Institution **CIOT - CTA**
Course **Adv Tech Tax of Larger Companies**

Event **NA**

Exam Mode **OPEN LAPTOP**

Answer-to-Question-_1_

Computation of corporation tax payable by McRaney Ltd for the year ended 31 December 2022

Particulars	Reference	£	£
Trading income	W1		5,845,390
Less: Charitable donations			100,000
Total taxable profits			5,745,390
CT @ 19%			1,091,624

W1) Computation of trading income

Particulars	Reference	£	£
Profit before tax			5,091,000
Add:			
Depreciation		4,000,000	
Loss on disposal of plant		250,000	
Legal expenses related to factory building		250,000	
Pension contribution	W2	2,100,000	
Qualifying charitable donations		100,000	
			11,791,000
Less:			
Capital allowances		5,906,860	
SBA		38,750	
Adjusted trading income			5,845,390

W2) Computation of pension contribution disallowance

If pension contribution during an accounting period exceeds 2.1 times of the pension contribution during the previous accounting period then the relevant excess i.e., the amount exceeding 1.1 times of the previous accounting period pension contribution will be allowed in installments in the subsequent year. The number of years for which the contribution is spread would depend upon the amount of relevant excess. Following is the computation in the present case:

Particulars	Remarks	£	
Pension contribution during the AP		5,000,000	
2.1 times of previous AP	(2,000,000*2.1)	4,200,000	
	Since the current AP contribution exceeds 2.1 times of previous AP contribution the pension contribution should be spread		
1.1 times of previous AP	(2,000,000*1.1)	2,200,000	
Relevant excess	(5,000,000-2,200,000)	2,800,000	
	Since the relevant maximum is more than 2 million it will be allowed over a period of four years		
Current year disallowance	2,800,000/4*3	2,100,000	

W3) Computation of capital allowances and SBA
Capital allowances:

Particulars	Reference	General pool	Special pool	Capital allowances
Opening TWDV		7,243,000	652,000	
Plant (FYA @ 130%)	N3 (2,000,000* 1.3)			2,600,000
Plant - (AIA)	N3			1,000,000
Plant (FYA @ 50%)	N3 (1,000,000*			500,000

	50%)			
Integral features (FYA@50%)				500,000
Disposals		(200,000)	-	
Total for capital allowances		7,043,000	652,000	
WDA @ 18%		1,267,740	-	1,267,740
WDA @ 6%		-	39,120	39,120
Additions after FYA (Integrals and plant)			1,000,000	
Closing TWDV		5,775,260	1,612,880	
Total capital allowances				5,906,860

SBA

Particulars	Reference	£	
Factory cost		11,000,000	
Less:			
Land	N4	2,500,000	
Integrals	N5	1,000,000	
		7,500,000	
Legal fees	N6	250,000	
Total for SBA		7,750,000	
SBA @ 3% for period in use i.e., 2 months	7,750,000*3%*2 /12	38,750	

Notes:

N1) It has been assumed that the loan is raised for building the factory and acquiring the plant hence it will be considered as trading debits. Otherwise the interest and legal fees will be considered as NLTR defecit. However, this will not change the CT liability since a current year claim can be made against trading income.

N2) In general provisions made as per accounting standards are allowed for tax purpose. Accordingly, the provision for bad debts would have been deductible in the earlier years assuming the

provision is as per the accounting standards hence the reversal during the current accounting period is not deducted. In case the provisions in the previous accounting periods are disallowed then the current reversal of GBP 3,000,000 needs to be deducted from the trade profits.
N3) The entire cost of the plant is payable within 4 months from the day the obligation arises hence the entire amount is eligible for capital allowance during the current AP. FYA @ 130% will be available on the portion eligible for general pool since it is incurred before 1 April 2023 and not a second hand machinery or acquired from a connected person. AIA and FYA 50% would be available on the amount eligible for the special rate pool for the reasons mentioned earlier.
N4) Land is not eligible for SBA
N5) Integrals are not eligible for SBA. However, capital allowances can be claimed on the same.
N6) Cost for planning permission, clearing site for construction and legal fees are eligible for SBA
N7) Capital loss on plant will not arise since it is sold for loss and capital allowances are already claimed
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--------------ANSWER-1-ABOVE---------------

--------------ANSWER-2-BELOW---------------

Answer-to-Question-_2_

Profits and gains of the overseas permanent establishment of a UK tax resident company will be taxable in the UK unless an election under section 18A of CTA 2009 is made by the company. In the case of Bonnerton Ltd it has PEs in two overseas jurisdictions viz. Ruritania and Utopia. Following are the brief UK Corporation tax implications in relation to the options considered by the management in relation to the said PEs.

Continuing to operate the Utopian business through a non-exempt PE:

If Bonnerton Ltd continues to operate the Utopian business through a non-exempt PE then the income and chargeable gains arising to the PE will be subject to tax in the UK.

Such income will also be taxed in Utopia based on the source rule. However, a credit for the Utopian tax paid by the PE will be available against the UK tax liability related to the operations of the PE. Such credit will be restricted to the minimum of the Utopian tax paid or the relevant UK tax liability. Considering the tax rate of 30% in Utopia and a 25% tax rate in the UK prima facie it appears that the DTR will be capped at the UK tax liability. In case some of the activities of the Utopian PE is carried out in the UK the remaining tax credit can be carried back or carried forward. An alternate option of claiming the Utopian tax paid as expenses for UK tax purpose is also available.

Further, the losses incurred by the Utopian PE will be available for relief under the other income and gains of Bonnerton Ltd provided it is not surrendered to other group companies in Utopia.

The profits or loss of the PE will be computed as if the PE is a separate entity from Bonnerton Ltd and with adequate equity and debt for financing its operations. Further, Bonnerton Ltd can make a reasonable apportion of management expenses to the PE. The transactions between Bonnerton Ltd and Utopian PE should be considered at arms length.

Making a permanent establishment exemption election:

An election is availble under section 18A of CTA 2009 for

exempting the profits of overseas PEs. Such election needs to be made for all the PEs and it is not possible to avail the election for only select PEs. Accordingly, if the Bonnerton Ltd decides to avail the exemption then the income of both Utopia and Ruritania PEs will be exempt from the UK tax. It is assumed that Bonnerton Ltd is not a small company and Ruritania is not a territory with which the UK does not have a full tax treaty. If the assumptions are not true then the exemption for Ruritania will not be available which would effectively let Bonnerton Ltd to avail the exemption for Utopia only.

The election under section 18A of CTA 2009 will be effective from the accounting period subsequent to the accounting period in which the election is made. Further, the election will come into force only when the losses, if any, made by the PEs before the election has been off-set by the profits. The loss position is looked at in an aggregate basis meaning losses and profits of all the PEs are aggregated to arrive at the Total Negative Opening Amount. Accordingly, if the ealier year losses of Utopia and current year loss of Ruritania is offset by earlier year profits of Ruritania then the election will take effect immediately. Otherwise the election will take effect once the TONA has been offset. It is possible to stream the losses to a specific PE. However, this may not be relevant in the current scenario.

Once the election is made all the profits and gains of the overseas PEs will not be subject to UK tax and no relief will be available in the UK on the taxes paid in the overseas jurisdiction.

Further, rules similar to CFC rules will apply for the overseas PE.

<u>Incorporation of Utopian PE</u>:

Upon incorporation of Utopian PE, Bonnerton Ltd will be deemed to be disposing the assets and liabilities of the PE at market value. Accordingly, the gains arising from such dispoals will be subject to tax in the UK.

However, if the consideration is satisfied by the incorporated entity by issue of shares and the UK compnay owns at least 25% of the incorporated entity (which appears to be the case in the given scenario) then the gains will be deferred till the shares are disposed off by Bonnerton Ltd. However, if the incorporated entity disposes any of the assets within 6 years from the date of the transfer then gains attributable to such assets will be

subject to tax immediately. Further, any gains attributable to cash consideration if any will be subject to tax immediately.

Once incorporated the income and gains of the incorporated entity will be taxable in Utopia unless its central management and control is situated in the UK. If Utopia has a double tax treaty with the UK which is based on the OECD model then such treaty will have a tie breaker clause to determine the residence of the entity. The HMRC and tax authorities of Utopia should arive at a mutual agreement about the residence of Utopian subsidiary based on the POEM. Considering that conditions related to excluded territory exemption are satisfied there will not be any CFC charge.

SSE may be available upon disposal of the shares of Utopian subsidiary by Bonnerton Ltd. However, the gains deffered upon incorporation will become taxable.

The dividends received from Utopian subsidiary will be exempt from UK tax. However, withholding tax requirements in Utopia to be factored.

Recommendation

Considering the gains arising upon incorporation it is advisable to first avail the exemption under section 18A of CTA 2009 and then incorporate the PE. This will mitigate the tax on gains arising from incorporation instead of deferring it. However, further information related to Ruritania such as its tax rate, profitability for the future, etc., needs to be considered before making a decision. Further, safeguards to be kept in place to avoid the CMC of the Utopian subsidiary in the UK. Advice need to be obtained from a tax expert in Utopia.

--------------ANSWER-2-ABOVE---------------

--------------ANSWER-3-BELOW---------------

Answer-to-Question-_3_

Following is a summary of the UK tax consequences that could arise pursuant to acquisition of shares of Huxsmith Ltd by Wolff Inc.

Loan relationship between connected parties:
Currently, Huxsmith Ltd and Eflow Ltd are not connected parties. However, post acquisition of shares of Huxsmith Ltd by Wolff Inc they will be connected parties since both are controlled by the same person.

This will not have any immediate impact since no impairment of the loan has been made in the past. In case any impairment is made by Eflow Ltd then corresponding credit will arise in the hands of Huxsmith Ltd upon becoming connected parties.

Once Huxsmith Ltd and Eflow Ltd have become connected party any impairment and waiver of loan will be disregarded for corporation tax purposes. This will not be considered as debit or credit for tax even if the entities become unconnected in the future.

Further, in case the interest payable to a loan from a participator is not paid within 12 months from it becoming due then it will be deductible only upon payment.

Corporate Interest Restriction rules:

CIR rules restricts deductible interest of a world wide group for the purpose of UK corporation tax. This rules apply irrespective of whether the loan is from connected parties or not. However, upon the proposed acquisition Huxsmith Ltd will be able to elect for GRDC. This will be beneficial if the entire group is highly leverage since the relevant percentage and interest cap will be higher.

Transfer pricing and thin capitalisation:

Huxsmith Ltd is a large company considering it turnover is GBP 100 million and it will exceeds the employee related threshold. Transfer pricing provisions apply to a large company if there is a transaction or arrangement between connected parties.

Considering that Huxsmith Ltd and Eflow Ltd will become connected parties the transcations between them should be at arms length otherwise an adjustment will be made for UK tax purposes. The following factors need to be considered: Whether the intetrest rate is at arms length; whether the terms of the loan such as the tenure and amount of loan is same as of between unconnected parties. This appears to be satisfied since the Huxsmith Ltd and Eflow Ltd were unconnected parties when the loan was made.

Huxsmith Ltd should maintain relevant documents to establish arms length price and considering that the turnover of Wolff Inc is USD 2 billion which would exceed GBP 200 million the Huxsmith Ltd would required to file CBCR in the UK since it is the only group company in the UK.

Hybrid mismatch:

If the tax authorities in Bermuda considers the interest payment as dividend due to the shareholding of Wolff Inc and does not tax the interest then a hybrid mismatch would arise. To counter this the deduction for interest will be denied in the hands of Huxsmith Ltd for the UK tax purposes.

--------------ANSWER-3-ABOVE---------------

--------------ANSWER-4-BELOW---------------

Answer-to-Question-_4_

1) Gain on grant of 40 year lease over office premises in Dundee: Grant of lease out of a freehold property will be considered as a part disposal. Leases for a period less than 50 years will be short leases. In case of grant of short lease part of the premium will be taxable as chargeable gain and part of the lease will be taxable as property income. The portion of premium chargeable as gain will be computed using the following formula 2%*premium*(no. of years - 1). Following is the relevant computation

Particulars	Reference	£	
Capital portion of premium received net off legal fees	(500,000*2%*39)-2,000	388,000	
Less:			
Cost of acquisition	3,000,000*388,000/(3,500,000+498,000). Indexation not available since land acquired after December 2017	291,145	
Chargeable gains		96,855	

2) Gain on sale of office premises in Peterborough:

Particulars	Reference	£	
Sale proceeds		7,000,000	
Less:			
Cost of acquisition	N2.1	4,000,000	
Unindexed gains		3,000,000	
Indexation allowance	4,000,000*((278.1-178.5)/178.5)indexation factor rounded to three decimals	2,232,000	
Chargeable gains		768,000	

Notes:
N2.1) Based on the description of activities undertaken by Bundell Developments Ltd it appears that it carrying on a trade of developing and selling the properties. Accordingly, it is assumed the office premises was a trading stock of Bundell Developments Ltd and its transfer to connected person viz.

Bundell Plc will be at market value for tax purposes. NGNL provisions will not apply for trading stock.
N2.2) No SBA would have been claimed on the building since it is not used for the trade and it has been constructed before October 2018

3)Gain on sale of factory in Northumberland:

Particulars	Reference	£	
Sale proceeds		7,500,000	
Less:			
Cost of acquisition	N3.1	3,500,000	
Enhacement expenditure	(750,000-400,000)	350,000	
Unindexed gains		3,650,000	
Indexation allowance			
- Cost	3,500,000*((278.1-166.6)/166.6)indexation factor rounded to three decimals	2,345,000	
- Enhancement	350,000*((278.1-201.6)/201.6) indexation factor rounded to three decimals	133,000	
Chargeable gains before rollover relief		1,172,000	
Roll over relief	W1	172,000	
Chargeable gains		1,000,000	

W1) Computation of roll over relief:
Roll over relief is available for gains arising from a qualifying asset if another qualifying asset is acquired within three years from the date of disposal or one year before the date of disposal. Factory used for the trade of wholly owned subsidiary will be a qualifying asset. Accorgingly, the gains from sale of Northumberland factoy will be eligible for roll over against cost of new factory. However, the properties acquired for leasing to third parties will not be a qualifying asset since it is not used for the trade of Blundell Plc. Those assets will be considered as investments. Following is the computation of roll over relief:

Particulars	Reference	£	
Sale proceeds		7,500,000	

Cost of new factory		6,500,000	
Gains not eligible for roll over relief		1,000,000	
Roll over relief	1,172,000 - 1,000,000	172,000	
GBP 172,000 will be reduced from the cost of new factory upon disposal			

Notes:
N3.1)Considering that the factory has been used by the new subsidiary post restructuring there is no change in use. Accordingly, there will no be any uplift of cost.
N3.2) No SBA would have been claimed since the building and refurbishment was before October 2018.

4) Computation of capital allowances

Particulars	Reference	General pool	Special pool	Allowances
Opening TWDV		500,000	2,500,000	
Additions				
Fixtures in new factory (AIA)				150,000
Fixtures in new office			200,000	
Disposals				
Fixtures in Peterborough office			(250,000)	
Fixtures in Northumberland factory		(300,000)		
Total for WDA		200,000	2,450,000	
WDA @ 18%/6%		36,000	147,000	183,000
Total capital				333,000

allowances				

Notes:
4.1) Considering that a joint election has been made in all cases it is assumed that fixed value requirement and pooling requirement are met
4.2) It is assumed that AIA limit is available
4.3) SBA will not be available in any of the building since all of the buildings are constructed before October 2018.

--------------ANSWER-4-ABOVE---------------

--------------ANSWER-5-BELOW---------------

Answer-to-Question-_5_

Tax implication on initial transfer and base cost

Donner Plc and Dancer Ltd forms a capital gains group since 100% of the control of Dancer Ltd is held by Donner Plc which is more than 75% control required for capital gains group. Accordingly, the transfer of warehouse by Dancer Ltd to Donner Plc in March 2009 will be a NGNL transfer. For tax purposes the transaction would have happened at a value of GBP 5,310,500(4,750,000*1+ (211.3-188.9)/188.9. Consequently, the base cost of the warehouse in the hands of Donner Plc will be GBP 279,500.

Tax implication on incorporation of Vixen Ltd

No immediate tax implication upon incorporation of Vixen Ltd. Its accounting period will begin from the date it commences trade or a source of income coming into existence. It should notify HMRC within three months of it coming within the charge to corporation tax. Further, an annual notice of chargeability to be issued to HMRC within 12 months from the end of accounting period. Failure may result in penalties.

Tax implications related to Option 1

Considering that 75% of the Vixen Ltd will be owned by Donner Plc it will be a part of the Donnel capital gains group. Accordingly, the transfer of warehouse from Donnel Plc to Vixen Ltd will happen at NGNL value. The NGNL value will be 6,988,618(5,310,500*(278.1-211.3)/211.3). This will be included as cost of the shares in Donner Plc in addition to the 2.25 million.

Vixen Ltd will also be a part of Donner Plc for group relief purposes. Accordingly, it will be able to surrender its losses during the year ended 30 June 2024 to Donner Plc and Dancer Ltd.

Tax implications related to Option 2

Vixen Ltd will neither be a part of Donner capital gains group or group relief group. Accordingly, the transfer of warehouse will give chargeable gains to Donner Plc. The chargeable gains will be GBP 7,500,000 - GBP 6,988,618 = GBP 511,382. This gains can be sheltered by the brought forward capital losses and trading losses of Donner Plc. Trading losses are available for set-off

since those are arising after 1 April 2017.

However, in the future, the losses of Vixen Ltd will not be available for group relief.

A company which is not a 75% subsidiary of any company and owned by two or more company will be considered as consortium company. The corporate shareholders of such companies holding at least 5% of the shares are consortium members. Consortium relief is available between consortium members and consortium company. Considering that Vixen Ltd is not a 75% subsidiary of Donner Plc or DP Ltd it will be a consortium company and Donner Plc and DP Ltd will be consortium members. Accordingly, Vixen Ltd could surrender a loss of GBP 975,000 (1,500,000*65%) to Donner Plc since the profits of Donner Plc is more than this. It can also surrender 35% of the loss to DP Ltd provided it has sufficient profits.

In both options Vixen Ltd will be considered as part of Donner Plc for various purposes such as computing AIA, tax rate, etc.,

In both the options SSE would be available in case of future disposal of shares of Vixen Ltd and dividend from Vixen Ltd will be exempt.

<u>Efficient option</u>
Option 2 would be efficient for the following reasons:
i) it allows utilisation of brought forward capital and trading losses of Donner Plc; and
ii) Consoritum relief will be avaliable for Donner Plc and DP Ltd. Remaining losses if any can be utilised by Vixen Ltd from year ended June 2025 onwards.

--------------ANSWER-5-ABOVE---------------

--------------ANSWER-6-BELOW---------------

Answer-to-Question-_6_

1) Fees for initial due diligence:

Cost for initial due diligence will be considered as management expenses and deductible from total taxable profits of Stevenson Investments Plc. The costs incurred before taking a decision to invest will not be considered as capital in nature. Management expenses that are not capital in nature are eligible for deduction. However, sufficient records to be maintained to substantiate this claim in view of recent ruling in the case of Centurica.

2) Fees for solicitors:

Expenses incurred after the decision for acquiring Target Ltd has been made will be capital in nature hence will not be deductible. Accordingly, the solicitor fee of GBP 100,000 for progressing the acquisition will not be deductible by Stevenson Investments Plc. However, this will be added to the cost of acquisition of shares of Target Ltd for chargeable gains purpose.

3) Funding of acquisition:

Cost of acquisition of shares in Target Ltd for chargeable gains purpose will be GBP 20 million. Interest paid on loan taken for acquisition will not increase the cost. However, such interest will be considered as non-trading loan relationship debits for Stevenson Investments Plc. Further, the arrangement fees paid by Stevenson Investments Plc will also be considered as non-trading loan relationship debits and will be allowed over the tenure of the loan in five installments. Repayment of loan and funding of acquisition through reserves will not have any specific tax implications.

4) Compensation for loss of office:

The compensation of GBP 125,000 paid by Target Ltd to its directors for loss of their office will be a deductible expenditure for Target Ltd. However, if the directors are also shareholders of the company and it is established that the compensation is for sale of shares then the same will not be

deductible.

5) Retention bonus:

Bonus is not deductible unless it is paid within 9 months from the end of the accounting period. In the present case bonus of GBP 100,000 will be deductible in the year of acquisition and the remaining GBP 100,000 will be deductible in the year of payment i. e., two years after acquisition, this will be disallowed in the year of acquisition.