ltd triggers gain	*1½*
Disposal of shares – SSE	*1½*
CGT analysis of transfer of property	*2*
SDLT analysis of transfer of property	*2*
Geometry protection for secondary tax liabilities	*2*
TOTAL	***20***

8. CALKE LTD

Corporation Tax penalties

A number of penalties can apply under the UK Corporation Tax self-assessment regime (CTSA). Penalties can apply where a tax return, or claim for relief, contains an inaccuracy which leads to an understatement of tax; or a false or inflated statement of a loss; or a false or inflated claim to a tax repayment. If a return contains more than one error a penalty is charged for each. Penalties can also be charged where there is a failure to notify chargeability to HMRC.

Based on the available information, the group may have several penalties to pay in respect of errors and failures.

Melton Ltd – Failure to notify chargeability to HMRC

The penalty is calculated by applying a percentage to the amount of tax unpaid 12 months after the end of the accounting period as a result of the failure - the potential lost revenue (PLR), unless there is a reasonable excuse for the failure.

The penalty percentage depends whether the failure to notify was: not deliberate; deliberate; or deliberate and concealed. It can be reduced if HMRC is told promptly about the failure and full disclosure is made, the group helps HMRC to calculate what is owed and allows access to the required company records. The minimum penalty is increased by 10% where the penalty relates to an offshore matter and the failure to notify was deliberate or deliberate and concealed.

As Melton Ltd has failed to notify HMRC of its chargeability to Corporation Tax within 12 months of the end of the accounting period (that is, before 31 May 2020), a penalty is due. As no tax was paid by this date, the potential lost revenue is £99,000. The £12,000 is not taken into account, as this was unpaid 12 months after the end of the accounting period.

The failure to notify was not deliberate, but disclosure was prompted less than 12 months after the date Corporation Tax was due (1 March 2020). The maximum penalty that can be charged is 30% of the PLR. However the penalty could be reduced to a minimum of 10% of the PLR, depending on the quality of the disclosure.

Transfer Pricing adjustment

Calke Ltd cannot claim a compensating adjustment in respect of the £20,000 transfer pricing adjustment added back to Melton Ltd profits for the period ended 31 May 2019, as Melton Ltd's return had not been filed. A claim for a compensation adjustment cannot be made unless a calculation has been made by the advantaged party effecting the arm's length provision in a return. However, Melton Ltd's PLR is reduced by the additional amount of tax paid by Calke Ltd as a result of the failure to notify. The potential lost revenue is reduced by £4,000.

Calke Ltd - accounting period ended 31 January 2020

The overstatement of the Research and Development tax credit claim will be treated as a careless error as the inaccuracy has arisen because of a failure to take reasonable care. HMRC would expect a prudent and reasonable taxpayer to seek advice on an area that they were not familiar with. The PLR is £42,000. However, as the company is still within the amendment time limit (being 12 months from the due filing date, which is 31 January 2022) it would be advisable to amend the return and avoid the penalty.

The error in respect of the incorrect implementation of the Corporation Tax avoidance scheme is treated as deliberate and concealed. The previous Managing Director was aware that the scheme was not implemented correctly but filed the Corporation Tax return on the basis it was, with incorrect figures. By creating false minutes of meetings he also took steps to conceal the inaccuracy. The PLR is £60,000.

Where there are two errors, the careless error is corrected first followed by the deliberate error, and the tax recalculated accordingly. The disclosure was unprompted, within 12 months of the tax being due, and provided that a full disclosure is made and the company helps and allows HMRC to have full access to the records, these penalties could also be mitigated from the maximum to the minimum amount.

In the case of the penalty incurred in respect of the tax avoidance scheme (where the behaviour was deliberate and concealed and the PLR is £60,000), the maximum penalty is 100% and the minimum penalty is 30%.

From the information provided, the company would not have grounds for making a claim for a reasonable excuse to mitigate the penalties further.

The company may also ask for a review and/or appeal any penalty to the tribunal. In the most serious cases HMRC may seek a civil settlement under COP9 or a criminal prosecution, however in the latter circumstances no penalties for inaccuracies would be charged.

MARKING GUIDE

TOPIC	***MARKS***
Presentation and higher skills	*1*
Explanation of basis and aims of regime	*2*
Explain potential lost revenue	*1*
Explanation and calculation of failure to notify penalty	*2*
Explain interaction of transfer pricing adjustment	*1*
Overstatement of Research and Development tax credit claim treated as careless	*1*
Avoidance scheme treated as deliberate and concealed	*2*
Explanation that calculation of PLR done on careless penalty first	*1*
Calculation of penalty on 2 errors period ended 31 January 2020	
Amendment of Calke Ltd's return	*2*
Serious cases may result in a criminal investigation/no reasonable excuse noted	*1*
Right of review or appeal	*1*
TOTAL	***15***

Examiner's report:

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Candidates struggled with the penalties for failure to notify chargeability in this question and the interaction with other penalties. Most cited standard penalties for late returns. Candidates did do well on the potential penalties and mitigation where errors had been made but few commented on the transfer pricing adjustment and treatment. Candidates could have scored more marks for this question by briefly commenting on some of the administrative aspects such as suspension of penalties, reasonable excuse and right of review or appeal.

9. SPARK LTD

UK Corporation Tax and overseas taxation

Existing overseas permanent establishments

Spark Ltd is subject to UK Corporation Tax on the profits earned from both its UK activities and those carried on by its two overseas permanent establishments. It is assumed that no election has been made to date to exempt the permanent establishments from tax.

Since Ruritania and Pangaea do not have Double Taxation Agreements with the UK, relief for overseas tax paid is only available under the unilateral relief provisions within UK domestic legislation. Under these provisions, the tax payable under the law of any territory and computed by reference to the profits arising in that territory is allowed as a credit against the UK Corporation Tax payable on those profits.

For the purpose of calculating taxable profits, a permanent establishment is treated as a distinct and separate enterprise engaged in the same or similar activities carried on in the same or similar conditions and dealing wholly independently with the company of which it is a permanent establishment. Trading income earned by a permanent establishment needs to be computed taking into account both directly and indirectly attributable expenses.

PE1
The credit for overseas tax payable is the lower of the overseas tax charged and the UK tax on the same source of income. In the case of PE1, the overseas tax charged is 30% of the profits of £1,100,000, so £330,000. This is higher than the UK tax rate of 19% on the same source of income, so the double tax relief is limited to the UK Tax of £209,000. The excess may be carried back three years or carried forward and set against tax on profits arising in respect of PE1.

PE2
Ordinarily, an election may be made not to claim relief by means of a credit where there is no or insufficient UK tax payable on the foreign income against which the foreign tax may be credited.

It is a condition of double tax relief ('DTR') that the tax must be of the same nature as the UK tax that it is being credited against. In this case the overseas tax is based on turnover and there is therefore uncertainty as to whether this tax does correspond to Corporation Tax and hence whether DTR is available.

An alternative approach is to claim a deduction for the tax against trading profits as a cost of operating the trade. The tax is £140,000 (turnover of £700,000 x 20%). Therefore, a deduction may be claimed against UK income for the foreign tax of £140,000.

Tutorial Note:

See SP7/91, Yates v GCA International Ltd.

Taxation of overseas dividend income

Where a UK company receives a dividend, it is treated as taxable income unless it falls within a specific exemption. Spark Ltd is not a small company for dividend purposes as it has at least 50 employees.

As Spark Ltd holds less than 10% of the share capital of Boltex Ltd, the dividend it receives is likely to fall within the exemption for distributions from portfolio holdings and not be subject to Corporation Tax.

Since the dividend is exempt from UK tax no relief is given for the withholding tax deducted by the Utopian tax authorities.

Overseas permanent establishments

An optional exemption exists from UK Corporation Tax on profits arising from all foreign permanent establishments. The exemption cannot be applied to individual permanent establishments and so would apply to the existing permanent establishments as well as the proposed new ones.

This exemption also applies to losses, so that losses made by an overseas permanent establishment would not be deductible from Spark Ltd's UK taxable profits.

If the election is made, it has effect from the beginning of the accounting period following the period in which the election is made.

The election may be made and withdrawn at any time up until the beginning of the accounting period for which the election applies. After that date the election becomes irrevocable.

In very broad terms, if the election is made, for each accounting period exemption adjustments would be made to the profits of Spark Ltd to remove those profits which relate to the overseas permanent establishments from the charge to corporation tax levied on Sparks Ltd.

The key matters to consider here are as follows:

1) Given that the election is irrevocable, Spark Ltd needs to be confident that the overseas permanent establishments will be profitable now or will become profitable in the near future.

2) One of the existing permanent establishments (PE2) is loss making. If this permanent establishment continues to be loss making and the election is made then future UK tax relief for these losses will be lost.

3) One of the proposed permanent establishments will be situated in a country which does not levy Corporation Tax on profits. Therefore Spark Ltd will gain a Corporation Tax saving by making the election in respect of this permanent establishment.

Pre-exemption losses

A transitional rule may operate to defer the date on which the exemption would otherwise take effect. The rule applies where on that date a company's overseas PEs are in a net loss position (taking into account the results of the PEs in the six-year period before that date). This is called an opening negative amount ('ONA').

The ONA is then reduced by the amount of any profits in the accounting periods starting with the date on which the election would otherwise have taken effect until it is extinguished. At that point the exemption will apply.

Territorial streaming

An election may be made by Spark Ltd to enable it to apply the transitional rule separately to losses of a PE in a particular territory so that they do not delay the application of the exemption to profitable PEs in other territories in relation to which the company would otherwise have no (or a shorter) transitional period.

An election for streaming is required which should be made at the same time as the election into the main regime. The transitional rule above will therefore apply separately to each streamed territory. The remaining un-streamed territories are aggregated.

Spark Ltd – year ended 31 March 2021
Calculation of UK Corporation Tax liability

	Spark Ltd	PE 1	PE 2
	£	£	£
Turnover	25,000,000	2,000,000	700,000
Direct costs	(5,000,000)	(700,000)	(800,000)
Indirect costs	(600,000)	(200,000)	(50,000)
Deduction of foreign tax			(140,000)
Profit before loss set-off	19,400,000	1,100,000	(290,000)
Less Losses	(290,000)		290,000
Taxable profits	19,110,000	1,100,000	0
CT at 19%	3,630,900	209,000	0
Double taxation relief		(209,000)	
Corporation Tax liability	3,630,900	0	0

MARKING GUIDE

TOPIC	***MARKS***
Presentation and higher skills	*1*
Calculation of tax payable	*2½*
CT to apply to Spark's UK income and income from branches	*½*
Credit available for overseas tax	*½*
Assumption made in calculating profit of PE	*½*
Trading nature of income and impact on calculation	*½*
Credit for overseas tax must not exceed tax on same source of income	*1*
Relief by deduction	*1½*
Taxation of overseas dividends	*1*
Election re overseas branches	
Outline of how election works	*2*
Application to Sparks Ltd's position	*1*
Discussion of transitional rule re pre-exemption losses	*2*
Discussion of election re territorial streaming	*1*
TOTAL	***15***

Examiner's report:
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This question was about double tax relief and the taxation of dividends and overall, it was reasonably well answered.

Candidates showed good knowledge of the principles of double taxation relief, available both by credit and by deduction. Most candidates could explain the tax exemption for dividends received. Some candidates, however, were confused as to whether the dividend regime for small companies or large companies was applicable.

Candidates took the opportunity to demonstrate their knowledge of the exemption for overseas permanent establishments. In some cases, too much detail was given that was not specific enough to the question. Some candidates discussed the controlled foreign company regime although the question stated that new permanent establishments, not overseas companies, were going to be set up. Also some candidates detailed the definition of a permanent establishment, which was not relevant to the question.

10. SPEY GROUP

Corporation Tax and Stamp Duty consequences of the proposed demerger of the Spey Group into the Tay and Tweed groups

Reconstruction

Step 1

The preliminary reorganisation of the shares in Spey Ltd into A and B shares will have no UK Corporation Tax or Stamp Duty consequences.

Tutorial note:

Non corporation tax observation: This will be a reorganisation of share capital from the perspective of the individual shareholders, with the new shares standing in the shoes of the original shares for capital gains base cost purposes.

Step 2

No significant direct tax consequences will arise from the incorporation of Tay Ltd. The incorporation of the company does not of itself bring the company within the charge of UK Corporation Tax.

There is no Stamp Duty on the issue of shares upon incorporation.

Step 3

The acquisition of Spey Ltd by Tay Ltd is a share-for-share exchange.

From a Corporation Tax perspective, Tay Ltd will be treated as having acquired Spey Ltd at its current market value. The value of the shares in Spey Ltd represents new consideration received by Tay Ltd. The shares are issued at a premium representing new consideration. This is important for distribution purposes (see Step 7).

Although the insertion of Tay Ltd between the shareholders and Spey Ltd involves a share-for-share exchange where the shareholders in Tay Ltd mirror their original holdings in Spey Ltd, the Stamp Duty relief associated with such an exchange is not available. This is because at the time of the share-for-share exchange arrangements are in place for the cancellation of the B shares in Tay Ltd after Step 7 (see below) which result in Mr Loudoun obtaining control of that company.

Tutorial Note:

Non corporation tax observation: As this is a share for share exchange, from the perspective of the individual shareholder there will be no capital gains disposal of their original shareholding and the new shares in Tay Ltd will stand in the shoes of the original Spey Ltd shares.

Step 4

The transfer of the shareholding in Burnawn Ltd to Tay Ltd will be an intra-group transfer and treated as being on a no gain/no loss basis for Corporation Tax purposes.

The transaction is prima facie eligible for group relief from Stamp Duty. However, group relief may be denied as the transfer is likely to be regarded as occurring under arrangements whereby the transferor (Tay Ltd) will cease to be the transferee's (Burnawn Ltd's) parent.

The declaration of a dividend by Burnawn Ltd to Tay Ltd will be an exempt distribution, being a dividend from a controlled company/UK company.

Step 5

No significant tax consequences will arise from incorporation of Tweed Ltd (see step 2 above).

There is no Stamp Duty on the issue of shares upon incorporation.

Step 6

The reduction of share capital will constitute a reorganisation of share capital for tax purposes. No Corporation Tax or Stamp Duty consequences will arise therefrom.

Tutorial Note:

Non corporation tax observation: This will be a reorganisation of share capital from the perspective of the individual shareholders, with the new shares standing in the shoes of the original shares.

Step 7

The distribution of Burnawn Ltd to Tweed Ltd will have to be considered both under the distribution legislation and for chargeable gains purposes.

Distribution rules

Following the reduction in the share capital of Tay Ltd, the distribution of Burnawn Ltd to the B shareholders of Tay Ltd will fall to be excluded from the distribution rules - being a repayment of share capital to a non-corporate shareholder (see Step 3 above).

Corporation tax on chargeable gains

The transfer of the shareholding in Burnawn Ltd will be on a no gain/no loss basis for Corporation Tax purposes under the reconstruction rules.

Although the shares in Burnawn Ltd were previously transferred at no gain/no loss to Tay Ltd, no de-grouping charge will arise as it is covered by the reconstruction rule above.

The de-grouping charge provisions (s.179 TCGA 1992) may however be in point if an asset has previously been transferred intra-group within the Spey group to Burnawn Ltd under the no gain/no loss provisions within the previous 6 years. However the interaction of these rules with the reconstruction rule will cause the exit charge to fall away.

As the shareholding in Burnawn Ltd has been acquired on a no gain/no loss basis, the period of ownership will be extended for Substantial Shareholding Exemption ("SSE") purposes to include the period of ownership of the transferor companies ie Spey Ltd.

Stamp Duty

Stamp Duty will be payable at a rate of 0.5% on the value of Burnawn Ltd on its transfer to Tweed Ltd as Tweed Ltd issues shares to Mr Clyde in return for the acquisition in Burnawn Ltd (the transaction thereby being treated, for stamp duty purposes, as a sale of the shares in Burnawn Ltd).

<u>*Tutorial Note:*</u>

The issue of shares to Mr Clyde will be a reorganisation of share capital with the new shares standing in the shoes of the original shares in Tay Ltd which have been cancelled. Furthermore, there is no distribution received by Mr Clyde who is merely receiving a return of his capital in Tay Ltd (and a mere return of capital is not, by definition, a distribution). As noted above, the issue of the shares in Tay Ltd was for new consideration comprising the contribution of the shares in Spey Ltd equal to its market value.

It is advisable that the group seeks statutory clearance under the Transactions in Securities and the Capital Gains Reconstruction provisions. Non-statutory business clearance could also be sought on other matters such as SSE. Such clearances should be received from HM Revenue & Customs within a 30-day time limit.

In summary, from a Corporate Tax perspective, the above transactions should allow for the demerger of Burnawn Ltd on a tax neutral basis, although charges to Stamp Duty may arise.

MARKING GUIDE

TOPIC	***MARKS***
Presentation and higher skills	*1*
Share reorganisation into A and B shares has no UK CT consequences	*1*
Incorporation of new companies – no tax consequence	*1*
Scheme of reconstruction (Sch 5AA TCGA 1992)	*1*
Transfer of shares intra-group at no gain/ no loss (s 171 TCGA 1992)	*1*
New consideration (s. 1115(1)(a) CTA 2010 and s. 1025(1)(a) s CTA 2010)	*1*
Intra-group dividend exempt (s.931E CTA09 – controlled company exemption)	*1*
Distribution rules	*1*
Exit charge (s.179 TCGA 1992) and interaction with s.139 TCGA 1992	*1*
Reconstruction involving transfer of business (s.139 TCGA 1992)	*1*
SSE and impact of no gain/ no loss rules (para 10 Sch 7AC TCGA 1992)	*1*
Potential clearance applications - statutory and non-statutory	*1*
Stamp Duty reconstruction and acquisition reliefs	*2*
Stamp Duty group relief (s.42 FA 1930)	*1*
TOTAL	***15***

Examiner's report:
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This question tested the ability of candidates to analyse the UK Corporation Tax and Stamp Duty consequences of a proposed reorganisation. In the specific example given this was a capital reduction demerger. The question required knowledge of the distribution rules. It also tested group no gain/no loss rules for intra-group transfer of capital assets and the no gain/no loss reorganisation provisions of s. 139 TCGA 1992. Many candidates failed to identify these areas.

It also tested the Stamp Duty analysis of the transactions and in particular the availability of reconstruction and group reliefs. Again this was poorly answered.

Whilst some candidates performed well, on the whole the question was badly answered, with candidates failing to pick up marks for some fairly basic tax knowledge.

11. TROUBLE PLC

Trouble plc – UK tax consequences of transactions

Proposed financing of Calamity N.B.

Interest accruing on the corporate bond ought to be tax deductible for Trouble plc under the loan relationship rules. Dependent on the jurisdiction of residence of the bondholders, interest payments receivable by Trouble plc may be subject to withholding tax ("WHT"). It may be possible to mitigate any WHT exposure through claiming relief under double tax treaties.

Danger Ltd is a Controlled Foreign Company ("CFC") under UK tax legislation. In broad terms, the CFC legislation is designed to prevent profits being diverted offshore to low tax territories from the UK. Profits of the CFC are chargeable to Corporation Tax if they pass through what is termed a "gateway" or the company cannot qualify for an exemption.

In the case at hand, the income should constitute "non-trading finance profits" as the company does not carry on a trade and the income can be traced to capital investment from the UK. The conditions of the "non-trading finance profits gateway" are therefore met and the profits pass through the gateway.

Danger Ltd should, however, qualify for the "finance company partial exemption" ("FCPE"). The FCPE offers partial exemption for non-trading finance profits derived from "qualifying loan relationships".

The loan should be regarded as a "qualifying loan relationship" as:

1) Non-trading finance profits are derived from UK capital investment and are not generated by UK activities;

2) The creditor (Danger Ltd) is a CFC connected with the debtor (Calamity N.B.) and both are under the control of the same UK resident person (Trouble plc);

3) Calamity N.B. is not resident in the UK and so is not within the charge to UK tax in respect of the debt payments it makes; and

4) Danger Ltd has business premises in Jersey (the trust company offices).

As a consequence, 75% of the interest should be exempt from CFC apportionment. Further exemption may be available under the "matched interest" rules subject to review at year-end.

Nambutu may impose WHT on interest payments by Calamity N.B. to Danger Ltd. Any WHT may be credited against any Corporation Tax payable on chargeable profits of Danger Ltd.

Dividend from Calamity N.B.

The dividend will not be exempt from Corporation Tax because a tax deduction is available for the distribution in Calamity N.B. The gross dividend of £10 million is subject to tax.

Trouble plc can claim a tax credit for the £1 million WHT together with any "underlying tax" ("ULT") being foreign tax paid in respect of the profits. The ULT will be £5 million calculated as:

$$\frac{\text{£10 million (gross dividend received)}}{\text{£10 million (profits available for distribution)}} \times \text{£5 million (actual tax paid)}$$

This results in maximum double tax relief ("DTR") of £6 million; however, this may only be relieved against the UK tax arising on the same source of income, ie the dividend. Assuming it is fully taxable, the dividend will be subject to Corporation Tax at a rate of 19% capping the DTR at £1.9 million. If a foreign tax credit cannot be claimed, the WHT credit of £1 million may be expensed as a tax deduction.

The Tax Exemption may apply to exempt chargeable profits of Calamity N.B. from CFC apportionment if the Nambutan corporate tax liability is at least 75% of the corresponding UK tax that would have been due on the profits.

Income and gains arising in Peril BV

Peril BV is also a CFC. However, the company is resident in The Netherlands, which is an "Excluded Territory", meaning that if certain conditions are met, the income of Peril BV will be fully exempt from CFC apportionment. As the royalty exceeds £50,000 and is the only source of income in the company, this exemption is unlikely to be available due to the fact the income is subject to a reduced rate of tax in The Netherlands.

The "Tax Exemption" may not apply in relation to Peril BV as The Netherlands appears to have a more favourable tax regime for intellectual property, despite the introduction of the UK patent box. As the IP has never been held in the UK, however, the profits should not pass through the gateway and as a consequence no CFC apportionment will arise.

The gain arising on sale of the investment property is outside the scope of the CFC rules and will not be apportioned to the UK.

Strife S.P.A.

The company should qualify for the CFC Low Profits Exemption provided no more than £50,000 of the profits relate to non-trading income. The Excluded Territories and Tax Exemptions may also apply.

MARKING GUIDE

TOPIC	***MARKS***
Presentation and higher skills	*1*
<u>Proposed financing of Calamity KK:</u>	
Comment on potential WHT on corporate bond	*1*
Reference to mitigating WHT under double tax treaties	*½*
Reference to “qualifying loan relationship” and conditions in s.371IG & s.371IH TIOPA 2010	*2*
Comment that 75% of income exempt pursuant to s.371ID TIOPA 2010	*1*
Reference to matched interest exemption in s.371IE TIOPA 2010	*½*
<u>Income and gains of Peril BV:</u>	
Reference to Excluded territories exemption	*1*
Reference to Tax Exemption	*1*
Comment that motive test likely met as pre-gateway carve out	*1*
Reference to capital gain outside scope of CFC rules	*1*
<u>Dividend from Calamity NB:</u>	
Comment that dividend not exempt as tax deductible pursuant to s.931D(c) CTA 2009	*½*
Credit for WHT	*½*
Calculation of underlying tax	*1*
Comment of restriction of DTR to tax on dividend	*1*
Comment that WHT can be expensed	*½*
Comment that Tax Exemption may apply	*½*
<u>Profits of Strife SPA:</u>	
Comment that Low Profit Exemption potentially available	*1*
TOTAL	***15***

12. FARADAY PLC

Faraday plc

Taxable profits	Notes	£
UK property income		2,000,000
Chargeable gain	(2)	4,864,400
Non-trading profits on IFAs	(3)	4,000,000
Management expenses		(90,000)
Taxable profits before group relief		10,774,400
Group relief		(10,774,400)
Taxable total profits		-

1) This is an investment company. It can obtain relief for ongoing costs related to its investment business as management expenses.

2) The gain on disposal of property is taxed as a chargeable gain. This is calculated as:

	£
Gross proceeds	12,000,000
Less: disposal cost	(220,000)
Net proceeds	11,780,000
Cost	(3,400,000)
Indexation (1.034 x £3,400,000)	(3,515,600)
Chargeable gain	4,864,400

Indexation factor = (278.1 – 136.7)/136.7 = 1.034

3) The patent income does not qualify for the patent box. Even if Faraday plc (being a member of a group) did meet the active ownership condition (requiring it to perform a significant amount of management activity in relation to its patents by formulating plans and making decisions in relation to their exploitation), it does not carry on a trade. The income is taxed as arising from a non-trading intangible fixed asset.

Faraday Consulting Ltd

	Notes	UK	Ireland	Total
		£	£	£
Profit before tax		8,460,000	930,000	9,390,000
Adjustments				
Bonuses – 2020	(2)	2,500,000	1,000,000	3,500,000
Bonuses – 2019	(2)	(1,200,000)	(800,000)	(2,000,000)
Lease premium adjustment	(3)	36,000		36,000
Restrict car rental	(5)	750		750
Disallow fine	(8)	20,000		20,000
Disallow client entertainment	(9)	450,000	280,000	730,000
Add back charitable donation	(10)	100,000		100,000
Reapportion interest	(11)	154,930	(154,930)	-
Trading profits		10,521,680	1,255,070	11,776,750
Qualifying charitable donation	(10)	(100,000)		(100,000)
Group relief	(14)	(10,421,680)	(553,317)	(10,974,997)
Taxable total profits		-	701,753	701,753
Corporation Tax at 19%		-	133,333	133,333
Double tax relief	(13)		(133,333)	(133,333)
Corporation Tax liability		-	-	-

Notes

1) The company is a trading company with a foreign permanent establishment in Ireland.

2) Bonuses are paid more than nine months after period end and are therefore deductible when paid.

3) Capital element of lease premium is £2,000,000 x 2% x (10-1) = £360,000.

   Revenue element of the lease premium is £2,000,000 - £360,000 = £1,640,000.

   Deduction for the year is therefore limited to £1,640,000 / 10 = £164,000 which means that £36,000 (£200,000 - £164,000) must be added back in computing taxable profits.

4) The computer equipment finance lease entered into on 1 October 2018 is not a long funding lease because it is for less than five years (being a lease entered into before 1 January 2019). Therefore, no adjustment is required because tax relief is given by way of allowing the depreciation and finance costs that are expensed through the income statement. No capital allowances are available.

5) Car leasing rentals should be restricted to 85% of the rental cost where CO_2 exceeds 130g/km for leases entered into between 1 April 2013 and 31 March 2018. Therefore, a restriction of £750 (£5,000 x 15%) applies.

6) Tax relief for bad debts is available in line with the impairment loss recognised under generally accepted accounting practice (GAAP).

7) All employee-related costs should be deductible as being wholly and exclusively for the purposes of the trade. This will include travel costs for the employee's family.

8) The fine for the breach of health and safety rules is non-deductible on policy grounds.

9) Client entertainment must be disallowed but not staff entertainment costs.

10) Relief is available as a qualifying charitable donation. The qualifying charitable donation can be allocated in the most preferential way. Therefore, none of this is allocated to the profits arising in respect of the Irish office.

11) Bank interest is deductible as a trading expense as the loan relationship is taken out for the purposes of the company's trade. There is no restriction under the corporate interest restriction regime of the bank interest payable or the finance cost in respect of leased equipment as the total of those amounts (ie £1,480,000 which is the ANTIE of the group) is less than £2,000,000.

    In determining this amount, expenses of the trade should be attributed to the permanent establishment on a just and reasonable basis. In particular, some of the bank interest should be deducted in calculating the profits of the branch. This has been done on the basis of staff costs (being the costs that the working capital is funding).

	UK	Ireland	Total
	£	£	£
Staff costs	30,000,000	5,500,000	35,500,000
Percentage	84.5%	15.5%	100%
Bank interest	845,070	154,930	1,000,000

12) The exchange gain arising on the retranslation of part of the company's business recognised in other comprehensive income is not taxable.

13) Double tax relief is available for foreign tax suffered on profits of a permanent establishment. Relief is based on the actual tax suffered, and this should be translated into sterling at the transaction date. Therefore foreign tax suffered is £133,333 (€140,000/1.05).

    Double tax relief is limited to the amount of UK Corporation Tax that arises on the corresponding profits in respect of which foreign tax has been suffered.

14) Group relief should be limited so as to leave £701,753 of taxable profits, so that the credit relief for the foreign tax is not wasted. (£701,753 = £133,333 / 19%).

MARKING GUIDE

TOPIC	***MARKS***
Faraday plc:	
– Investment co / management expense	*1*
– Property business	*1*
– Intangible fixed asset	*1*
– Patent box	*1*
– Gain on disposal of freehold property	*1*
	5
Faraday Consulting Ltd:	
– Bonuses	*1*
– Lease premium	*1*
– Equipment – finance lease	*1*
– Leased car restriction	*1*
– Bad debts	*1*
– Family travel costs – no restriction in relief	*1*
– Health and safety fine (HMRC v McLaren Racing Ltd [2014] UKUT 0269)	*1*
– Client entertainment	*1*
– QCD	*1*
– Bank interest – trading deduction	*1*
– Forex gain in OCI	*1*
– Calculation of CT Liability / CT Rate	*1*
	12
DTR / Group relief	
– Credit relief	*1*
– Restricted to UK tax (lower of test)	*1*
– Calculation of group relief	*1*
	3
TOTAL	***20***

Examiner's report:
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Although candidates performed well overall, a significant number of candidates struggled with the DTR aspects of the question. Some of the common errors were:

- *Incorrectly assuming that Faraday plc and Faraday Consulting Ltd had a nine-month period of account;*

- *Incorrectly treating Faraday plc as a trading company;*

- *Not identifying the royalty income as taxable as profits from a non-trading intangible fixed asset, and also not commenting that the IP would be ineligible for the Patent Box rules;*

- *Assuming that Faraday Consulting Ltd had to claim group relief against all of its taxable profits; and;*

- *Claiming expense relief for DTR against taxable profits rather than as credit relief against the company's Corporation Tax liability.*

13. CIR

1) Background to the CIR

The CIR was developed in response to the OECD Base Erosion and Profit Shifting (BEPS) project. The CIR applies from 1 April 2017 to all companies within the charge to corporation tax. It operates by placing a limit on the amount of interest expenses and certain other finance costs that can be deducted when calculating profits chargeable to corporation tax.

There are two main exemptions:

- Groups with less than £2m per year of net interest expense (including certain other finance costs) will not suffer any restriction and have no reporting requirements.
- An optional exclusion is available in certain circumstances for interest incurred on third party financing of public benefit and infrastructure projects.

Groups with interest expense exceeding £2m a year have to calculate two separate caps and apply the lower. There is also the possibility of applying a group ratio method (see below).

The CIR applies after all other potential restrictions on interest deductibility such as anti-hybrid, unallowable purpose and transfer pricing rules. It will therefore still be necessary for the group to consider whether it has a thin capitalisation disallowance before applying the CIR.

2) Potential disallowance under the fixed ratio method

Based on the information in the draft consolidated accounts and draft UK tax computations of the group it is possible to estimate what the CIR disallowance will be for the group in the year ending 31 March 2021.

The default mechanism for calculating a group's interest disallowance is known as the 'fixed ratio method'. Under this method, the basic interest allowance available to the group is the lower of:

- 30% of the worldwide group's aggregate tax-EBITDA (the 'tax-EBITDA cap')
- The fixed ratio debt cap

Where the group's 'net tax interest expense' exceeds this basic interest allowance a restriction will arise.

The calculation is mechanical, and follows a number of steps:

Step 1 – Calculate the net tax interest expense

The first step to take in calculating the disallowance is to determine the aggregate net tax interest expense of those companies subject to corporation tax.

Amounts taken into account include:

- Relevant loan relationship debits and credits – broadly amounts deductible/taxable under the loan relationship rules but excluding exchange losses and impairment losses.
- Relevant derivative contract debits and credits
- Finance expenses/income from finance leases, debt factoring or similar.

Based on the information in the draft consolidated UK tax computations for the Cicely Group, the net tax interest expense for the year ending 31 March 2021 will be:

	£'000
Loan interest expense	3,000
Finance lease interest expense	300
Interest income	(250)
Net tax interest expense	3,050

Step 2. Calculate tax-EBITDA cap

The tax-EBITDA cap is 30% of the group's aggregate tax-EBITDA.

Aggregate tax-EBITDA is, broadly, the total of the group's UK taxable earnings before certain finance income and expenses, tax, depreciation and amortisation computed under corporation tax principles.

Based on the information in the draft consolidated UK tax computations for the Cicely Group, the tax-EBITDA cap for the year ending 31 March 2021 will be:

	£'000
Taxable profit	5,600
Add back:	
Trading losses b/f	500
Loan interest expense	3,000
Finance lease interest expense	300
Capital allowances	500
Less:	
Interest income	(250)
Aggregate tax-EBITDA	9,650
Tax-EBITDA cap (30% of aggregate tax-EBITDA)	2,895

Notes:

No adjustment is required in respect of the foreign exchange loss on trading loan relationships as exchange losses are specifically excluded from relevant interest expenses under the legislation.

Depreciation has already been added back in arriving at the taxable profits of £5,600,000 so no further adjustment is required.

Step 3. Calculate the fixed ratio debt cap

This cap is equal to the worldwide group's adjusted net group-interest expense (ANGIE) which is £4,500,000.

Step 4: Identify interest allowance

The interest allowance is the lower of:

30% of aggregate tax-EBITDA (Step 2) = £2,895k
ANGIE (Step 3) = £4,500k
ie £2,895k

Step 5: Calculate the disallowance

The disallowance will be the excess of the net tax interest expense (from Step 1) over the interest allowance calculated at Step 4:

£3,050k – £2,895k = £155k

The potential disallowance for the Cicely Group under the fixed ratio method for the year ending 31 March 2021 is therefore estimated to be £155,000.

3) <u>Group ratio method</u>

The group ratio method is an optional method which groups can elect to apply instead of the fixed ratio method when calculating their disallowance under the CIR.

Broadly, under this method:

- The 30% applied to aggregate tax-EBITDA is replaced by a 'group ratio percentage' which is based on the proportion of net external interest expense to EBITDA of the worldwide group.

- The fixed ratio debt cap is replaced by a 'group ratio debt cap', which is based on the qualifying net group interest expense for the worldwide group.

The group ratio method may be helpful where a group's net interest expense exceeds the cap calculated under the fixed ratio method, in particular where the worldwide gearing of the group exceeds that of the UK companies.

It is not possible to calculate the potential disallowance for the Cicely Group based on the information provided.

4) <u>Administrative requirements</u>

The main administrative requirements under the CIR are set out in Sch 7A TIOPA 2010. These include:

- Groups are required to appoint a 'reporting company' and notify HMRC within twelve months of the end of a period of account.

- The reporting company must be a group member who is subject to corporation tax. Once appointed it remains in place until HMRC or the group revoke the appointment.

- The reporting company is responsible for preparing and submitting interest restriction returns for the group.

- A full interest restriction return has to include information on the composition of the group, a statement of calculations, allocations of interest restrictions and reactivations (if any) within the group and any elections made (eg to use the group ratio method).

- An abbreviated return can be submitted where there are no interest restrictions.

- The filing date for returns is the later of 12 months from the end of the period of account, or 3 months after the appointment of the reporting company.

MARKING SCHEME

TOPIC		***MARKS***
Presentation and higher skills mark		*1*
Part 1		
CIR and why it was introduced		*1*
Overview of how CIR operates		*2*
Interaction with thin cap rules		*1*
	Sub-total	*4*
Part 2		
Explanation of the items that need to be calculated		*4*
Application to facts given		*4*
Conclusion on the disallowance		*2*
	Sub-total	*10*
Part 3		
Outline of the group ratio method		*2*
Circumstance in which beneficial to use		*1*
	Sub-total	*3*
Part 4		
1 mark for each relevant point		*3*
TOTAL (MAX)		***20***

14. SPOT LTD

Spot Ltd – Controlled Foreign Companies

The definition of a Controlled Foreign Company (CFC) is:

1) A company which is not UK tax resident AND
2) The company is controlled by UK resident persons.

“Control” in this context means broadly the power to secure that the affairs of the company are conducted in accordance with the UK resident persons’ wishes.

Dalmatian Ltd, Mark Ltd and Blemish Ltd are all non-UK resident companies. Therefore the first condition is met. All of the companies are wholly owned subsidiaries of Spot Ltd. Therefore the second condition is met.

If a company meets the definition of a CFC it is necessary to consider the following:

1) The nature of the income of the company (as only certain sources of income are caught).

2) Whether any of the statutory exemptions apply. Those exemptions are the temporary period of exemption, the excluded territories exemption, the low profits exemption, the low profit margin exemption and the tax exemption.

3) If none of the exemptions apply, whether the company’s profits pass through any of five statutory gateways. Those gateways are:

    a) Profits attributable to UK activities
    b) Non-trading finance profits
    c) Trading finance profits
    d) Captive Insurance business (relevant to insurance businesses)
    e) Solo consolidation (relevant to banking subsidiaries)

If any profits pass through a gateway, then the taxable profits of the CFC are calculated, and those profits apportioned to Spot Ltd.

The taxable profits of each CFC are calculated as if the company were UK tax resident and are subject to certain statutory assumptions. These are very detailed. Examples include that the CFC is not a close company and the CFC has made all relevant claims and elections sufficient to obtain the maximum amount of relief.

The main rate of Corporation Tax (19% for the year to 31 March 2022) is always applied to determine the amount of tax to pay.

Looking at each CFC individually:

Dalmatian Ltd

A company with accounting or total taxable profits of no more than £500,000 of which no more than £50,000 represents non-trading income is exempt from the CFC charge. This is the low profits exemption mentioned above. Dalmatian Ltd is predicted to have taxable trading profits of £290,000 and non-trading income of £47,000 so the exemption would apply to this company.

Mark Ltd

It does not appear that any of the exemptions will apply to the profits of Mark Ltd so the five gateways must be considered. Spot Ltd must consider whether any of its profits pass through any of the five gateways. If this happens then those profits may be subject to tax under the CFC regime. The sources of income, trading and interest income, should be considered separately.

Trading profits

The gateway that needs to be considered is “profits attributable to UK activities”. Profits pass through the gateway unless one of four conditions is met. The relevant conditions to consider here are referred to as “A” and “B”.

“A” is broadly that, at no time during the accounting period does the CFC hold assets or bear risks under an arrangement whose main purpose is to reduce the tax payable by one or more persons in any territory.

“B” is broadly that at no time during the accounting period does the CFC have any UK managed assets or bear any UK managed risks. The legislation defines both terms in more detail.

The reasons for establishing Mark Ltd relate to access to the Laputian market and the requirements of the Laputian authorities. Accordingly, “A” appears to be met. This is sufficient for the profits not to pass through the gateway.

Since Mark Ltd has no activities in the UK at all and Spot Ltd appears not to manage risks on its behalf, “B” appears to be met as well.

The four conditions are alternatives, so it is sufficient for either “A” or “B” to be met. The trading profits of Mark Ltd will, therefore, fall outside of the CFC charge.

Interest income

The relevant gateway here is the one relating to non-trading finance profits. The interest income will pass through the gateway and be caught by the CFC regime where the following tests are met:

1) The profits consist of non-trading profits from loan relationships and non-exempt distributions. Since the interest income has been earned from a holding of Laputian government stock, that test appears to be met.

2) The profits fall into one of four taxable categories. The relevant category here is that they arise from the investment of UK monetary assets. Spot Ltd has subscribed for share capital in Mark Ltd and it is this capital which has given rise to the interest income. Therefore, this test appears to be met.

The legislation lists a number of exclusions from the definition of non-trading finance profits. An exclusion for the investment of funds held by Mark Ltd for the purpose of its trade may be relevant here. However, given that it will not be possible to access the funds for ten years, it is hard to see how the trade of Mark Ltd can benefit.

If, as seems likely, the investment is not for the purpose of the trade, then all interest income of Mark Ltd less any allowable deductions will be subject to UK Corporation Tax at 19%, payable by Spot Ltd.

Blemish Ltd

Under the low profit margin exemption, a company is exempt from the CFC charge if its accounting profits are no more than 10% of its relevant operating expenditure. Accounting profits are profits before deduction of interest. Relevant operating expenditure is the operating expenditure brought into account in determining the accounting profits, excluding the cost of goods purchased unless they are actually used in the CFC’s territory of residence. The cost of any expenditure which gives rise directly or indirectly to income of a related person is also excluded.

It would appear that the company's accounting profit will be less than 10% of its operating expenditure for the year. On the face of it the low profit margin exemption would appear to apply and the profits of the trade should be excluded from the CFC charge on this basis.

In summary:

1) Dalmatian Ltd: Low profits exemption applies. So the CFC tax charge is nil.

2) Mark Ltd: Trading profits do not pass through the profits attributable to UK activities gateway. So the CFC tax charge is nil

The interest income passes through the non-trading finance profits gateway so it is subject to the CFC charge at 19%

3) Blemish Ltd: Low profit margin exemption applies. So the CFC tax charge is nil.

CIOT MARKING GUIDE

TOPIC	***MARKS***
Presentation and higher skills	*1*
Definition of Controlled Foreign Company	*½*
Confirmation that the three subsidiaries of Nut Ltd meet this definition	*½*
Discuss exemptions, statutory gateways and apportionment of profits	*2½*
Calculation of taxable profits	*½*
Use of standard rate of Corporation Tax	*½*
Dalmatian Ltd profit is not within CFC charge, explain why	*1½*
CFC Exemptions do not apply to Mark Ltd	*½*
Describe gateway relevant to Mark Ltd trading profits - "profits attributable to UK activities"	*1*
Discuss first condition for avoiding gateway	*2*
Discuss second condition for avoiding gateway	*2*
Describe gateway relevant to interest income - "Non trade finance profits"	*½*
Describe first test to be met for profits to pass through gateway and conclude	*2*
Describe second test to be met for profits to pass through gateway and conclude	*2*
Discuss potential exclusion from CFC charge and conclude it does not apply	*1*
Conclude that the profits earned from interest will be subject to Corporation Tax at 19%	*½*
Blemish Ltd profit is not within CFC charge. Explain why	*1½*
TOTAL	***20***

Examiner's report:
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This question was principally about controlled foreign companies. Candidates showed a good knowledge of the law in this area and generally commented effectively on the application of the exemptions and gateways to the scenarios outlined in the question. Generally they showed good exam technique and worked through the question systematically. A few candidates appeared confused about the application of specific gateways and some candidates spent too long commenting on the residency for tax purposes of the various companies in the Spot group. Overall, however, the question was well answered.

15. TEACUPS GROUP LTD

Background

Under FRS 102, companies should recognise deferred tax for timing differences. Timing differences are differences between taxable profits and accounting profits that arise from the inclusion of income and expenses in tax returns in periods different from those in which they are recognised in financial statements.

Unrelieved tax losses and other deferred tax assets shall be recognised only to the extent that it is probable that they will be recovered against the reversal of deferred tax liabilities or other future taxable profits. The very existence of unrelieved tax losses is strong evidence that there may not be future taxable profits against which the losses will be relieved.

Deferred tax liabilities and assets should be measured using the tax rates and laws that have been enacted or substantively enacted by the reporting date that are expected to apply to the reversal of the timing difference.

Under FRS 102, deferred tax shall not be recognised on permanent differences. Permanent differences arise because certain types of income and expenses are non-taxable or disallowable (e.g. client expenditure), or because certain tax charges or allowances are greater or smaller than the corresponding income or expense in the financial statements.

Teacups Ltd

	£
Net book value	1,436,000
Less: Tax written down value	(908,000)
	528,000
Deferred tax liability at 19%	100,320

Deferred tax liabilities must be recognised.

	£
Directors’ deferred bonuses	200,000
Deferred tax (asset) at 19%	(38,000)

This deferred tax asset in respect of directors’ bonuses should be recognised as the company is generally profitable and so it is expected that Teacups Ltd will have sufficient taxable income in the future to be able to recover the deferred tax asset. Furthermore, the directors’ bonuses are expected to reverse before the deferred tax liabilities on accelerated capital allowances. As such, it would be possible to utilise the asset against the deferred tax liability.

Saucers Ltd

	£
Net book value	56,000
Less: Tax written down value	(70,000)
	(14,000)
Deferred tax liability / (asset) at 19%	(2,660)

While the company is currently loss making, future claims for capital allowances will allow the company to surrender group relief to Teacups Ltd and obtain value for these losses. On the basis that Teacups Ltd is profitable and also because it has deferred tax liabilities in excess of this amount, a deferred tax asset for this amount should be recognised.

	£
Trading losses c/f	434,000
Deferred tax (asset) at 19%	(82,460)

The company is currently loss making and if it is unlikely that Saucers Ltd will have future taxable profits against which the losses could be relieved, the deferred tax asset in respect of trading losses carried forward should not be recognised. Recognition would, however, be appropriate to the extent that future projections indicated it is probable the losses will be recovered against future taxable profits. Furthermore, to the extent that any of the brought forward trading losses arose after 1 April 2017, recognition of a deferred tax asset will be appropriate to the extent it is probable that the losses can be recovered by way of group relief to Teacups Ltd.

CIOT MARKING GUIDE

TOPIC	***MARKS***
Presentation and higher skills	*½*
Timing differences	*1*
Recognition of deferred tax assets	*1*
Permanent differences (and so no deferred tax on client entertaining)	*1*
Measurement	*1*
Capital allowances – calculation of DT liability and recognition criteria	*1½*
Deferred directors' bonuses – calculation of DT asset and recognition criteria	*1½*
Capital allowances – calculation of DT asset and recognition criteria	*1½*
Tax losses – calculation of DT asset and recognition criteria	*1½*
TOTAL (MAX)	***10***

Examiner's report:
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This question tested deferred tax requirements and the majority of candidates scored well.

Generally, candidates were comfortable with the calculation of deferred tax calculations, particularly on accelerated capital allowances. Some candidates missed marks by not stating, or incorrectly stating, whether deferred tax balances were assets or liabilities. Many candidates did not attempt to explain why the deferred tax liabilities and assets should be recognised (or be unrecognised).