Tolley® Exam Training

CTA ADVANCED TECHNICAL PAPER

TAXATION OF MAJOR CORPORATES

PRE REVISION QUESTION BANK

FA 2019

May and November 2020 Sittings

PQ723
CTA

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Tax intelligence from LexisNexis®

INTRODUCTION

This Pre Revision Question Bank for the Advanced Technical TOMC paper contains 15 exam standard questions (all with answers updated to Finance Act 2019).

Using this question bank

All the CTA exams, with the exception of the Awareness paper, are **3¼ hours** in length. The initial 15 minutes are pre examination reading time and during this time you are permitted to read the question paper and the legislation and **annotate the question paper** but will not be allowed to write in the answer folder. Calculators may be used during this period. There will be an announcement at the end of the fifteen minutes reading time after which you may start writing in the answer folder.

During the 3 hour writing period we recommend you initially **allocate 1.7 minutes per mark** to allow time for a final review stage at the end of each question.

10 mark question = 17 minutes
15 mark question = 25 minutes
20 mark question = 34 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 **write the answers out** yourself.

Writing “proper” answers also gives you a good idea of how long an exam standard answer will take you to write.

Reviewing your answers

It is essential to read through your answer when you have finished writing 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? You want those red ticks to be flowing freely onto your page!

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

You may be able to make some small corrections at this review stage – 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 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.

Perhaps consider giving your answer to somebody else (even a non-tax person) to read. If they can understand the points you are trying to make, your communication skills are fine. Remember that you are writing letters / memos etc for someone else to read, so look at your work from the viewpoint of the reader. 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

	2019/20	2018/19
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 – 34,500
Higher rate band	37,501 – 150,000	34,501– 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 – 2,049	1 – 2,000
Scottish basic rate	2,050 – 12,444	2,001 – 12,150
Intermediate rate	12,445 – 30,930	12,151 – 31,580
Higher rate	30,931 – 150,000	31,581 – 150,000
Top rate	150,000 +	150,000 +

INCOME TAX - RELIEFS

	2019/20	2018/19
	£	£
Personal allowance(2)	12,500	11,850
Married couple's allowance(3)	8,915	8,695
- Maximum income before abatement of relief - £1 for £2	29,600	28,900
- Minimum allowance	3,450	3,360
Transferable Tax allowance for married couples and civil partners(4)	1,250	1,190
Blind person's allowance	2,450	2,390
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) From 6.4.18, the limit is £2 million, where over £1 million is invested in knowledge intensive companies.

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ISA limits	**2019/20**	**2018/19**
Maximum subscription:	£	£
'Adult' ISAs	20,000	20,000
Junior ISAs	4,368	4,260

Pension contributions

	Annual allowance(1)	**Lifetime allowance**	**Minimum pension age**
	£	£	
2018/19	40,000	1,030,000	55
2019/20	40,000	1,055,000	55

Basic amount qualifying for tax relief £3,600

Notes (1) The annual allowance is tapered by £1 for every £2 of adjusted income above £150,000 for individuals with threshold income above £110,000. It cannot be reduced below £10,000.

Employer Supported Childcare

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

Notes (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

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

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

INCOME TAX - BENEFITS

Car benefits

Emissions	**2019/20**(1)	**2018/19**(1)
0 – 50 g/km	16%	13%
51 – 75 g/km	19%	16%
76 – 94 g/km	22%	19%
95 g/km or more	23% + 1% for every additional whole 5g/km above threshold	20% + 1% for every additional whole 5g/km above threshold
165 g/km or more	37%	
180g/km or more		37%

Fuel benefit base figure	**2019/20**	**2018/19**
	£24,100	£23,400

Notes (1) 4% supplement for diesel cars excluding those that meet the Real Driving Emissions Step 2 (RDE2) standard.

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Van benefits	2019/20	2018/19
	£	£
No CO_2 emissions	2,058	1,340
CO_2 emissions > 0g/km	3,430	3,350
Fuel benefit for vans	655	633

	2019/20	2018/19
Official rate of interest	2.5%	2.5%

INCOME TAX - SIMPLIFICATION MEASURES

Allowances

	2019/20	2018/19
	£	£
'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

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)(4)	6%
WDA on patent rights and know-how	25%
WDA on structures and buildings (SBA) (5)	2%

Notes (1) On first £1,000,000 of investment in plant & machinery (not cars) from 1 January 2019 to 31 December 2020 (£200,000 before 31 December 2018 & from 1 January 2021).

(2) The main pool rate applies to cars with CO_2 emissions of not more than 110 g/km (130 g/km for expenditure incurred before 1 April 2018).

(3) The special pool rate applies to cars with CO_2 emissions greater than 110 g/km (130 g/km for expenditure incurred before 1 April 2018).

(4) The special pool rate was 8% prior to 6 April 2019 (1 April 2019 for companies).

(5) The 2% rate applies to expenditure from 29 October 2018 on new qualifying non-residential structures and buildings on a straight-line basis.

100% First year allowances available to all businesses

1) New energy saving plant and machinery, and water efficient plant and machinery (until April 2020).
2) Capital expenditure incurred by a person on research and development.
3) New zero-emission goods vehicles (until April 2021).
4) New cars registered before 31 March 2021 if the car either emits not more than 50 g/km of CO_2 (75g/km before 1 April 2018) or it is electrically propelled.
5) Electric vehicle charging points expenditure incurred from 23 November 2016 until April 2023.

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NATIONAL INSURANCE CONTRIBUTIONS

Class 1 limits	**2019/20**			**2018/19**		
	Annual	**Monthly**	**Weekly**	**Annual**	**Monthly**	**Weekly**
	£	£	£	£	£	£
Lower earnings limit (LEL)	6,136	512	118	6,032	503	116
Primary threshold (PT)/ Secondary threshold (ST)	8,632	719	166	8,424	702	162
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	46,350	3,863	892

	2019/20	2018/19
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%.

	2019/20	**2018/19**
Employment allowance		
Per year, per employer	£3,000	£3,000
Class 1A contributions	13.8%	13.8%
Class 1B contributions	13.8%	13.8%
Class 2 contributions		
Normal rate	£3.00 pw	£2.95 pw
Small profits threshold	£6,365 pa	£6,205 pa
Class 3 contributions	£15.00 pw	£14.65 pw
Class 4 contributions		
Annual lower profits limit (LPL)	£8,632	£8,424
Annual upper profits limit (UPL)	£50,000	£46,350
Percentage rate between LPL and UPL	9%	9%
Percentage rate above UPL	2%	2%

OTHER PAYROLL INFORMATION

Statutory maternity/adoption pay	First 6 weeks @ 90% of AWE Next 33 weeks @ the lower of £148.68 and 90% of AWE	
Statutory shared parental pay /paternity pay	For each qualifying week, the lower of 90% of AWE and £148.68	
Student Loan	Plan 1:	9% of earnings exceeding £1,577 per month
	Plan 2:	9% of earnings exceeding £2,143 per month
Postgraduate Loan		6% of earnings exceeding £1,750 per month

National living/minimum wage (April 2019 onwards)

Category of Worker	**Rate per hour**	**Category of Worker**	**Rate per hour**
Workers aged 25 and over	£8.21	18–20 year olds	£6.15
21–24 year olds	£7.70	16–17 year olds	£4.35
		Apprentices	£3.90

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CAPITAL GAINS TAX

	2019/20	2018/19
Annual exempt amount for individuals	£12,000	£11,700

CGT rates for individuals, trusts and estates		
Gains qualifying for entrepreneurs' relief/investors' relief	10%	10%
Gains for individuals falling within remaining basic rate band(1)	10%	10%
Gains for individuals exceeding basic rate band and gains for trusts and estates(2)	20%	20%

Notes (1) The rate is 18% if the gain is in respect of a residential property
(2) The rate is 28% if the gain is in respect of a residential property

Entrepreneurs' relief and Investors' relief(1)	**2019/20**	**2018/19**
Relevant gains (lifetime maximum)	£10 million	£10 million

Notes (1) The first claims for investors' relief can be made in 2019/20.

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

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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		

CORPORATION TAX

Financial year	**2019**	**2018**	**2017**
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**
From 4.1.11	20%	1/6

Limits	**From 1.4.19**	**From 1.4.18**
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

OTHER INDIRECT TAXES

	2019/20	**2018/19**
Insurance premium tax(1)		
Standard rate	12%	12%
Higher rate	20%	20%

Tobacco products duty	**From 29.10.18**	**Until 28.10.18**
Cigarettes	16.5% x retail price + £228.29 (or £293.95 (2)) per thousand cigarettes	16.5% x retail price + £217.23 (or £280.15 (2)) per thousand cigarettes
Cigars	£284.76 per kg	£270.96 per kg
Hand-rolling tobacco	£234.65 per kg	£221.18 per kg
Other smoking/chewing tobacco	£125.20 per kg	£119.13 per kg
Tobacco for heating from 1 July 2019	£234.65 per kg	N/A

Notes (1) Premium is tax inclusive (3/28 for 12% rate and 1/6 for 20% rate).
(2) The £293.95/£280.15 per thousand cigarettes is a minimum excise duty (if higher than the first calculation).

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INHERITANCE TAX

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

Notes (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

Notes (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 1.4.19**	**From 1.4.18**
>£0.5m - ≤ 1m	£3,650	£3,600
> £1m - ≤ 2m	£7,400	£7,250
> £2m – ≤ 5m	£24,800	£24,250
> £5m – ≤ 10m	£57,900	£56,550
> £10m – ≤ 20m	£116,100	£113,400
> £20m	£232,350	£226,950

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.

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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 pay 15% on purchases of residential property valued > £500,000.

(3) First-time buyers purchasing a single dwelling as their only or main residence on or after 22.11.17 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)(4)	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% (for effective dates on or after 25 January 2019) 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. Where the effective date is on or after 25 January 2019 but the contract was entered into prior to 12 December 2018, the 3% (prior) rate will apply.

(3) For contracts entered into after 8 February 2018, where the effective date of the transaction is on or after 30 June 2018, there is a relief for first-time buyers where a 0% rate is applied to the first £175,000 of the purchase consideration.

(4) These rates apply where the effective date is on or after 25 January 2019. Prior to this date the 0% band was the same, £150,001-£350,000 was 3%, £350,001+ was 4.5%.

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+

Note (1) Residential leases are generally exempt

QUESTIONS

1. You are a tax manager at a firm of Chartered Tax Advisers and recently met with the finance director of a new client, Toolco Ltd. He has requested advice on a number of matters.

Toolco Ltd has three wholly owned subsidiaries, Nail Ltd, Chisel Ltd and Torque Ltd, which it has owned for many years. It also owns 70% of the shares in Drill Ltd, and 40% of the shares in Nut Ltd. The remaining shares in both companies are owned by unconnected third parties, none of whom owns a controlling interest in either company. Chisel Ltd has a wholly owned subsidiary, Wrench Ltd. Until June 2019, the only activity of Chisel Ltd was the holding of shares in Wrench Ltd.

In June 2019, Torque Ltd transferred a freehold shop used in its trade to Chisel Ltd. The shop was bought in January 2013 for £75,000 and was sold to Chisel Ltd for £300,000 when its market value was £400,000. Chisel Ltd immediately granted a 40-year lease over the shop to Wrench Ltd for a premium of £200,000. The lease was valued by an independent surveyor at £180,000. It is now proposed to sell Chisel Ltd and Wrench Ltd to an unconnected company. The finance director informs you that Torque Ltd is proposing to buy a new shop for use in its trade for £250,000. Toolco Ltd is also proposing to buy a shop for £450,000 to let out on the open market.

In November 2019, Toolco Ltd assigned the lease of an office to Drill Ltd for a premium of £150,000. The lease was assigned to Toolco Ltd in November 2010 for £50,000. In November 2019, the lease had exactly 45 years left to run. In the same month Toolco Ltd also sold a painting to Drill Ltd for £6,500. The painting was purchased for £500 in January 1984.

In June 2015, Drill Ltd and Nail Ltd acquired 8% and 5% respectively of the ordinary share capital of Spanner Ltd. The remaining share capital is owned by unconnected third parties. Drill Ltd also acquired 10,000 5% preference shares in Spanner Ltd. An unconnected third party has approached Drill Ltd and offered to purchase its 8% holding of ordinary shares plus its holding of 10,000 5% preference shares in Spanner Ltd.

Spanner Ltd is an investment company with two subsidiaries: Bit Ltd, which specialises in selling goods from retail outlets, and Chuck Ltd, which owns a number of investment properties.

Toolco Ltd acquired 200 shares in Key Ltd, representing 20% of the ordinary share capital, in May 2016. In April 2018 it sold 150 of the shares. It has now received an offer from an unconnected company which wishes to buy the remaining 50 shares.

Nut Ltd acquired a 15% interest in the share capital of Bubble Ltd, a company whose sole activity is holding a portfolio of shares, in October 2016. It has now received an offer to buy its entire interest from an unconnected company.

Requirement:

Write a letter to the finance director of Toolco Ltd in which you explain, with the aid of calculations where appropriate, the Corporation Tax consequences of the above matters. (20)

2. You are a Tax Manager at a firm of accountants, Smith Accountants LLP, and have been assigned to a new client, White Ltd. You have recently met Mr Blue, the newly appointed Finance Director of White Ltd, who has limited tax knowledge. He has advised you of the following.

White Ltd has only two sources of income: dividends receivable from wholly owned UK subsidiaries and a small amount of interest receivable from monies held on deposit in bank accounts.

White Ltd acquired all of the shares of Cyan Ltd on 1 April 2019, incurring legal and accountancy fees of £250,000. The acquisition of Cyan Ltd was partly financed by new bank loans. Interest payable thereon for the accounting period ended 31 March 2020 was £1,500,000. The bank arrangement fees of £150,000 are amortised for accounting purposes over the 10-year term of the debt in accordance with UK GAAP.

During the year ended 31 March 2020, White Ltd considered acquiring another UK company, Purple Ltd. Legal and accountancy fees of £100,000 were incurred on initial investigations and due diligence but ultimately the acquisition was not made.

The shareholders of White Ltd have recently received an offer from a third party UK resident company, Rouge Ltd, to acquire the entire share capital of White Ltd. If acquired by Rouge Ltd, Rouge Ltd would change White Ltd's investment portfolio to include investment properties. Rouge Ltd has suggested that the purchase of these properties could be funded by a loan from its wholly-owned subsidiary, Black Ltd, with interest payable by White Ltd of 8% per annum.

Requirement:

Write a letter to Mr Blue explaining the Corporation Tax consequences of the information provided by Mr Blue. (15)

3. You are Derek Smith, the Tax Manager at Swan Ltd, a manufacturer of fishing tackle. Swan Ltd 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.

You have received an email from Terry Williams, Group Finance Director, as follows:

Hi Derek

I would like your tax advice on the following:

1) Goose Ltd is selling a freehold building, Stone House, which was bought on 1 May 2008 for £250,000. Until 31 December 2011, it was rented out to a neighbouring business. From 2012 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 2020.

2) Goose Ltd is planning to purchase a freehold building, Bear House, for £620,000 in March 2021. 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 2020.

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 2014 for £100,000. They were transferred to Pelican Ltd on 30 September 2018 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. For the purposes of your advice, you can assume that the sale will take place on 30 September 2021.

Please let me have your thoughts.

Regards

Terry

Requirement:

Write a memo to Terry Williams advising on the Corporation Tax consequences of the above proposals. Ignore indexation allowance. (20)

4. You are a Tax Manager at WorldTax LLP and have been asked to complete a Corporation Tax computation for Circle Ltd for the year ended 30 September 2020.

Circle Ltd is a UK tax resident pipe manufacturer based in Norfolk and has been a client of your firm for many years. It has no related 51% group companies.

You have been supplied with a draft profit and loss account and fixed asset note prepared by the company's bookkeeper.

Circle Ltd
Year ended 30 September 2020
Draft profit and loss account

Circle Ltd	£
Turnover	21,432,574
Cost of sales	(14,863,663)
Gross profit	6,568,911
Administrative expenses	(6,852,084)
Bank interest receivable (gross)	27,218
Interest payable	(98,247)
Loss on disposal (land)	(17,000)
Loss on disposal (plant)	(40,000)
Net loss	(411,202)

Tangible fixed assets	Freehold land	Factory buildings	Plant and equipment	Motor vehicles	Total
	£		£	£	£
At 1 October 2019	270,000	150,000	552,078	55,000	1,027,078
Additions	0	0	250,000	43,000	293,000
Disposals	(17,000)	0	(223,000)	0	240,000)
At 30 September 2020	253,000	150,000	579,078	98,000	1,080,078
Depreciation					
At 1 October 2019	0	30,000	278,000	22,000	330,000
Charge for the year	0	19,000	178,000	14,000	211,000
Eliminated on disposal	0	0	(78,000)	0	(78,000)
At 30 September 2020	0	49,000	378,000	36,000	463,000
Net book value					
At 1 October 2019	270,000	120,000	274,078	33,000	697,078
At 30 September 2020	253,000	101,000	201,078	62,000	617,078

All income and expenses are included within the profit and loss account unless otherwise stated. The depreciation charge is included within administrative expenses.

You have been told the following:

1) Circle Ltd took out a loan in 2018 to purchase a 4% shareholding of WCL Ltd, a UK tax resident company. The interest payable by Circle Ltd on this loan during the year ended 30 September 2020 was £30,000. The remainder of the interest payable related to another loan used to fund working capital for the trade. On 1 April 2020 Circle Ltd received a dividend of £45,000 from WCL Ltd (included in turnover).

2) Circle Ltd made a contribution of £800,000 to a registered pension scheme set up for its employees. The purpose of the contribution was to clear a funding deficit. Circle Ltd makes a regular annual contribution of £250,000. The contribution for the year to 30 September 2020 was fully paid to the pension scheme during that year.

3) In November 2019 Circle Ltd gifted a piece of freehold land to the recently disabled widow of a former employee so she could build a house on it adapted to her needs. The employee died two years ago. The land was purchased for £17,000 in December 2009 and valued at £38,000 at the time of the gift.

4) Legal fees of £73,000 were spent on an abortive application for planning permission relating to the extension of a factory building owned by Circle Ltd. A further £20,000 of legal fees were incurred in defending title to three acres of land adjacent to the factory building following a dispute over ownership with a neighbour.

5) Entertaining costs incurred were £15,000 for the accounting period. £600 of this expense related to pens which were gifts for clients, had the company's name on them and cost £60 each. £2,000 of the entertaining costs was incurred on the annual staff party.

6) Compensation of £50,000 was paid to another neighbour when a tree on the factory site fell on the neighbour's house and badly damaged it.

7) On 1 October 2019 the tax written down value of the general pool was £275,000 and the special rate pool was £196,000.

8) Fixed asset additions during the year were as follows:

   Plant and equipment

   a) Pipe cutting equipment, £50,000, purchased on 1 November 2019.

   b) Electrical and hot water systems, £175,000, purchased on 1 March 2020.

   c) IT equipment, £25,000, purchased on 8 April 2020.

   The IT equipment has an expected useful life of five years. The other plant and equipment has an expected useful life of 15 years.

Motor cars	£
New lorry	15,000
New Audi car	25,000 (CO_2 emissions 150g/km)
Second hand Nissan car	3,000 (CO_2 emissions 100g/km)

   All motor vehicles were purchased in April 2020.

9) The equipment disposed of was packing equipment.

10) In the year to 30 September 2019, Circle Ltd had taxable profits of £120,000 and paid £23,400 in Corporation Tax.

Requirement:

Prepare a Corporation Tax computation for Circle Ltd for the year ended 30 September 2020 with supporting explanations as appropriate. (20)

5. You have recently joined Swift plc, the parent company of a large multinational trading group, as their new in-house Tax Manager. Your predecessor retired some time ago and the UK tax compliance for the group has been neglected. The Swift group has 10 UK tax resident wholly owned subsidiaries and the Finance Director would like all their tax affairs to be brought up to date as quickly as possible.

In relation to the UK companies, you have ascertained that:

1) Corporation Tax computations and returns for the year ended 31 December 2016 were submitted on time. However, the return for one of the UK trading companies, Wren Ltd, erroneously showed its trading income to be £60,000 instead of £600,000.

2) Corporation Tax computations and returns for the year ended 31 December 2017 have not yet been submitted. The UK group was in an overall loss making position and so no Corporation Tax payments have been made.

3) Corporation Tax computations and returns for the years ended 31 December 2018 and 31 December 2019 have not yet been submitted. Timely Corporation Tax payments based upon the tax audit provision calculation for the purpose of preparing the group's financial accounts were made under Corporation Tax Self Assessment for both years. Recently prepared draft Corporation Tax computations show that some of the individual UK companies have underpaid Corporation Tax for the year ended 31 December 2018 but the group is still in an overpayment position overall.

4) On 1 January 2019, one of the UK companies, Bluebird Ltd, entered into a royalty agreement to pay for the use of certain patent rights held by Robin B.V., an associated company resident in The Netherlands. On 1 January 2019, Bluebird Ltd entered into a similar royalty agreement with another associated company, this time resident in the US. You have not found any documentation that explains how the price was determined nor have you found any evidence that withholding tax has been applied on any payments made.

5) Following a group reorganisation in August 2019, the Finance Director thinks that one of the UK companies may fall within the charge to the diverted profits tax.

Requirement:

Prepare notes for a meeting with the Finance Director of Swift plc to discuss the tax and penalty implications of the above information. (20)

You should assume that you are writing in July 2020 and you should note that the main rate of corporation tax for the accounting period ended 31 December 2016 was 20%.

6. You are Jamie Pinkman, the Group Tax Manager of the White Ltd group. You have received an email from David Norris, the Group Finance Director, containing the following information:

As a process of corporate simplification, the number of companies in the group will be reduced. 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 2019 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 2019 and has been dormant since then. The balance sheet at 31 December 2019 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:

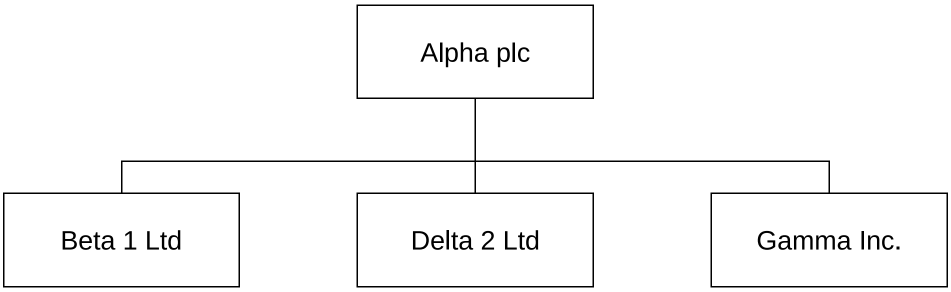
	£
Bank	10,000
	10,000
Share capital	10,000
Profit and loss account – reserves	0
Capital and reserves	10,000

Thereafter the company will be liquidated.

Requirement:

Write a memo to the Group Finance Director advising on the Corporation Tax consequences of the proposed transactions and the liquidation of the dormant subsidiaries as outlined above. (15)

7. You are a Senior Tax Adviser at a firm of accountants that acts for Alpha plc, which is a FTSE 250 listed holding company of a property development group with operations in the UK and the US. The group structure is set out below. All subsidiaries are wholly owned by Alpha plc. Gamma Inc. is incorporated and tax resident in the US and all other companies are incorporated and tax resident in the UK.



You have been asked to prepare the Corporation Tax computations for Alpha plc and Beta 1 Ltd for the year ended 31 December 2019.

Alpha plc

The company recorded the following result for the year ended 31 December 2019:

	Note	£
Income from grant of lease	1	14,000,000
Dividend income	2	5,000,000
Administrative expenses	3	(12,000,000)
Impairment of investments	4	(17,000,000)
Interest on external debt		(6,000,000)
Foreign exchange gain	5	5,000,000
Loss before tax		(11,000,000)

Notes

1) On 1 July 2019 Alpha plc granted a 30-year commercial lease to Omega Ltd, an unrelated London based retail company. Alpha plc acquired the freehold interest in the property as an investment on 1 September 2016 for £30 million and incurred no further expenditure prior to letting. The £14 million of income recognised comprises a £12 million premium and £2 million of rent. The reversionary interest is valued at £20 million and the right to receive future rent is valued at £15 million.

2) Alpha plc received a £5 million dividend from Delta 2 Ltd on 31 October 2019. Delta 2 Ltd was acquired on 1 February 2016 and carried on a specialist property refurbishment trade until being placed into voluntary liquidation by Alpha plc on 1 July 2019.

3) Administrative expenses comprise the following:

	£
Due diligence fees (ultimately did not acquire target)	2,000,000
Legal advice regarding liquidation of Delta 2 Ltd	500,000
Directors' remuneration	5,200,000
Advice in connection with external finance	3,000,000
Defence of takeover bid (price offered too low)	1,200,000
Financial Conduct Authority fine (unlawful activity)	100,000
Total	12,000,000

4) Alpha plc's investment in Delta 2 Ltd has been fully impaired following distribution of substantially all the company's assets. In addition, its investment in Gamma Inc. has also been subject to impairment.

5) The foreign exchange gain is in respect of an external US dollar loan. The Board of Alpha plc approved the company taking out the debt in order to hedge its underlying investment in Gamma Inc.

Beta 1 Ltd

Beta 1 Ltd has been trading for many years and specialises in the construction of residential property. The company recorded the following result for the year ended 31 December 2019:

	Note	£
Turnover		47,000,000
Cost of sales	1	(28,000,000)
Administrative expenses	2	(7,000,000)
Profit before tax		12,000,000

Notes:

1) Included within cost of sales is depreciation expense totalling £3.5 million.

2) Included within administrative expenses is £2 million in respect of a formal waiver of a loan from Beta 1 Ltd to Delta 2 Ltd after Delta 2 Ltd was placed into liquidation.

3) Beta 1 Ltd incurred the following capital expenditure during the year:

	£
Installation of a lift at head office (a freehold property owned by the company)	150,000
Conversion of ground floor into open plan office space	100,000
New bespoke accounting software	1,500,000
A second hand zero emissions lorry	150,000
Total	1,900,000

The company has a tax written down value brought forward on the general pool of £15,400,000 and no other company in the Alpha group claims capital allowances. The company began to use the newly converted office space on 1 July 2019.

4) You are advised that Beta 1 Ltd intends to make an election under s.815 CTA 2009 in respect of the computer software. An amortisation charge of £500,000 is included within cost of sales.

Delta 2 Ltd

The liquidation of Delta 2 Ltd was completed on 31 December 2019. The company realised a trading loss for tax purposes of £6 million for the period ended 31 December 2019 of which £4 million was carried back to the previous accounting period.

Requirement:

Prepare the Corporation Tax computations for Alpha plc and Beta 1 Ltd and state the due dates and amounts of payments for the year ended 31 December 2019. Where relevant, include explanations of the tax treatment of items of income and expenditure. Do NOT consider the application of the corporate interest restriction regime. (20)

8. Your client is Collop plc, a UK tax resident manufacturer of paint rollers.

Ashton Smith, the finance director, is preparing budgets and cash flow forecasts for the year to 31 March 2021. He has provided you with the following information about the Collop group companies, which, unless otherwise noted, are all wholly owned subsidiaries of Collop plc and have the same 31 March 2021 year end.

1) Speck Ltd. This company is tax resident in Pangaea. The company is forecast to have taxable trading profits of £400,000 and interest receivable of £40,000. Pangaea does not charge tax of any kind on company profits.

2) Tog Ltd. This company is tax resident in Laputia, a country with no double taxation treaty with the UK and where profits are not subject to local withholding or Corporation Tax. Collop plc owns a 20% interest in the share capital of this company with the remainder of the share capital being held by Laputian individuals. Estimated profits are £75,000.

3) Algarat Ltd. The company is tax resident in Gondwana. Its sole asset is the cash representing the share capital subscribed for by Collop plc. The company is expected to earn £100,000 in interest from a bank account in Gondwana. Gondwana does not charge Corporation Tax on profits but 10% local withholding tax will be deducted from the interest paid.

4) Mayhard Ltd. This company is also tax resident in Gondwana and manufactures and sells paintbrushes in that country only. The company was acquired two years ago. It is staffed entirely by locally recruited employees and has no activities whatsoever in the UK. The directors of Collop plc make occasional visits to Gondwana to review its activities but have no further involvement. All management decisions are made locally and Collop plc has provided no finance and minimal services of any other kind from the UK. Mayhard Ltd's expected profits for the year are £600,000.

The finance director has told you that he is aware that there is a regime for controlled foreign companies but he knows very little about it. "Tell me the basics and the tax administration," he says, "but only what is relevant to my group".

A colleague has confirmed to you that none of the subsidiaries are resident in countries included on the 'Excluded Territories' list.

Requirement:

Write a letter to the finance director commenting on the UK Corporation Tax consequences for the Collop group of the controlled foreign companies regime.

(20)

9. You are a Tax Manager at a firm of Chartered Tax Advisers. One of your clients is Organic Fruit plc, 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 2019 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 2019, 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 2019, 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 2020.

Requirement:

Prepare a letter to Paul Smith, the Finance Director of Organic Fruit plc, setting out 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)

10. You are Sam Cooper, the Tax Manager for Travel Agents plc, the non-trading holding company for a UK group.

Travel Agents plc applies EU-endorsed International Financial Reporting Standards (IFRS) for both its consolidated group accounts and individual company accounts. The group is not within the Senior Accounting Officer regime. The company has not previously used any derivatives.

You report to Arun Patel, the group's Finance Director, and you have just received the following email message from him:

Hi Sam

As you know, we have generally looked to finance Travel Agents plc using bank loans with variable rate interest. Our largest loan is for £50 million from Bank plc with an interest rate of LIBOR plus 4%.

We are concerned about the risk for the business if interest rates were to rise and are therefore considering the possibility of Travel Agents plc entering into an interest rate swap with Bank plc.

The swap will be treated as a derivative financial instrument in the accounts and will be measured at its fair value. We are planning to designate the swap as a cash flow hedge of the Bank plc loan. Under IFRS, most of the movements in fair value on the swap will be recognised in 'other comprehensive income' rather than in the income statement. These will subsequently be transferred ('recycled') from other comprehensive income to profit or loss in line with the hedged risk.

However, the hedge may not fully cover the additional costs of borrowing if interest rates rise. The part of the fair value movements relating to any failure of the hedge to fully cover these additional costs (the hedge 'ineffectiveness') will be recognised directly in the income statement as an item of profit or loss.

I would like to understand the Corporation Tax treatment of the loan and the swap. I am concerned that we might end up being taxed on the fair value volatility on the swap. The current market rates for the interest rate swap look attractive, so we would like to execute this over the next week if possible.

Kind regards

Arun

Requirement:

Draft an email response to Arun explaining the UK Corporation Tax consequences of the loan and derivative. (10)

11. You are a partner in an accountancy firm. Your client, H-to-O plc, is considering refinancing two of its UK subsidiaries, Water Ltd and Aqua Ltd. The Finance Director of H-to-O plc, Nick Nash, has contacted you in connection with the following proposed arrangements.

Water Ltd is to be provided a loan by the National English Lending Bank plc, a UK bank. This will take the form of an interest bearing revolving credit facility of £50 million over a 10-year term.

Sac d'Argent S.A., an unconnected Luxembourg non-bank lender, will also provide finance to Water Ltd over several years. The final terms have yet to be agreed, including whether the lending would be from Luxembourg or through Sac d'Argent S.A.'s London branch.

Aqua Ltd wants to expand its operations by acquiring the shares in Engine Ltd (described below). To enable this purchase, it has obtained a three-year financing package from Money Bags Ltd, an unconnected Cayman Islands lender. The terms give Aqua Ltd the ability to "capitalise" its interest payments (i.e. to roll up and defer payment of the interest), and ultimately to issue shares in itself in satisfaction of payment of the interest.

The shares in Engine Ltd are to be acquired from two individuals (Michael and Frank Engine). Due diligence has revealed that there are existing loan agreements between Engine Ltd and each of Michael and Frank, which are each for a term of nine months and repayable on demand. Nick is concerned by a "gross-up" clause (i.e. a clause obliging an additional payment to be made by Engine Ltd in the event a payment is subject to tax) in both those loan agreements.

Requirement:

Write a letter to Nick Nash, the Finance Director of H-to-O plc, explaining:

1) **The UK Withholding Tax obligations for the matters described above.** (13)

2) **The differences between the warranty and indemnity protection that Aqua Ltd could request from Michael and Frank Engine in the share purchase agreement.** (2)

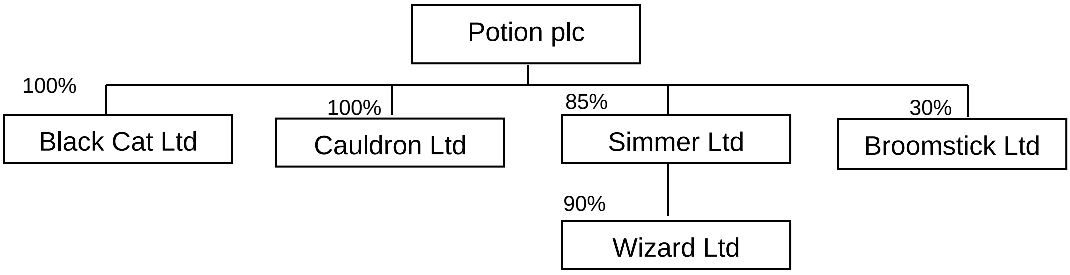
Total (15)

12. The Government has taken steps in recent years to make the UK tax system much more competitive with the aim of making it the location of choice for multinationals setting up a holding company.

Requirement:

Explain why the UK Corporation Tax system might be attractive to a multinational group setting up a holding company in the UK. (15)

13. You are a Tax Manager at an accountancy firm and you are assisting a partner in relation to the tax affairs of a new client, the Potion plc group. The group structure is shown below.



You have been supplied with the following information in relation to the companies, which are all UK tax resident. The Tax Manager at Potion plc has recently joined and he has not yet been able to locate full records, hence the information below is somewhat limited.

You may however assume that Potion plc and Simmer Ltd have no taxable income and that no shares are held as trading stock.

Black Cat Ltd

Results for the year ended 30 June 2018:	£million
Trading loss	(8.0)

All the shares in Black Cat Ltd were acquired by Potion plc on 1 March 2018 from a third party. On 1 July 2018, all the assets of Black Cat Ltd were transferred to another group company and Black Cat Ltd ceased trading.

Cauldron Ltd

Results for the year ended 31 December 2018:	£million
Trading profit	11.0
Qualifying charitable donation	(1.0)

At 1 January 2018, Cauldron Ltd had trading losses brought forward of £5 million and had a non-trading loan relationship deficit brought forward of £9 million (both amounts incurred in the year ended 31 December 2016).

Results for the year ended 31 December 2019:	£million
Trading profit	13.0
Non-trading loan relationship deficit	(10.0)
Chargeable gains	0.5

Cauldron Ltd does not wish to relieve its non-trading loan relationship deficit in the year ended 31 December 2019, but will carry it forward.

Wizard Ltd

Results for the year ended 31 December 2019:	£million
Trading loss	(3.0)

In August 2019, the directors of Potion plc agreed with a third party to sell Wizard Ltd, subject to contract. The heads of terms specified that the sale should be completed by 31 December 2019 but the sale aborted; the buyer had concerns relating to the unusually high interest rate contained in Wizard Ltd's debt facility agreement.

<u>Broomstick Ltd</u>

Results for the year ended 31 December 2019:	£million
Trading loss	(6.0)
Property business loss	(0.8)
CFC apportioned profits	0.2
Chargeable gains	0.5

Broomstick Ltd is a trading company and has nine other corporate shareholders. No shareholder holds less than 5% of the share capital.

Requirement:

Write a report for the Tax Partner discussing the operation of the group relief rules for Potion plc group for all relevant periods, using supporting calculations where appropriate. You are NOT required to discuss any filing obligations. (20)

14. You are the newly appointed in-house Tax Manager for Black Mining plc, the UK parent company of a global mining group. On 1 November 2019, Black Mining plc incorporated Gold Mine Ltd, a UK company. Gold Mine Ltd immediately registered a permanent establishment in Ruritania. On 1 December 2019 it made an election under s.18A CTA 2009.

The initial accounting period of Gold Mine Ltd ended on 30 June 2020, with its accounts prepared under FRS 102.

On 1 July 2020, Gold Mine Ltd acquired the rights to mine gold in Ruritania and its permanent establishment commenced mining operations. The group had not previously mined gold, focusing instead on copper, silver and iron.

Gold Mine Ltd funded the acquisition and its operations by way of a US$500 million fixed rate interest bearing loan from Black Mining plc. Black Mining plc had raised the capital through a combination of a rights issue and external debt carrying a floating rate of interest.

Gold Mine Ltd entered into a range of commodity hedging contracts in the form of put options. These contracts provide a strike price derived from the price of gold and the other commodities mined by the wider group. If the market price falls below the strike price, the options will be in-the-money and a payout will be made on a monthly basis.

Gold Mine Ltd has also entered into fixed interest rate swaps to hedge the interest rate exposure on the external debt raised by Black Mining plc. Hedge accounting is applied in the group's consolidated financial statements but not in Gold Mine Ltd.

The Group Finance Director, John Silver, has explained that no tax advice was previously taken on the financing and hedging transactions and has asked you to review the tax implications. In addition, John would like to understand whether it would be advantageous from a tax perspective if a similar permanent establishment structure were used to acquire new mining investments.

Requirement:

Draft a memo to John Silver advising on:

1) **The Corporation Tax implications of the intra-group financing and hedging transactions.** (11)

2) **Whether from a Corporation Tax perspective the structure may be suitable for future prospects.** (4)

Total (15)

15. Alpha Ltd, a company that manufactures plastic bottles, holds 40% of the issued share capital of Beta Ltd, a company that produces and sells soft drinks. Under the Shareholders' Agreement of Beta Ltd, Alpha Ltd's Board of Directors holds the right to appoint a majority of directors to the Board of Beta Ltd. Two other corporate shareholders each hold 30% of the issued share capital of Beta Ltd; neither are otherwise connected to Alpha Ltd or to each other. Beta Ltd has only one class of shares, all with identical rights and powers.

Alpha Ltd also holds 20% of the issued share capital of Finco Ltd. None of the other shareholders of Finco Ltd are otherwise connected to Alpha Ltd or Beta Ltd or to each other. Finco Ltd has only one class of shares, all with identical rights and powers, and there is no Shareholders' Agreement.

In the year to 31 December 2018, Alpha Ltd lent Finco Ltd £10 million. Finco Ltd on-lent the £10 million on the same terms to Beta Ltd. Both loans are repayable on demand and were documented in a loan agreement. Repayment of both loans has now been demanded but Beta Ltd is unable to make the repayment and therefore Finco Ltd is unable to repay the loan to Alpha Ltd.

In the year to 31 December 2019, Alpha Ltd sold bottles to Beta Ltd. One invoice, for £200,000, remains unpaid.

A provision for bad debts of £10.2 million in respect of the £10 million loan and the £200,000 unpaid invoice has been included in the profit and loss account for Alpha Ltd in the year to 31 December 2020.

All of the above-mentioned companies are UK tax resident.

Requirement:

Explain how the loan relationships legislation will apply to Alpha Ltd. (10)

ANSWERS

1. TOOLCO LTD

Our address

Your address

Date

Dear Sir

PROPERTY DISPOSALS

It was good to meet you yesterday. I can advise as follows on the matters which you raised.

Transfer of assets to Chisel Ltd

Prior to the sale of Chisel Ltd, Torque Ltd and Chisel Ltd are within the same group for the purposes of corporation tax on chargeable gains, since both Torque Ltd and Chisel Ltd are wholly owned subsidiaries of Toolco Ltd. Accordingly the sale of the shop to Chisel Ltd in June 2019 occurred at no gain/no loss and no charge to corporation tax arose. The base cost of the shop to Chisel Ltd would be the cost plus indexation to December 2017.

If Chisel Ltd is subsequently sold within 6 years of the intra-group transfer still owning the shop, a "de-grouping" gain or loss arises on the sale of the shop to Chisel Ltd, based on the market value of the property at the time of the transfer (in June 2019), less its indexed cost. A gain arises in this case as follows:

	£
Market value of the shop at transfer (June 2019)	400,000
Less: Cost of shop (Jan 2013)	(75,000)
Less: Indexation to Dec 17 ((278.1-245.8)/245.8) = 0.131 x 75,000)	(9,825)
Degrouping gain	315,175

As Chisel Ltd will leave the group as a result of a disposal of shares, the gain will be added to the consideration received by Toolco Ltd in calculating the gain or loss on the disposal of its shares in Chisel Ltd. If the substantial shareholding exemption applies with regard to the gain/loss on the shares (see below), it will also apply with regard to the gain under the de-grouping charge rules. If SSE does not apply it is possible to transfer the gain to another group member under s.171A TCGA 1992.

However, Toolco Ltd may elect (under s.179ZA TCGA) for part of the de-grouping gain not to be so treated but instead to reduce the base cost of the shop owned by Chisel Ltd. The amount of the reduction must take into account the amount paid for the shop by Chisel Ltd. Such an election may be beneficial in this case if the gain realised by Toolco Ltd on its disposal of Chisel Ltd does not qualify for the substantial shareholdings exemption (SSE) (which would effectively operate to shelter part of the de-grouping gain – see below for a discussion of the availability of SSE), especially since Chisel Ltd enters into a transaction in respect of the shop with a fellow group company in respect of which the no gain/no loss treatment applies.

Grant of lease to Wrench Ltd

Since the lease has less than fifty years to run, a portion of the lease premium charged to Wrench Ltd is taxable as UK property income of Chisel Ltd as follows:

UK property business income: 22% x 200,000 = £44,000

22% is computed as (50 years less 39 years)/50 years.

Tutorial Note:

Alternative calculation is 2% x (40 – 1) = 78% of the premium is capital.

The remaining portion of the premium would ordinarily be taken into account in computing the chargeable gain arising on the grant of the lease. However, since Chisel Ltd and Wrench Ltd are within the same group for the purposes of chargeable gains, the disposal takes place at no gain/no loss and no chargeable gain arises.

A de-grouping charge on the grant of the lease does not arise when Chisel Ltd is sold since both Chisel Ltd and Wrench Ltd are associated companies, Wrench Ltd being a 75% subsidiary of Chisel Ltd from the date of the intra-group transfer until immediately after they leave the group.

Transfers of assets to Drill Ltd

Toolco Ltd and Drill Ltd are not within the same gains group since Toolco Ltd owns less than 75% of the ordinary share capital of Drill Ltd. Toolco Ltd and Drill Ltd are connected persons for tax purposes since the former controls the latter. Accordingly the leasehold interest and the painting are deemed to be disposed of at their market value for the purposes of computing any chargeable gains.

Toolco Ltd may wish to agree an open market value for the disposals once they have taken place with HMRC using form CG34. Alternatively full details of the open market values used and how they have been computed should be disclosed on Toolco Ltd's company tax return.

On the assumption that the values given are open market values, the chargeable gains arising are as follows:

Leasehold interest	£
Market value at transfer (Nov 2019)	150,000
Less: Cost (50,000 x 98.059%) (note) (Nov 2010)	(49,030)
Less: Indexation to Dec 17 ((278.1-226.8/226.8) = 0.226 x 49,030)	(11,081)
Chargeable gain	89,889

Note: This is the wasting fraction: 45yrs/54yrs - 98.059%/100%
(TCGA 1992 Sch 8, para 1 refers)

Painting	£
Market value at transfer (Nov 2019)	6,500
Less: Cost (Jan 1984)	(500)
Less: Indexation to Dec 17 ((278.1-86.84)/86.84) = 2.202 x 500)	(1,101)
Chargeable gain	4,899

This gain is restricted to 5/3 x (gross proceeds – 6,000) = £833.

Disposal of shares in Spanner Ltd

The sale of this interest may qualify for the substantial shareholdings exemption (SSE) and be exempt from corporation tax on chargeable gains. The following conditions need to be met:

1) The shares must be held for at least twelve months in a period ending not more than six years before the disposal.

   Drill Ltd has owned the shares in Spanner Ltd for longer than one year. This condition is therefore met.

2) At least 10% of the ordinary share capital of Spanner Ltd must be owned.

Drill Ltd owns only 8% of the ordinary share capital; however shareholdings owned by members of the same group are aggregated. Nail Ltd owns 5% of the share capital. "Group" for the purposes of the SSE is defined as including 51% subsidiaries. Accordingly Nail Ltd and Drill Ltd are in the same group and this test is met as Drill Ltd is regarded as owning 13% of the ordinary share capital of Spanner Ltd.

3) Spanner Ltd must be a trading company or the holding company of a trading group or subgroup after the disposal and throughout the period beginning with the start of the latest 12-month period required for the substantial shareholding condition and ending with the date of disposal, which it is and has been.

From the information given, it appears that Bit Ltd is a trading company and Chuck Ltd is an investment company. Whether Spanner Ltd is the holding company of a trading group will depend on whether taken as a whole, the Spanner Ltd group's activities do not include to a substantial extent activities other than trading activities. HMRC have indicated that in coming to a conclusion on this matter they will consider the following:

1) The group's turnover and profits;
2) The value of its trade and non-trade assets; and
3) The activities of its employees and officers.

HMRC generally consider 20% to be 'substantial'. I will need more information to help me determine whether or not the Spanner Ltd group qualifies as a trading group.

Alternatively, if the conditions for the SSE are not satisfied at the time of the disposal the SSE may still be available if the conditions were satisfied at some time in the previous two years. This is termed the second subsidiary exemption. Among other conditions, the substantial shareholding must have been owned by the group companies for a period of twelve months in the two years prior to the disposal and Drill Ltd must be tax resident in the UK at the time of disposal for the exemption to be available.

If the disposal of the ordinary shares in Spanner Ltd qualifies for the SSE then the disposal of the fixed rate preference shares will also qualify for the SSE.

Disposal of shares in Chisel Ltd

Similar comments to the above apply to the disposal of the shares in Chisel Ltd. The company has been wholly owned by Toolco Ltd for more than twelve months in the qualifying period. However, Chisel Ltd is an investment company and the disposal will only qualify for the SSE if it is the holding company of a trading group or subgroup, using the criteria set out above. It will thus be necessary to find out more about the activities of Wrench Ltd in order to ascertain whether the SSE is available in respect of this transaction.

Disposal of shares in Key Ltd

Any gain arising on the pending disposal of the 5% interest in Key Ltd will not qualify for the SSE since a substantial shareholding has not been owned by Toolco Ltd for a continuous period of twelve months in the period of at least six years ending on the date of disposal.

Disposal of shares in Bubble Ltd

In order for the disposal of Bubble Ltd to qualify for the SSE, Bubble Ltd would need to be a trading company or the holding company of a trading group or subgroup throughout the period beginning with the start of the latest 12-month period in relation to which the substantial shareholding test was met and ending with the time of disposal. Since Bubble Ltd's sole activity throughout this period is an investment activity, the SSE will not be available on this disposal.

If you have any further questions please do not hesitate to contact me.

Yours faithfully

A Jones – Tax Adviser

Tutorial Note:

The question does not give address details, therefore the short cut letter format is acceptable. The examiner's comment in relation to the reallocation of the degrouping charge and the opportunity to claim rollover relief is now obsolete following a change in the law in FA 2011.

MARKING GUIDE

TOPIC	***MARKS***
Letter format	*1*
Transfer of assets to Chisel Ltd	
− explaining NGNL disposal	*1*
− identifying de-grouping gain/loss arises on sale of Chisel Ltd + basis of calculation	*1*
− calculation of de-grouping gain	*1*
− treatment of gain	*½*
− identifying possible s.179ZA election	*½*
− implications of election for group	*1*
Grant of lease to Wrench Ltd	
− identifying element of premium charged as UK property income	*½*
− calculation of amount charged as property income	*½*
− identifying NGNL disposal	*½*
− identifying no de-grouping charge on sale of Chisel Ltd	*1*
Transfers of assets to Drill Ltd	
− identifying not within group	*½*
− identifying connected	*½*
− identifying disposal at MV	*½*
− discussion re form CG34/disclosure	*½*
− gain on leasehold interest	*1*
− gain on painting	*1*
Disposal of shares in Spanner Ltd	
− Conditions for SSE to be met + application to group (1 each)	*4*
− discussion re whether Spanner subgroup qualifies as a trading group	*1*
− discussion re second subsidiary exemption	*1*
− identifying further information needed re trading position of Spanner group	*1*
− application to preference shares	*½*
Disposal of shares in Chisel Ltd	
− consideration of SSE	*½*
Disposal of shares in Key Ltd	
− explaining why SSE does not apply	*1*
Disposal of shares in Bubble Ltd	
− explaining why SSE does not apply	*1*
TOTAL (MAX)	***20***

Examiner's report:
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This question was about two things – the tax consequences of certain capital disposals and the operation of the substantial shareholdings exemption. Overall candidates grappled well with both parts of the question and it was well answered.

Candidates were able to identify who did and who did not form part of a 75% gains group for tax purposes. They also explained well the operation of the degrouping charge and calculated it accurately. There was generally a good discussion of the election available to transfer the degrouping charge to other members of the gains group and the opportunity to claim rollover relief. The property income charge on the grant of a lease was also usually correctly calculated.

Most candidates realised that Drill was not a member of the gains group and that disposals to it triggered a chargeable gain. Few candidates observed that such a gain was deemed to be at market value and some candidates struggled with the calculation of the gain on sale of the painting and the chattels relief available. However this was a minor part of the question.

Candidates had clearly been well trained in the application of the Substantial Shareholdings Exemption (SSE) and scored well. Many realised that the shareholdings of Drill and Nail Ltd should be aggregated to determine whether or not SSE was available though fewer noted that the exemption would also in this instance apply on the disposal of the preference shares. Most candidates explained correctly that the SSE was not available for the disposals by Key and Nut. Some candidates missed easy marks by not listing the conditions for SSE to apply, such as it is available for a holding of at least 10% of the share capital in a company.

2. WHITE LTD

A Tax Manager
Smith Accountants LLP
[Address]

Mr Blue
Finance Director
[Address]

Date

Dear Mr Blue

WHITE LTD

Further to our recent meeting, I have set out below the Corporation Tax implications of the issues we discussed.

Company with investment business

White Ltd is actively managing investments and will be classified as a company with investment business for Corporation Tax purposes.

Dividend income

The dividend income received from wholly owned subsidiaries is exempt from Corporation Tax. If White Ltd is a small company for this purpose the dividend income is exempt because it is paid by UK companies. If White Ltd is not a small company the dividend income is exempt because it is paid by companies under White Ltd's control.

Expenses of Management

A company with investment business is entitled to a deduction for expenses incurred in managing its investments provided a number of conditions are met. The expenses must be incurred in respect of so much of the company's business as consists of making investments, must not be incurred for an unallowable purpose during the accounting period, and must not be capital in nature.

An investment is held for an unallowable purpose if it is not held for a business or commercial purpose, or is held for the purpose of activities in respect of which the company is outside the charge to corporation tax.

The capital test may preclude a deduction of the whole or part of White Ltd's legal and professional fees (£250,000). Expenditure up to the date at which the decision to acquire (or not acquire) an investment is made is not capital because up to that point the company is merely appraising its investment opportunities. This rule also applies to abortive costs regarding the purchase of Purple Ltd. Whether the professional fees are deductible as management expenses depends, therefore, on their nature and when they were incurred. A full review of expenditure and the transaction time lines should be performed.

Relief for management expenses

Management expenses are automatically set against total profits of the company for the accounting period to which they relate. Where they exceed the gross income and gains in the current accounting period the "excess" is carried forward for offset against future total profits of the company.

Excess management expenses can also be group relieved against taxable profits of qualifying group companies (which includes wholly owned UK subsidiaries).

Loan relationships

Interest receivable by White Ltd on bank deposits will be treated as a non-trading loan relationship credit (NTLRC) and interest payable on the loan to purchase the investment is a non-trading loan relationship debit (NTLRD).

Bank arrangement fees will qualify as NTLRDs. Their recognition for tax purposes will follow their accounting treatment.

NTLRDs and NTLRCs are pooled together to give a net “profit” or a net “loss” (called a “deficit”). If White Ltd has a deficit, relief can be obtained by offsetting it against total profits of the period, by carrying it back against NTLR profits of the previous 12 months, or possibly by surrendering it as group relief.

Subject to prescribed limitation, unutilised NTLRDs are carried forward against total profits of future periods or may be surrendered as group relief in future periods.

Investment properties

Income from all UK property is treated as a single source of business income for Corporation Tax.

Transfer pricing

As White Ltd and Black Ltd will be connected (both being subsidiaries of Rouge Ltd), the companies must ensure that the 8% interest rate on the loan from Black Ltd to White Ltd does not exceed the rate that would be payable to a third party lender, to avoid falling foul of the transfer pricing rules.

Change in ownership of company

Anti-avoidance rules exist which restrict the availability of certain tax losses for carry forward in a company with investment business where there is a change in ownership of the company and other conditions are met within the prescribed period. The rules apply to NTLRDs and excess expenses of management where, within the prescribed period, there is a major change in the nature or conduct of the business, which includes a major change in the nature of investments held by a company.

If Rouge Ltd acquires White Ltd and changes the activities of White Ltd to include investment properties, this is likely to constitute a major change in the nature or conduct of the investment business.

Tax group

After its acquisition, White Ltd and its subsidiaries would be part of the Rouge Ltd group for Corporation Tax. This can have a number of consequences including for group relief, capital gains grouping and group payment arrangements.

The Rouge group entities will also count as related 51% group companies for the whole of the accounting period.

If you have further queries please don’t hesitate to contact me.

Yours sincerely

A Tax Manager
Smith Accountants LLP

CIOT MARKING GUIDE

TOPIC	***MARKS***
Presentation	*1*
Definition of company with investment business	*1*
Expenses of management – statutory conditions	*1*
Expenses of management – capital restriction and timeline	*1*
Expenses of management – capital – abortive costs, case law e.g. Camas	*1*
Dividend exemption	*1*
Loan relationships – interest paid and received	*1*
Loan relationships – costs of raising loan finance	*1*
Expenses of management – current period offset / group relief / c/f	*1*
Debits to loan relationships - current period offset / group relief / c/f	*1*
Property income	*1*
Transfer pricing – loan from Black Ltd to White Ltd	*1*
Rouge Ltd tax group / number of 51% subsidiaries	*1*
Change in ownership – loss restrictions (expenses of management / NTLR)	*2*
TOTAL	***15***

Examiner's report:
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This question addressed the candidate’s understanding of companies with investment business and relief for management expenses and non-trade loan relationship deficits. In particular the question focused on the rules regarding capital expenditure incurred in relation to the purchase of investments e.g. Camas v Atkinson. Many candidates failed to note that a full analysis of deal costs may identify a proportion that are revenue rather than capital in nature – relating to advice prior to the decision being made to make the acquisition.

The question also expected candidates to identify the likely tax consequences of differing income sources within the investment company and the potential tax consequences of differing types of loss, for example, management expenses and non-trade loan relationship deficits arising in the company. These points were missed by many candidates.

3. SWAN LTD

Memo

To: Terry Williams, Group Finance Director
From: Derek Smith, Tax Manager
Subject: Property sales and transfers
Date: X November 2020

As requested I set out the tax consequences of the proposed transactions.

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 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 2021, 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.

<u>Disposal of Wyvern House</u>

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 the proceeds are "rolled over" into the acquisition of a qualifying asset in 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 into 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, i.e. 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.

<u>Transfer of fly reel patents</u>

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). This 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 (i.e. for three years from 1 October 2018 until 30 September 2021).

So (£10,000 x (150,000/100,000) - £10,000) x 3 years = £15,000 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 - £15,000 = £75,000.

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

APPENDIX 1
Calculation of gain on sale of Wyvern House

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

Rollover relief calculation

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%)

Tutorial Note:

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	*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.

4. WORLDTAX LLP

Circle Ltd

Tax computation – year ended 30 September 2020

	£
Trading profit	Nil
Non-trade loan relationship credit	Nil
Chargeable gain (Note 1)	16,308
Less non-trading loan relationship deficit (Note 2)	(2,782)
Less current year trading loss	(13,526)
Total taxable profit	Nil
Tax to pay	Nil
Taxable profit in previous year	120,000
Loss carried back	(82,794)
Taxable profits (revised)	37,206
Tax at 19%	7,069
Tax already paid	(23,400)
Tax to be repaid	(16,331)

Tax Adjustments

	Note	£	£
Loss before tax			(411,202)
Add:			
Depreciation		211,000	
Excess pension contribution	3	262,500	
Loss on disposal of land	1	17,000	
Legal costs	4	73,000	
Compensation costs	5	50,000	
Entertaining costs	6	13,000	
Interest payable re loan	2	30,000	
Loss on disposal re plant		40,000	
			696,500
Less			
Dividend receivable	7	45,000	
Capital allowances	8	309,400	
Interest receivable	2	27,218	
			(381,618)
Trading loss			(96,320)

Loss working

	Trading losses	Non-trade loan relationship deficit
	£	£
Loss arising during the year	96,320	2,782
Offset against chargeable gain arising in the year	(13,526)	(2,782)
Carried back against prior year profits	(82,794)	
Carried forward at 1 October 2020	0	0

Capital allowance working

	Note	Main pool	Special rate pool	Allowances claimed
		£	£	£
Tax written down value at 1 October 2019		275,000	196,000	
Additions:				
Pipe cutting equipment		50,000		
Electrical and hot water systems			175,000	
New IT equipment	8(a)	25,000		
New lorry		15,000		
New Audi car	8(b)		25,000	
Second hand Nissan car	8(b)	3,000		
Disposal proceeds	8(c)	(105,000)		
		263,000	396,000	
Annual Investment Allowance	8(d)	(90,000)	(175,000)	265,000
		173,000	221,000	
Writing down allowance (18%/6%/18%)		(31,140)	(13,260)	44,400
Tax written down value at 30 September 2020		141,860	207,740	
Allowances claimed				309,400

Notes

1) The gift of land will be treated as a disposal of a chargeable asset. Proceeds of sale are deemed to be the market value at time of sale.

	£
Deemed sale proceeds (= market value of land)	38,000
Cost of land	(17,000)
Indexation factor (December 2009 to December 2017) (0.276 x 17,000)	(4,692)
Chargeable gain on disposal of land	16,308

Calculation of indexation factor: (278.1 – 218.0)/218.0 = 0.276 (to 3 decimal places).

2) Interest payable (£30,000) in the current year relating to the loan to purchase an interest in WCL Ltd is a non-trade loan relationship debit and will automatically be offset against the interest receivable (£27,218) in calculating the net NTLR credit/deficit for the year. The NTLR deficit (£2,782) incurred in the year can then be used to offset against other profits in the period. This would be used before the trading loss. Assuming the rest of the interest relates to a loan used to obtain working capital for use in the trade, a deduction against trading profits may be claimed for the remaining interest payable.

3) The additional pension contributions (£550,000) are more than 210% of the amount in the previous period (£250,000). There is, therefore, an 'excess' which is the amount of the contribution in the current period that is more than 1.1 times the contribution in the previous period – so £525,000 ((£800,000 – (1.1 x £250,000)). £525,000 is greater than £500,000 and therefore the deduction for the £525,000 will need to be spread over two periods. This amount is split equally (£525,000/2 = £262,500) over the current chargeable period and the next chargeable period. £262,500 will therefore be disallowed in the year to 30 September 2020 and deducted in the next period.

4) Legal costs

   a) £73,000 relates to proposed capital expenditure, being the extension of the factory, and so is disallowed. The fact the plans to extend were abortive does not impact on this.

   b) £20,000 relates to defending title already owned by Circle Ltd, which is used in the trade. The expenditure is incurred to maintain the existing position without addition or improvement, so is allowable.

5) The damage to the house triggered by the collapsing tree is caused by Circle Ltd in its capacity as property owner not as a trader, so the compensation payment is not deductible. It is not a loss connected with or arising out of the trade.

6) The staff party costs of £2,000 are deductible. The pens are not deductible since they cost more than £50 each. The rest of the entertaining costs are disallowable.

7) The dividend of £45,000 from WCL Ltd benefits from the portfolio exemption within the dividend exemption legislation on the basis that Circle Ltd owns less than 10% of the share capital of WCL Ltd. So the dividend is not taxable.

8) Capital allowances

   a) Although the computers have a useful life of less than eight years, there is no advantage to be obtained in making a short life asset election as the expenditure on them qualifies for AIA. The effect of the election would be to have an amount of zero in the short life asset pool. Were the IT equipment to be disposed of within eight years of being purchased, a balancing charge would arise by reference to the disposal proceeds (which would be treated as taxable trading income at the time of the disposal).

   b) The Nissan has vehicle emissions of less than 110g/km so the cost is allocated to the main pool. The Audi's emissions are higher than 110g/km so the cost is allocated to the special rate pool.

   c) The proceeds on disposal have been allocated to the main pool.

Net book value of assets disposed of (plant)	£
(= 223,000 – 78,000)	145,000
Loss on disposal (plant)	(40,000)
Proceeds on disposal	105,000

   d) The maximum Annual Investment Allowance (AIA) for the period is £1,000,000. AIA is available for machines and tools, IT equipment and lorries, but it does not apply to cars.

CIOT MARKING GUIDE

TOPIC	***MARKS***
Add back depreciation and loss on disposal	*1*
Excess pension contribution and explanation	*2*
Gift of land	*1*
Legal costs re abortive expenditure	*1*
Legal costs re defending title to land	*1*
Compensation payment to neighbour (Strong & Co of Romsey Ltd v Woodifield (1906) 5 TC 215).	*1*
Entertaining costs	*1*
Treatment of dividend	*1*
Annual Investment Allowance for the year	*2*
Allocation of plant additions	*1*
Allocation of motor vehicles	*1*
Calculate disposal proceeds and deduct from main pool	*1*
Compute writing down allowance and capital allowance claim	*1*
No short life asset election made	*1*
Trading loss	*1*
Loan relationship debits and credits, priority rules. (S461 CTA 2009)	*2*
Loss carry back and tax refund.	*1*
TOTAL	***20***

Examiner's report:
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Overall the question was very well answered. Candidates showed a good knowledge of how to compute the taxable trading profits of a company and were able to identify the disallowable costs incurred by Circle Ltd.

Candidates showed a strong knowledge of capital allowances and were able to establish what assets qualified for each allowance. Many candidates calculated the Annual Investment Allowance correctly and dealt effectively with the disposal proceeds in relation to the packing equipment.

Most candidates were able to distinguish between trading and non-trading interest and were able to identify and compute the loss carry back.

Points of difficulty included the disposal by way of gift, which is a chargeable gain with proceeds deemed to be market value. Some candidates thought that the amount spent on the ownership dispute with the neighbour were capital in nature when in fact they were likely to be deductible from the trading profits.

5. ROBIN BV & BLUEBIRD LTD

NOTES

If a taxpayer has taken 'reasonable care' in completing a return and has taken reasonable steps to disclose any errors, no penalty will apply. 'Reasonable care' varies according to the circumstances and abilities of the taxpayer. If taxpayers do not promptly tell HMRC when they discover an error, this will be a careless inaccuracy even when the taxpayer took reasonable care.

<u>Company Tax Returns 2016</u>

The potential penalty for submitting an inaccurate return is a percentage of the potential lost revenue ('PLR') as a result of the inaccuracy and the percentage depends on the behaviour of the taxpayer. If the behaviour here was carelessness, the penalty is 30% x PLR.

In this case the PLR is likely to be £600,000 - £60,000 = £540,000 x 20% = £108,000 so that the penalty is £108,000 x 30% = £32,400.

This penalty may be reduced to nil provided the company makes an unprompted disclosure and corrects the error.

<u>Company Tax Returns 2017</u>

The filing due date for Company Tax returns is 12 months after the end of the accounting period so the returns should have been submitted by 31 December 2018. There is an immediate £100 penalty per return, regardless of whether the tax payable has been paid. The total penalty for all 10 companies is £1,000. In addition, daily penalties of £10 per day apply where the return is more than 3 months late for a maximum of 90 days, so £9,000 (90 days x £10 = £900 x 10 companies). The total fixed penalty is £10,000.

The returns are over 6 and 12 months late so there is potentially a tax-based penalty. That penalty for being 6 months late is related to the tax that should have been shown in the returns. That penalty for being 12 months late is:

- 70% x tax due where the withholding of information is deliberate and not concealed, or

- 100% x tax due where withholding of information is deliberate and concealed, or

- 5% x tax due in other cases.

If relevant group relief claims are made, there should be no tax payable for the group and so no tax based penalty.

However, as the returns are over 6 months late, there is still an additional penalty of £300 per return (i.e. £300 x 10 = £3,000). Also, as the returns are over 12 months late, there is still a further additional penalty of £300 per return (i.e. £300 x 10 = £3,000).

<u>Company Tax Returns 2018</u>

Since these returns were due to be filed by 31 December 2019, they are over six months late. The position is as per the 2017 company tax returns.

The 5% tax based penalty will not apply provided that any group company that has overpaid tax surrenders its tax overpayment to the other group companies that have underpaid. For a tax surrender to be effective both companies must be members of the same group, as defined for group relief purposes, throughout the accounting period to which the refund relates, and have the same accounting period. A joint surrender notice must be given to HMRC before the refund is made to the surrendering company.

Company Tax Returns 2019

These returns are due to be filed by 31 December 2020 and as such no late filing penalties have yet been incurred.

Royalty payments made to Robin B.V.

Withholding Tax

Royalties paid for the use of a patent are subject to the withholding tax provisions as the payment is of an income rather than a capital nature. 20% withholding tax should be deducted from the royalty payment and accounted for to HMRC on a quarterly basis.

However, royalties paid between associated companies within the EU are free of withholding tax so no further action is required.

Corporation Tax

Patent royalties are dealt with under the rules for intangible fixed assets and are taxed on an accruals basis. The royalty payment should be deducted from Bluebird Ltd's trading profits.

Transfer Pricing

If Robin B.V. and Bluebird Ltd are under the same participation, i.e. if Swift plc controls both Robin B.V. and Bluebird Ltd, the transfer pricing provisions may apply if there is a UK tax advantage – for instance, if Bluebird Ltd's trading profits are reduced as a result of an over-priced royalty payment or losses are increased as a result of the royalty payment.

The price of the royalty payment should adhere to the arm's length provision, determined by OECD guidelines. So the price should be based on the terms and conditions that independent parties would adopt. If not comparable, then transfer pricing rules will apply and the taxable profits of Bluebird Ltd must be restated using an arm's length price for the royalty payment.

A transfer pricing adjustment to the profits of Bluebird Ltd could lead to double taxation (if the same profit is taxed in the UK and in the Netherlands) if it is not matched by an adjustment to the profits of Robin B.V. There is an arbitration convention to avoid such double taxation arising between EU member states.

Under Corporation Tax Self-Assessment a company is required to self-assess its liability under the transfer pricing rules, supported by documentation. Companies must keep all records used in making and delivering a correct tax return until the latest of:

- Six years from the end of the accounting period;
- The date after which enquiries may not be commenced; and
- The date any enquiries are completed.

Failure to keep records could result in a maximum penalty of £3,000.

Royalties paid to a connected party in the US

Bluebird Ltd may choose to make the royalty payment at the reduced treaty rate of deduction (if applicable) without prior clearance from HMRC if the company reasonably believes that the US entity is entitled to the treaty benefit.

The Corporation Tax and transfer pricing comments above apply equally here.

Diverted Profits Tax ("DPT") notification

If a company is potentially within the charge to DPT, it must notify HMRC in writing accordingly within 3 months of the end of the accounting period. As the accounting period ended on 31 December 2019, the notification was due by 31 March 2020. As the company has failed to notify HMRC within the relevant time frame, a tax-geared penalty may be issued.

MARKING GUIDE

TOPIC	***MARKS***
Wren Ltd 2016	
Reasonable excuse discussion	*1*
Calculation of penalty for inaccurate return due to carelessness	*½*
Mitigation	*½*
Due filing date for returns	*1*
Tax returns 2017	
Rules for fixed penalty rules for filing late £100 + £10 per day x90 days	*1*
Rules for tax based penalty rule for filing late	*½*
Application of the rules to question £1,000 per company	*½*
total for the group	*½*
Tax returns 2018	
Amount of fixed penalty for late filing £1,000	*½*
Explanation of tax surrenders and conditions	*1*
Amount of tax based penalties	*½*
Royalties	
Explanation of withholding obligations s.903 ITA 2007 and	*1*
EU directive application	*1*
Corporation tax treatment of patent royalties	
Royalties paid – accruals basis	*1*
Deduction from trading income	*1*
Transfer pricing	
Special relationship so rules potentially apply	*1*
OECD guidelines arm's length pricing and independent prices explanation	*1*
What the UK tax advantage is here	*1*
Consequences – profits taxed on independent prices	*½*
Double taxation – EC convention	*½*
CTSA - Documentation requirement for TP	*½*
Keeping records and penalty for failure	*1*
Royalties to US entity	
Reduction in rate under DTA s.911 ITA 2007	*1*
Diverted Profits Tax	
Duty to notify	*½*
Time – 3m from AP. Notification not made and so tax geared penalty may apply	*1½*
TOTAL	***20***

6. WHITE LTD

INTERNAL MEMO

From: Jamie Pinkman
To: David Norris
Subject: Corporate Simplification
Date: xx

Dear David

I refer to your recent email on the proposed process of corporate simplification.

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) Clearances

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.

I will be happy to discuss these matters more fully with you at your convenience.

CIOT MARKING GUIDE

TOPIC	***MARKS***
Presentation	*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 stated that the memo should 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.

7. ALPHA PLC & BETA LTD

Alpha plc

Corporation tax computation – Year Ended 31 December 2019

	Workings	£
Property income	(W1)	7,040,000
Chargeable gains	(W2)	2,295,319
Non-trade loan relationship deficit	(W3)	(9,000,000)
Expenses of management	(W4)	(7,200,000)
Taxable total profits		(6,864,681)
Group relief surrendered (Beta 1 Ltd)		6,864,681
Taxable total profits after group relief		Nil

Workings:

W1) Calculation of property income

The element of the premium received taxable as income is calculated as follows:

$$£12,000,000 \text{ (premium)} \quad X \quad \frac{50 - 29}{50} = £5,040,000$$

This amount is then added to the rent received: £5,040,000 + £2,000,000 = £7,040,000.

W2) Calculation of chargeable gains

The receipt of a premium is to be treated as a part disposal with the element subject to income excluded.

Sale proceeds: £12,000,000 - £5,040,000 = £6,960,000

The allowable expenditure is apportioned as follows:

$$£30,000,000 \text{ (acquisition cost)} \quad X \quad \frac{6,960,000}{12,000,000 + 35,000,000} = £4,442,553$$

It is then necessary to calculate indexation allowance:

		£
(RPI 12/17-RPI 09/16)/RPI 09/15 ((278.1 – 264.9)/264.9	= 0.050 X £4,442,553 (base cost)	222,128

Indexed base cost: £4,442,553 + £222,128 = £4,664,681

Chargeable gain: £6,960,000 - £4,664,681 = £2,295,319

W3) Non-trade loan relationship debits

	£
Interest deduction on external loan	(6,000,000)
Advice in connection with external finance	(3,000,000)
Total deficit	(9,000,000)

Note:

The £5,000,000 foreign exchange gain is automatically disregarded under the Disregard Regulations.

W4) Expenses of management

	£
Due diligence fees (deductible where no decision to acquire)	(2,000,000)
Directors' remuneration	(5,200,000)
Total	(7,200,000)

Notes:

The following are not allowable expenses of management:

Legal advice on liquidation is a capital expense.

Advice in connection with defence of a takeover bid does not relate to managing underlying investments; it relates to a change of the ownership of Alpha plc.

A fine for infraction of a law.

The loss resulting from Alpha plc impairing its investments in Delta 2 Ltd and Gamma Inc (connected parties).

W5) Other

The dividend paid by Delta 2 Ltd to Alpha plc should be an exempt income distribution as the latter controls the former. The dividend was, however, paid subsequent to the company being placed in liquidation and therefore represents a part disposal of the shares. Although the dividend qualifies for exemption as an income distribution, it may still be taken into account in determining chargeable gains. As Delta 2 Ltd was a trading company it is assumed that the Substantial Shareholding Exemption should apply to exempt any gain or loss from tax.

Beta 1 Ltd

Corporation tax computation – Year Ended 31 December 2019

	Workings	£
Profit before tax		12,000,000
Add:		
Depreciation and amortisation expense		4,000,000
Loss resulting from loan waiver	(W1)	2,000,000
Deduct:		
Capital allowances	(W2)	(3,917,000)
Taxable total profits		14,083,000
Group relief claimed (Alpha plc)		(6,864,681)
Group relief claimed (Delta 2 Ltd)	(W3)	(2,000,000)
Taxable total profits after group relief		5,218,319
Corporation Tax Payable @ 19%		991,481
Due dates:		
14 July 2019		247,871
14 October 2019		247,870
14 January 2020		247,870
14 April 2020		247,870

Workings:

W1) Calculation of property income

Ordinarily the debit arising would not be deductible for the debtor company per s.354 CTA 2009. This treatment remains even where the liquidation causes a cessation of control per s.355 CTA 2009.

W2) Capital allowances

	£	£
P&M General pool:		
Opening tax written down value:	15,400,000	
Additions:		
Computer software	1,500,000	
Second hand zero emissions lorry	150,000	
	17,050,000	
Annual investment allowance	(850,000)	(850,000)
Writing down allowance @ 18%	(2,916,000)	(2,916,000)
Closing tax written down value:	13,284,000	
P&M Special rate pool:		
Opening tax written down value	Nil	
Additions:		
Integral features (lift installation)	150,000	
Annual Investment Allowance	(150,000)	(150,000)
Closing tax written down value:	Nil	
Structures & buildings allowance:		
Conversion of ground floor into office space – first use on 1.7.19	100,000	
2% straight line allowance *£100,000 x 2% x 6/12*		(1,000)
Total available allowances		(3,917,000)

Tutorial Note:

The maximum AIA for the period is £1,000,000. It is more tax efficient to set this first against expenditure in the special rate pool. Structures and buildings expenditure does not qualify for the AIA.

W3) Group relief from Delta 2 Ltd

The commencement of the winding up brought Delta 2 Ltd's accounting period which started on 1 January 2019 to an end and a new accounting period starts on 1 July 2019. This accounting period ends on 31 December 2019, the date on which the winding up is completed. The loss for this final 6 month period is £6 million of which £4 million is to be carried back to the previous accounting period, leaving a loss of £2 million available for group relief.

As Delta 2 Ltd has a short accounting period, s.138 CTA 2010 requires that the amount of group relief is limited to the lower of (i) the unused part of the surrenderable amounts and (ii) the unrelieved part of the claimant company's profits for the claim period.

Both periods overlap for 6 months (1 July 2019 to 31 December 2019). Take the lower of:

The loss available for surrender:

$\frac{6}{6}$ X £2 million = £2 million

AND

The overlapping profits of the claimant company:

$\frac{6}{12}$ X £7,218,319* = £3,609,160

*Profits of Beta 1 Ltd for the year to 31 December 2019 as reduced by previous group relief claimed from Alpha plc.

MARKING GUIDE

TOPIC	***MARKS***
ALPHA PLC TAX COMPUTATION	
Calculation of property income:	
Calculation of apportionment per s.217 CTA 2009	*1*
Inclusion of rental income	*½*
Calculation of chargeable gain:	
Part disposal calculation per s.42 TCGA 1992	*2*
Calculation of indexed gain	*1*
Calculation of non-trade loan relationship debits:	
Inclusion of costs relating to external finance	*½*
Exclusion of foreign exchange gain under Disregard Regulation 3	*1*
Calculation of expenses of management:	
Allow due diligence costs	*1*
Allow Directors' remuneration	*½*
Disallow costs related to liquidation of Delta 2 Ltd	*1*
Disallow costs related to advice in connection with takeover defence	*1*
Disallow fine for infraction of the law	*1*
Disallow impairment loss	*½*
Company distributions:	
Exclude dividend from taxable profits on the basis s.931E CTA 2009 (or other exemption) and note the application of s.931RA CTA 2009 and that SSE should apply to exempt any capital gain.	*1½*
BETA 1 LTD TAX COMPUTATION	
Additions to profit before tax:	
Depreciation and amortisation	*½*
Deduction in respect of loan waiver	*1*
Capital allowances:	
Inclusion of computer software in general pool	*½*
Inclusion of second hand zero emission lorry in general pool	*½*
Calculation of writing down allowance in general pool	*½*
Inclusion of integral feature in special rate pool	*½*
Inclusion of Annual Investment Allowance in special rate pool	*1*
Calculation of structures & buildings allowance	*1*
Computation of tax liability	
Group relief claim from Alpha plc	*½*
Group relief claim from Delta 2 Ltd	*1*
Calculation of tax liability at correct Corporation Tax rates	*1*
Stating correct due dates and amounts payable	*½*
TOTAL (MAX)	***20***

8. COLLOP PLC

John Sams
Special Tax LLP
Our address

Ashton Smith
Collop plc
Your address

9 May 2020

Dear Ashton

Collop plc - Controlled Foreign Companies

As requested, I shall provide you with some explanation of the Controlled Foreign Companies regime and explain the implications of it for the Collop group.

1) Definition of a controlled foreign company (CFC)

A company is a CFC if it is not UK tax resident AND it is controlled by UK resident persons.

The first condition is met by all of the companies mentioned.

The second condition is met by all of the subsidiaries other than Tog Ltd since they are wholly owned. Tog Ltd is controlled by persons resident in Laputia; so Tog Ltd is outside the CFC regime.

2) Exemptions and Gateways

If a company meets the definition of a CFC it is necessary to consider whether it is nevertheless exempt from the CFC regime. If none of the exemptions apply, it must then be asked whether any of the company's profits pass through any of the statutory gateways (as only those profits are then subjected to tax under the regime).

If any of the profits pass through the statutory gateways, then the taxable profits of the CFC company are calculated, and those profits are apportioned to the UK resident corporate shareholders holding at least 25% of the ordinary share capital, based on their shareholdings.

The taxable profits are calculated as if the company was UK tax resident and are subject to certain statutory assumptions, such as 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 UK rate of corporation tax is applied to determine the amount of tax to pay.

Having established which companies are CFCs, the next step is to consider the tax position of each CFC.

Speck Ltd

A company with low profits, which is defined as taxable profits of less than £500,000 of which no more than £50,000 represents non-trading income, is exempt from the CFC charge. Speck Ltd is predicted to have trading profits of £400,000 and interest receivable of £40,000, so the exemption would appear to apply to the profits earned by this company.

Algarat Ltd

It does not appear that any of the exemptions will apply to the profits of Algarat Ltd so we must consider the five gateways. We 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 two gateways relating to insurance and banking companies are not applicable here. The gateway relating to trading finance also does not apply since this company does not appear to have a trading finance activity. The gateway relating to profits attributable to UK activities is also not applicable since all of the company's profits relate to non-trade finance activities.

The key gateway is the one relating to non-trade financing profits. The profits 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 Algarat's income has been earned from deposits at a bank this 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. The profits of Algarat Ltd have arisen from funds which have been provided by Collop plc, a UK resident company. Therefore this test appears to be met.

It would appear therefore that the profits of Algarat Ltd will be attributed to Collop plc and subject to UK corporation tax. As Algarat is wholly owned, all the profits will be taxable on Collop plc.

Since 10% withholding tax has been deducted it should be possible to claim relief for this against the CFC liability as creditable tax. The ordinary rules for double taxation relief apply.

Mayhard Ltd

Again, none of the exemptions appears to apply to Mayhard Ltd, so the gateways must be considered. The gateway that needs to be considered here is "profits attributable to UK activities". This gateway is applicable unless one of four statutory conditions is met. Particularly relevant are conditions 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. These terms are defined in the legislation in more detail.

I note at this stage that the company was purchased as a going concern two years ago and continues to produce locally to supply a local market. As such this would suggest very broadly that condition A is met. As for condition B, I note that Mayhard Ltd appears to have no activities in the UK at all and Collop Ltd appears not to manage risks on its behalf. This suggests that condition B is met.

To conclude, it seems reasonable to assume that the profits of Mayhard Ltd will be excluded from the gateway and should fall outside of the CFC charge, although more information would be needed to confirm this matter.

Yours sincerely
John Sams

CIOT MARKING GUIDE

TOPIC	***MARKS***
Presentation	*1*
Definition of controlled foreign company	*1*
Which companies in the Collop group meet the definition	*1½*
Discuss exemptions, statutory gateway and apportionment of profits	*2*
Calculation of taxable profits	*1*
Use of UK rate of Corporation Tax	*½*
Speck Ltd profit is not within CFC charge. Explain why	*1½*
Exemptions do not apply to Algarat Ltd	*½*
Describe 5 gateways and say which do and do not apply to Algarat Ltd	*1½*
Describe gateway relating to non-trade finance profits and are the two tests met and conclude	*2½*
Discuss creditable tax	*1*
Discuss relevant gateway	*1*
Discuss first condition for avoiding gateway	*2*
Discuss second condition for avoiding gateway	*2*
Conclude and more information needed	*1*
TOTAL	***20***

Examiner's report:
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Candidates needed to show good knowledge of the new controlled foreign company regime and be able to apply this knowledge to the scenario. Most candidates showed this knowledge and therefore passed the question. Candidates generally adopted a methodical approach. They defined a controlled foreign company (CFC) and explained how the profits of a CFC would be taxed in the UK. They described the exemptions and then the gateway tests. Most then applied the exemptions and gateway tests correctly to the profits of the overseas companies.

However, some candidates spent too long describing all of the exemptions and gateways. The client in the question had asked for information "relevant to my group". Credit was given for an outline of all the exemptions and gateways but not where detailed information was provided about CFC exemptions that the client could not use.

Some candidates described the administration of the CFC regime – so completing the relevant forms on the Company Tax Return. Credit was given for this and candidates should mention tax administration matters when appropriate.

Overall a well answered question.

9. ORGANIC FRUIT PLC

P Smith Esq.
Address

Tax Advisors LLP
Address

May 2020

Dear Mr Smith

Below are the 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, SSE will not be available as Sweet Fruit Ltd will fail to satisfy one of those conditions in that it will not have traded for one year as at July 2020 when its shares are sold. Sweet Fruit Ltd became a trading company within the SSE definition when it started preparing to trade in September 2019. If commercially practicable, Organic Fruit plc could seek to defer the sale of Sweet Fruit Ltd to October 2020.

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 14 – Dec 17		
[(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 2022 if the sale is made in July 2020.

If the sale of Sweet Fruit Ltd is delayed until October 2020 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 2019 (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.

Following the sale of the shares, companies in the Organic Fruit plc group will not be able to utilise any brought forward losses of Sweet Fruit Ltd until 5 years after its acquisition.

Yours sincerely
Tax Manager

CIOT MARKING GUIDE

TOPIC	***MARKS***
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.

10. ARUN PATEL

To: APatel@Travelagents.com
From: SCooper@Travelagents.com
Date: X May 2020
Subject: Bank loan and interest rate swap

Hi Arun

You asked about the Corporation Tax treatment of the bank loan and proposed interest rate swap.

Loan

The loan is a 'loan relationship' because it is a money debt arising from a transaction for the lending of money.

The company will obtain relief for the interest paid in line with the accounting treatment. These will be non-trading loan relationship debits given that the company is a holding company, and does not carry on a trade.

Any net debits can be used as non-trade loan relationship deficits as follows:

a) Set against the taxable profits of the company for the accounting period;

b) Carried back against the non-trading loan relationship profits of the company in the previous 12 months;

c) Carried forward and set against any future profits of the company;

c) Group relieved to another group company in the current accounting period; or

e) Carried forward and group relieved to another group company in a future accounting period.

Derivative contract

The interest rate swap will be a derivative contract for tax purposes as:

a) It is a relevant contract (a contract for difference);

b) It satisfies the accounting conditions (accounted for as a derivative financial instrument); and

c) It is not an excluded contract (eg. certain derivatives over shares are excluded from meeting the definition of a derivative for tax purposes).

The derivative will be a non-trading instrument. As such, the profits and losses will be brought into account as non-trading loan relationship debits and credits.

The amounts brought into account for tax purposes will be the amounts recognised in the income statement. Amounts recognised as items of other comprehensive income (OCI) will only be brought into account when they are transferred to the income statement.

As a result, the company would not be taxable on the fair value movements recognised in OCI. However, it will be taxed on amounts recognised in the income statement, including any volatility relating to ineffectiveness in the hedge.

<u>Disregard Regulations</u>

The Disregard Regulations apply to 'disregard' certain fair value movements, such as those that can arise under IFRS.

With the swap, the company has the option of applying regulation 9 of the Disregard Regulations. This applies where an interest contract is taken out to hedge a risk where the risk is not taxed on a fair value basis.

Regulation 9 has the effect of disregarding the fair value movements on the derivative contract for tax purposes, and instead taxing the company on the basis of an 'appropriate accruals basis'. This will spread the profits and losses on the derivative over the period of the hedged risk.

This therefore removes the tax volatility for the company, making it easier to forecast the company's tax payments. Depending on the particular movements, this could result in higher or lower tax in the short term.

Given that the company has not previously held any derivatives and it is not within the Senior Accounting Officer regime, it will need to make an election before 12 months from the end of the accounting period.

Kind regards

Sam

MARKING GUIDE

TOPIC	***MARKS***
Loan:	
Loan relationship definition	*1*
Interest expense as a non-trading debit	*1*
Use of NTLR deficits	*1*
Derivative:	
Derivative contract definition	*1*
Profits and losses taxed and relieved as non-trading LR debits and credits	*1*
Follows amounts in P&L, amount in OCI not taxed until recycled	*1*
Disregard regulations:	
Background	*1*
Conditions for reg 9	*1*
Application of reg 9 (disregard FV movements, apply accruals basis)	*1*
Election required within 12 months of year end	*1*
TOTAL	***10***

Examiner's report:
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This question considered the tax treatment of an interest rate swap functioning as a cash flow hedge of the group borrowing costs. This is an area which has become more relevant with the recent changes in accounting standards.

Many candidates made no reference to the application of the Disregard Regulations. Some went into detail of the application of anti-avoidance legislation which was not relevant to the scenario.

There were, however, plenty of marks available on the basic elements of the loan relationship and derivative contracts rules. Candidates need to make sure that they are picking up on these basic points, even where the scenario posed may be unfamiliar to them.

11. H-TO-O PLC

[Accountants]

[Address]

Finance Director

H-to-O plc

[Address]

Date: [ ] November 2020

Dear [name of Finance Director]

H-to-O plc – Withholding Tax issues

Thank you for your recent instruction.

A company has a duty to deduct an amount representing income tax at 20% (‘WHT’) on payments of ‘yearly’ interest arising in the UK. Broadly, interest will be ‘yearly’ where the loan to which it relates exceeds a year. The loans from the National English Lending Bank plc, Sac d’Argent S.A. and Money Bags Ltd all have a term in excess of a year and so the interest would be yearly interest. All interest payments described below are likely to have arisen in the UK.

Water Ltd

An exemption from WHT exists where interest is paid on an advance made by a ‘bank’ within the charge to Corporation Tax. National English Lending Bank plc is a ‘bank’ (an entity authorised under FSMA 2000), and within the charge to Corporation Tax. No WHT will therefore be imposed on interest payments under that loan.

Sac d’Argent S.A. is not a bank and the above exemption will not apply. If Sac d’Argent S.A. lends from Luxembourg, the payment of interest may be exempt from WHT under the terms of the UK/Luxembourg Double Tax Treaty if such Treaty gives the recipient country taxation rights in respect of the interest. Water Ltd would however have a duty to withhold until it has received clearance from HMRC to pay gross.

If Sac d’Argent S.A. has applied for a passport under the Double Taxation Treaty Passport Scheme, it will be entitled to be paid gross. Water Ltd must notify HMRC that it intends to take advantage of the scheme before any interest is paid.

If Sac d’Argent S.A. lends from London and Water Ltd is satisfied that there is a proper trade being carried on in the UK through that branch and the interest received will be taxed in the UK, the interest payments would also be exempt from WHT.

Aqua Ltd

The WHT obligation arises when interest is paid, not when it is due. If Aqua Ltd rolls up its interest, no WHT will arise on each actual interest payment date. The shares issued by Aqua Ltd in satisfaction of the payment of the interest will constitute ‘funding bonds’ and be deemed to be an actual payment of interest. No specific exemption applies to the WHT on payments of interest to Money Bags Ltd (there is unlikely to be a Double Tax Treaty exempting the interest in this case). Aqua Ltd must therefore retain an amount of shares equal to the interest that would otherwise have been withheld. It may remit these to HMRC in lieu of payment.

If (exceptionally) it were impracticable to retain the shares and Aqua Ltd notified HMRC of the identity of Money Bags Ltd, then the duty to retain the shares and to make any payment to HMRC in respect of the WHT would not apply.

If shares were issued, no WHT obligation arises in respect of dividends paid.

The loans from Michael and Frank have a term of nine months. The interest will not be 'yearly' interest. There will be no WHT due from Engine Ltd in respect of such payments, and therefore, no grossing-up required.

Filing obligations

Where an obligation to deduct exists, the relevant company must file a return to HMRC accompanied by payment of the WHT within 14 days of the end of the relevant return period (return periods are usually three months long, ending on the last day of March, June, September or December, although can be shorter depending on when the last day falls within the accounting periods of the relevant companies).

Protections in the SPA

The agreement for the acquisition of the shares in Engine Ltd could contain warranties and indemnities from Michael and Frank. Warranties are representations of fact about the status of the company. If they are incorrect, Aqua Ltd may rescind the contract or sue for damages. Indemnities are a promise to pay the company or the purchaser if certain events arise causing a liability. Unlike with damages, there is no need to prove loss, just that the events giving rise to the liability have arisen.

Please do not hesitate to contact me if you have any questions.

Yours sincerely

[Partner]

Tutorial Note

The answer refers to the Tax Treaty Passport Scheme in relation to the payment of annual interest gross to an overseas entity. The scheme is not mentioned in your manuals and so it is important that you learn about it from this question. A passport is similar in nature to an exemption certificate in relation to the payment of interest gross to EU associate companies (see section 1 of the chapter entitled 'Accounting for Income Tax' in the UK Corporation Tax manual).

MARKING GUIDE

TOPIC	***MARKS***
Presentation	*1*
<u>General</u>	
Identifying the general duty to deduct income tax at 20% on payments of yearly UK source interest made by a company (s.874(1) and (2) ITA 2007).	*½*
Explanation of yearly interest.	*½*
<u>National English Lending Bank plc</u>	
Referring to exemption from duty to deduct in respect of interest paid to banks within charge to Corporation Tax (s 879 ITA 2007).	*1*
Reference to National English Lending Bank plc being a bank as defined (s.991 ITA 2007).	*½*
<u>Sac d'Argent S.A.</u>	
Noting treaty relief may be available in respect of UK income tax (s.6 TIOPA 2010) for Sac d'Argent S.A.	*1*
However duty to withhold exists until direction has been issued to payer by HMRC (s.849 ITA 2007 and reg. 2 Double Taxation Relief (Taxes on Income) (General) Regulations 1970).	*1*
Note DTT passport scheme could have been applied for by Sac d'Argent S.A.	*½*
If lending through London branch, exemption applies (s.934 ITA 2007), and reasonable belief exists that it is an excepted payment (s.930 ITA 2007).	*1*
<u>Money Bags Ltd</u>	
When interest is 'capitalised', no 'payment' and so no duty to withhold on date interest is due (SAIM 9100).	*½*
Issue of shares in satisfaction of interest is an issue of funding bonds (s.413 CTA 2009).	*1*
Where duty to withhold under s.874 ITA 2007, apply s.939 ITA 2007, and retain shares equal to tax otherwise withheld.	*1*
Shares may be tendered to HMRC.	*½*
Exception from duty to deduct if impracticable to do so and information provided to HMRC (s.940 ITA 2007).	*½*
No WHT on dividends	*½*
<u>Fire Engine Ltd</u>	
This is not yearly interest and so no withholding and no gross-up required (s.874 ITA 2007).	*1*
<u>Filing obligations</u>	
If duty to withhold does exist, Water Ltd must make a return and pay the income tax to HMRC (ss.949 and 951 ITA 2007).	*1*
<u>Protections in SPA</u>	
Warranty protection: representations in relation to the company. Can rescind or sue for damages.	*1*
Indemnities: promise to pay the company or purchaser if a liability arises. No need to show loss as for damages, just circumstances of claim.	*1*
TOTAL	***15***

12. HOLDING COMPANY

An ideal location for a holding company should have a number of characteristics from a tax perspective, as outlined below, together with a description of how well the UK meets these.

Participation exemption

A participation exemption for both income and gains is key.

In the UK, a distribution received will be exempt from Corporation Tax if it falls within one or more of the classes below, unless an anti-avoidance rule applies:

1) Distributions from controlled companies;

2) Distributions in respect of non-redeemable ordinary shares;

3) Distributions in respect of portfolio holdings;

4) Distributions derived from transactions not designed to reduce tax;

5) Dividends in respect of shares accounted for as liabilities.

The Substantial Shareholding Exemption (SSE) exempts gains from Corporation Tax providing the relevant conditions are met:

1) The company whose shares are being disposed of must meet certain 'trading' conditions.

2) The 'investing company' must have held at least 10% of the shares in the 'investee company' for a continuous period of at least 12 months ending not more than six years before the disposal.

Treaty network and withholding taxes

A holding company needs to be able to benefit from a good treaty network to minimise withholding taxes deducted from dividend, royalty and interest payments made to it.

The UK has an extensive treaty network. Additionally, as a member of the European Union, the UK implemented the EU Parent/Subsidiary Directive and EU Interest and Royalties Directive into domestic law, resulting in a withholding tax rate of nil on income received from European subsidiaries.

There is no withholding tax applied to dividends paid by UK companies.

Controlled Foreign Companies (CFC)

Ideally, a holding company should not need to bring into tax the profits of its subsidiaries arising in other territories.

The UK's CFC regime seeks to charge UK tax on foreign profits only when these are artificially diverted from the UK. But the rules are complex.

In order to determine whether a CFC is subject to Corporation Tax, it is necessary to consider:

1) The nature of the income of the company.

2) Whether any of the statutory exemptions apply, such as 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, then a CFC will be subject to Corporation Tax if any of its profits pass through one of the statutory gateways:

   a) Profits attributable to UK activities

   b) Non-trading finance profits

   c) Trading finance profits

   d) Captive Insurance business

   e) Solo consolidation

Financing

It would be advantageous for a holding company to be able to obtain tax relief for the financing costs of acquiring subsidiaries.

In the UK, financing costs for making acquisitions are tax deductible. For related party loans, the UK has thin capitalisation rules which limit the amount of deductible interest to the amount of interest which would have been payable on arm's length terms. Companies are able to enter into Advance Thin Capitalisation Agreements with HMRC.

"Corporate interest restriction" rules place a limit on the amount of interest expenses and certain other finance costs that can be deducted when calculating a company's taxable total profits.

Losses

Obtaining tax deductions for financing costs is more beneficial if any losses can be offset against profits arising in other companies within the group.

The UK has group relief provisions which enable losses arising in a company to be offset against profits arising in the same or a later accounting period in other UK companies within the group.

Other advantages

A territory which offers a stable tax regime and has a low corporate tax rate is attractive.

The UK has a long-standing and stable tax regime. There is also a statutory clearance and non-statutory clearance service.

The UK has a competitive Corporation Tax rate of 19% (reducing to 17% from 1/4/20).

The UK has no capital taxes/duties except for stamp duty which is payable on transfers of UK shares at 0.5% (group relief available).

The UK tax regime also includes incentives such as research and development tax credits and patent box, which whilst not necessarily relevant for holding companies nevertheless make the UK an attractive place to invest.

Conclusion

The UK is a good location for a holding company from a tax perspective with many tax benefits, albeit that conditions need to be met in certain circumstances.

MARKING GUIDE

TOPIC	***MARKS***
UK dividend exemption	*1*
List exempt classes	*1*
SSE	*1*
Qualifying conditions	*1½*
Double tax treaties	*½*
EU Parent/Subsidiary Directive and Interest and Royalties Directive	*½*
No UK WHT on dividends	*½*
CFC exemptions	*1*
Gateways	*1*
Tax deductions for financing costs or acquisitions	*1*
Anti-avoidance – thin cap and corporate interest restriction	*½*
Losses – group relief	*1*
Stable tax regime	*½*
APAs	*½*
Competitive tax rate	*½*
Stamp duty 0.5%	*½*
Double tax relief	*½*
Incentives such as patent box, R&D tax credits, stock options	*1*
Reliefs such as intangible amortisation, AIA, ECAs, EU group relief	*1*
TOTAL	***15***

Marks will be given for each incentive, relief and any other relevant points made.

13. POTION PLC

To: [Partner]
From: [Tax Manager]
Date: X November 2020
Subject: Potion plc group – group relief

1. Executive Summary

The key issue is whether group relief can be surrendered by the loss-making companies held by Potion plc to those that are profit-making.

Cauldron Ltd is the only profit-making company in the group, with taxable profits of £5 million and £13.5 million for the years ended 31 December 2018 and 31 December 2019 respectively.

For the year ended 31 December 2018, losses of £1,666,667 should be available for surrender to Cauldron Ltd from Black Cat Ltd, leaving it with taxable profits of £3,333,333 and a tax liability of £633,333.

For the year ended 31 December 2019, losses of £1,830,000 should be available for surrender to Cauldron Ltd from Broomstick Ltd, leaving it with taxable profits of £11,670,000, and a tax liability of £2,217,300.

Further losses could be surrendered from Wizard Ltd if Wizard Ltd falls within the group for group relief purposes.

2. General

Losses arising in one company (the surrendering company) may be surrendered to another company (the claimant) if certain conditions are satisfied.

For UK tax resident companies (such as those in the Potion plc group), a surrender of losses may be made if the companies concerned meet the ‘group condition’ or a ‘consortium condition’.

In general, the group condition will be met if the companies are members of the same group, ie one is a 75% subsidiary of another, or both are 75% subsidiaries of a third company. A 75% subsidiary is one in which at least 75% of the ordinary share capital is held directly or indirectly by another company other than as trading stock.

The following companies should, in principle, be in a group:

i. Potion plc;

ii. Black Cat Ltd;

iii. Cauldron Ltd;

iv. Simmer Ltd (as Potion plc owns 85%); and

v. Wizard Ltd (as Potion plc owns 76.5% indirectly – 85% x 90%).

3. Black Cat Ltd

Losses can only be surrendered to the extent accounting periods of the claimant and the surrendering company “overlap”, during a time at which the group condition is met.

The only overlap period for Black Cat Ltd with another group member is from 1 March 2018 to 30 June 2018, four months.

The maximum losses available for surrender from Black Cat Ltd are therefore 4/12 x £8 million = £2,666,667.

4. Cauldron Ltd

We need to establish the ‘available profits’ of Cauldron Ltd against which losses can be surrendered.

For the year ended 31 December 2018 – they are £5 million

i. Deduct b/f trading losses (assuming a claim for deductions allowance is made);

ii. Can’t deduct b/f NTLRD (there are only trading profits and the NTLRD was incurred before 1 April 2017); and

iii. Deduct qualifying charitable donation

For the year ended 31 December 2019 – they are £13.5 million

i. Don’t deduct NTLRD (no claim has been made);

ii. Can’t deduct b/f NTLRD (there are only trading profits and the NTLRD was incurred before 1 April 2017); and

iii. Add chargeable gains.

5. Wizard Ltd

Wizard Ltd appears to be a 75% subsidiary of Potion plc. However, it will not be treated as a member of the group between August and December 2019 as there are ‘arrangements’ in place for Wizard Ltd to cease to be a member of the group at some time during or after the 2019 accounting period.

Acceptance of an offer subject to contract is sufficient to constitute arrangements. It is immaterial that the sale finally aborted.

On a time apportioned basis, the losses available for surrender for the year ended 31 December 2019 are those deemed to arise from 1 January 2019 to 31 July 2019, seven months: 7/12 x £3 million = £1.75 million.

It is possible that none of the losses are capable of surrender: a company will only be a 75% subsidiary of another for group relief purposes where that other company is beneficially entitled to at least 75% of the profits and the assets on a winding up of the subsidiary, in each case available for distribution to equity holders.

Equity holders include loan creditors of the company in relation to a loan other than a normal commercial loan. The concern with the unusually high interest rate in Wizard Ltd’s debt facility may indicate that the interest payable exceeds a reasonable commercial return. In that case, the loan would not be a normal commercial loan and the loan creditor could be an equity holder. If such equity holder were entitled to more than 25% of profits or assets as described above, Wizard Ltd would not be in a group relief group.

6. Broomstick Ltd

Broomstick Ltd is not a group company. It is however a company owned by a consortium as at least 75% of its ordinary share capital is owned by other companies, each of which beneficially owns at least 5% of that capital. Potion plc is a consortium member.

As a consortium company, Broomstick Ltd should be able to surrender its losses to a member of the Potion plc group, as:

i. It is a trading company;

ii. Potion plc is a link company (it is a member of the consortium and a member of a group); and

iii. It is not held by Potion plc as trading stock.

The maximum surrenderable amount will be £1.83 million, which is 30% of £6.1 million (the property losses can only be used to the extent they exceed the CFC apportioned profits and chargeable gains so £800,000 less £200,000 less £500,000).

7. <u>Possible surrenders and tax calculation</u>:

Year ended 31 December 2018:

Black Cat Ltd can surrender up to £2,666,667. However, the available profits of Cauldron Ltd attributable to the overlap period (1 March 2018 to 30 June 2018) are 4/12 x £5 million = £1,666,667. Only £1,666,667 can therefore be surrendered.

Cauldron Ltd's taxable profits are £5 million - £1,666,667 = £3,333,333.

Tax payable is therefore £3,333,333 x 19% = £633,333.

Year ended 31 December 2019:

Cauldron Ltd can claim surrenders from:

i. Broomstick Ltd of £1,830,000; and

ii. Wizard Ltd (possibly) of £1,750,000.

Cauldron Ltd's taxable profits are £11,670,000 or £9,920,000 (deducting from taxable profits of £13.5 million) with consequent tax (at 19%) of £2,217,300 and £1,884,800 respectively.

CIOT MARKING GUIDE

TOPIC	***MARKS***
Presentation	*1*
<u>General</u>	
Note that losses can be surrendered between various companies if certain conditions are met (s.97 CTA 2010).	*½*
Note group condition or consortium condition needs to be met for claim (s.130(2) CTA 2010).	*½*
Set out group condition (ss.131, 152, 151, 1154(3), 1155 CTA 2010) and note which companies are in group.	*1½*
<u>Black Cat Ltd</u>	
Noting the requirement for there to be an "overlapping period" (s.130 CTA 2010) during which group condition has to be met.	*½*
Overlapping period: 1 March 2018 to 30 June 2018 – 4 months – apportioned on time basis so 4/12 of £8 million is £2,666,667 loss available – can't all be surrendered as limited to available profits.	*½ +½*
<u>Cauldron Ltd</u>	
Establish 'available profits'	
2018 results - £5 million	
- Deduct b/f losses (s.137(4) CTA 2010);	*½*
- Can't deduct b/f NTLRD (s.458 CTA 2009); and	*½*
- Deduct qualifying charitable donation	*½*
2019 results - £13.5 million	
- No claim for NTLRD so don't deduct (s.459 CTA 2009 and s.137(4)(b) CTA 2010); and	*½*
- Add chargeable gains (note no points awarded for b/f NTLRD as same answer as for 2018)	*½*
<u>Wizard Ltd</u>	
Note arrangements in place (s.154 CTA 2010).	*½*
Arrangements – widely defined (s.156 CTA 2010 and SP3/93).	*½*
No need for sale to complete.	*½*
Apportion on time basis (Shepherd v. Land Law plc (1990 STC 795)) – possible surrender of £1.75 million.	*½*
Reference to loan:	
Additional 75% requirement (s.151(4) CTA 2010) – could loan holder be equity holder? (s.158 CTA 2010).	*1*
Non-commercial loan where excessive return (s.162(4) CTA 2010).	*1*
<u>Broomstick Ltd</u>	
Explain consortium company (s.153 CTA 2010).	*1*
Explain that can surrender to group as there is a link company (ss.130 and 133(1) CTA 2010).	*1½*
Establish qualifying losses:	
Can use trading losses (s.99 CTA 2010).	*½*
Property loss can only be surrendered to the extent it exceeds CFC apportionment and chargeable gains (s.105 CTA 2010).	*1*
Calculate how much – 30% of £6.1 million is £1.83 million.	*½*
<u>Calculation</u>	
Work out profits for overlapping period - 4/12 of £5 million.	*1*
Black Cat Ltd Can only surrender up to amount of profit (s.138 CTA 2010).	*½*
Calculate tax for Cauldron for 2018 @ 19%.	*½*
Calculate profits and tax for Cauldron for 2019 @ 19%.	*2*
TOTAL	***20***

14. GOLD MINE LTD

INTERNAL MEMORANDUM

To: John Silver, Group Finance Director
From: [Name], Tax Manager
Date: X July 2020
Subject: Gold Mine Ltd – Tax implications of financing and hedging arrangements

I set out below the Corporation Tax implications of the financing and hedging arrangements and reasons why we might wish to replicate this structure for future investments.

Financing of Gold Mine Ltd

Interest income and expense arising in Black Mining plc will be automatically offset with the net amount brought into account for tax purposes under the loan relationship rules. Any foreign exchange movements are taxable under the loan relationship rules if the currency of the loan differs from the functional currency of Black Mining plc, unless the external loan can be treated as a hedge of the investment in Gold Mine Ltd.

Interest expense in Gold Mine Ltd should be allocable to the exempt branch resulting in no UK tax deduction. No deduction should be allocated to the corporate head office as all activities are taking place in Ruritania. As both companies are related parties, the terms of the intra-group loan should be at “arm’s length” under transfer pricing principles.

We should analyse an appropriate loan amount and interest rate by reference to the group transfer pricing policy or put one in place if required. If the loan is not at arm’s length, a different amount of interest income may be imputed in the UK (and may also restrict interest deductibility in Ruritania).

The rights issue does not give rise to any tax consequences for Black Mining plc.

It should be established whether Ruritania imposes withholding tax (“WHT”) on interest paid to overseas lenders and whether a double tax treaty exists with the UK. A treaty may provide for a preferential rate of WHT and typically where the lender resides in the UK, a claim for treaty relief will be filed with HMRC. Any WHT may be credited against UK tax arising from same source income or claimed as an expense deductible against the same source of income.

Hedging arrangements

Under FRS 102, Gold Mine Ltd must measure derivative financial instruments on the balance sheet at fair value. This represents a change for subsidiary companies previously applying “old UK GAAP” where such instruments were accounted for on settlement only. As the company commenced operations after FRS 102 came into force, no reliefs are available for a change in accounting policy.

The options will be taxed as derivative contracts if they meet the definition of a “derivative contract”. The “accounting requirement” should be met under FRS 102. As the values of the contracts are tied to the market price of various commodities, they should be “contracts for differences” and meet the definition of a “relevant contract”.

Gains and losses in respect of options related to gold should be attributable to the exempt branch on the same basis as the interest expense.

The Disregard Regulations were introduced to manage tax volatility arising from fair valuing financial instruments. Various Regulations apply to different types of hedging arrangements but fundamentally the rules are designed to allow tax efficient hedging. Disregard Regulation 8 exempts gains and losses in respect of commodity hedging contracts, however, it cannot apply to contracts hedging commodities other than gold as the underlying assets reside in other companies. Taxable profits and losses related to these contracts will be calculated by reference to any movement in the fair value of the contracts during the year and any cash receipts (net of premium expense).

Disregard Regulation 9 exempts fair value movements on interest rate contracts but will not apply, as the underlying exposure arises in Black Mining plc. Fair value gains and losses on the interest rate swaps will therefore be subject to tax.

<u>Structuring future investments</u>

This structure should be replicated in future as it avoids incorporating local subsidiaries that can result in trapped capital and tax leakage through dividend WHT. A separate UK company with a local branch should be formed for each new prospect to segregate assets and provide flexibility around future disposals.

The structure is tax efficient as the UK exempts income and capital gains in relation to overseas branches. Note, the Controlled Foreign Company rules (through the "anti-diversion" rules) have been extended to branches and applicability should be reviewed on a case-by-case basis.

Dividends will be free from WHT and exempt from Corporation Tax in Black Mining plc. The Substantial Shareholdings Exemption should apply to exempt any gain on future sale of the companies.

CIOT MARKING GUIDE

TOPIC	***MARKS***
<u>Financing of Gold Mine Ltd:</u>	
Interest and foreign exchange movements taxable under the loan relationship rules	*1*
Note that foreign exchange could be disregarded if loan a hedge of investment in Gold Mine Ltd	*½*
Transfer pricing – mention benchmarking volume / interest rate and need to document approach	*2*
Reference to potential restriction of interest deductibility overseas	*½*
Reference to rights issue not giving rise to adverse tax consequences for Black Mining plc	*½*
Reference to potential WHT on interest	*½*
Reference to double tax treaty and process for claiming relief	*½*
Reference to expensing WHT	*½*
<u>Hedging arrangements:</u>	
Comment on impact of FRS 102 to derivatives	*1*
Note that foreign branch exemption applies to gains and losses on contracts hedging gold price exposure	*½*
State that put options are a "contract for differences" per s.582 CTA 2009	*½*
State that "accounting condition" should be met per s.579 CTA 2009	*½*
Brief summary of Disregard Regulations	*½*
Comment that Disregard Regulation 8 cannot apply	*½*
Explanation of how taxable profit will be calculated on derivatives	*1*
State that Disregard Regulation 9 cannot apply to gains and losses on interest rate swaps	*½*
<u>Structuring future investments:</u>	
Comment that structure avoids dividend WHT	*½*
Availability of branch exemption and no need to incorporate locally	*½*
Comment on possible impact of anti-diversion rules	*½*
Dividends free of WHT	*½*
Dividends exempt if received by Black Diamond plc	*½*
Likely availability of Substantial Shareholdings Exemption on future disposal	*1*
<u>Presentation and higher skills marks:</u>	
Drafting memo with conclusion	*½*
TOTAL	***15***

15. ALPHA LTD

The loans provided from Alpha Ltd to Finco Ltd and from Finco Ltd to Beta Ltd are "loan relationships". A company has a loan relationship if it owes or is owed money as respects a money debt, and that debt arose from a transaction for the lending of money.

The unpaid invoice for the plastic bottles is treated as a loan relationship for tax purposes. It is a relevant non-lending relationship on the basis that:

- There is a money debt, that is, a debt which falls to be settled by the payment of money, which was not created by the lending of money; and

- The debt creates an impairment loss in respect of an unpaid business payment; that is, a payment that would be taken into account as a receipt of a trade.

The general rule is that all profits arising to a company in connection with its loan relationships are taxable. The amounts to be brought into the Corporation Tax computation are the 'credits and debits' which:

- Are computed in accordance with generally accepted accounting practice; and

- Represent the company's profits and losses and interest and expenses arising from its loan relationships.

Special rules apply to the taxation of the loan relationships where at any point during the accounting period, a company and the person "standing in the position of creditor or debtor" are connected. This definition includes a person who indirectly stands in that position by reference to a series of loan relationships. As such, the special rules will apply if Beta Ltd and Alpha Ltd are connected; even if Finco Ltd is not connected to Alpha Ltd. These rules mean that impairment losses are non-deductible, and where relevant, a company is not required to bring in a credit for the release of a debt.

Connected within the loan relationship rules means:

- Alpha Ltd controls Beta Ltd;
- Beta Ltd controls Alpha Ltd; or
- The same person controls Beta Ltd and Alpha Ltd.

Control is defined as "the power of a person to ensure the company's affairs are conducted in accordance with their wishes" by:

- The holding of shares or the possession of voting power; or

- As a result of power conferred in the Articles of Association or any other document.

In this case, control is not created due to the holding of shares or voting power as Alpha Ltd only holds 40% of the shares and voting power in Beta Ltd. However, on the basis Alpha Ltd, acting through its directors, can appoint a majority of the directors to the Board of Beta Ltd, Alpha Ltd can ensure that Beta Ltd's affairs are conducted in accordance with its wishes. Alpha Ltd and Beta Ltd are therefore connected.

As Alpha Ltd and Beta Ltd are connected, Alpha Ltd will not be able to claim a tax deduction for the debits in its Corporation Tax computation arising due to the bad debt provision or the unpaid invoice.

CIOT MARKING GUIDE

TOPIC	***MARKS***
Loans meet the definition of a loan relationship	*1*
Unpaid invoice treated as a money debt (s.479 CTA 2009)	*1*
Unpaid invoice treated as a loan relationship (s.478 CTA 2009)	*1*
Profits and losses from loan relationships are taxable	*½*
Generally follows accounting principles	*½*
Special rules apply if connected at any point in accounting period, includes indirect creditor through series of relationships.	*2*
Definition of connection (s.466 CTA 2009)	*1*
Definition of control (s.472 CTA 2009)	*½*
Beta - Not connected through shareholding or voting rights	*½*
Connected due to shareholders' agreement	*1*
Special rule means no deduction for debit in Alpha Ltd	*1*
TOTAL	***10***