

The Chartered Institute of Taxation

Advanced Technical

Taxation of Larger Companies and Groups

November 2025

Suggested answers

Answer to Question 1

(1) Corporation Tax computation

	£'000
Trading profits (W1)	436,240
Non-trade loan relationships	1,000
Qualifying charitable donations	<u>(1,000)</u>
Taxable total profits	<u>436,240</u>
Corporation tax at 25%	109,060
Less: Double taxation relief (W5)	(40,000)
Corporation tax liability	69,060
Corporation tax paid	(60,000)
Less: R&D expenditure credit (W3)	<u>(300)</u>
Outstanding corporation tax payment due	<u>8,760</u>

Workings (W)

(W1) Trading profits

	£'000	£'000
Profit before tax per accounts		434,000
<u>Add</u>		
Provisions tax adjustment - Long term incentive (W2)	150	
Provisions tax adjustment – Pension (W2)	50	
Qualifying donations	1,000	
Fixed asset depreciation	10,000	
Third party hospitality (E1)	500	
100,000 bottles of branded prosecco worth £20 to each supplier (E2)	2,000	
Penalties (E3)	1,000	
R&D expenditure credit (W3)	300	
<u>Deduct</u>		15,000
Capital allowances (W4)	(1,760)	
Exempt dividends (E6)	(10,000)	
Non-trade loan relationship credits per accounts	(1,000)	
		<u>(12,760)</u>
Adjusted trading profit		<u>436,240</u>

(W2) Provisions

	Brought forward	Utilised allowed	P&L amount	Carried forward	Tax adjustment
	£'000	£'000	£'000	£'000	£'000
Long term incentive plan (2024)	75			75	
Long term incentive plan (2025)		(30)	180	150	150
Pension contributions (2024)	200	(200)			(200)
Pension contributions (2025)		(4,750)	5,000	250	250
Total	<u>275</u>	<u>(4,980)</u>	<u>5,180</u>	<u>475</u>	<u>200</u>

- Salary related costs are only deductible if they are paid within nine months after the year end.
 - The amounts unpaid at 31 March 2024 of £25,000 were paid within nine months of the year end and therefore a deduction for that amount would have been received in the prior year.
 - The amount of £150,000 for 31 March 2025 is paid after nine months after the year end, and therefore is not deductible in the current year.
- Pension contributions are deductible in the accounting period in which they are paid.
 - No deduction should have been received for the amounts unpaid at 31 March 2024 of £200,000, and instead a deduction is allowed for that amount during the year ended 31 March 2025.
 - A balance of £250,000 remains unpaid at 31 March 2025 and no deduction is therefore allowed for that amount.
- Pension spreading is not required because the current year contributions do not exceed the prior period's contributions by more than £500,000.

(W3) Research and expenditure credit (RDEC)

	£'000
Personnel costs	1,000
Consumables	<u>500</u>
Total qualifying expenditure	<u>1,500</u>
RDEC @ 20%	300

- Repair costs are not qualifying if they are not undertaken by staff. As these are external equipment repair costs it would not be qualifying research and development (R&D).

(W4) Capital allowances

	Notes	Main pool		Special rate pool		Total allowances
		£'000	£'000	£'000	£'000	£'000
Tax written down value (TWDV) b fwd			2,500		1,000	
Expenditure on which 100% full expensing claimed	(E7,E8)	250	-	-	-	-
First year allowances		(250)	-	-	-	(250)
Writing down allowances (WDAs) claimed @ 18%		-	(450)	-	-	(450)
Expenditure qualifying for WDA at @ 6% pa	(E9, E10)	-	-	1,000	-	-
Annual investment allowance (AIA)	(E11)	-	-	(1,000)	-	(1,000)
WDAs claimed @ 6%		=	=	=	<u>(60)</u>	<u>(60)</u>
TWDV cfwd		=	<u>2,050</u>	=	<u>940</u>	<u>(1,760)</u>

(W5) Double taxation relief (DTR)

Withholding tax (WHT) suffered	£'000
Total income	40,250
Maximum relief available @ 25%	<u>160,000</u>
	<u>40,000</u>

- Unliteral tax relief is available as there is no double taxation agreement in place.
- DTR is restricted to the UK tax on the overseas income that gave rise to the overseas tax.
- The royalties can be treated as one source of income and the tax credits aggregated.

(2) Total tax charge

Current tax charge	£'000
Foreign tax relief	109,060
After double taxation relief	<u>(40,000)</u>
Foreign taxation	69,060
Total current tax charge / (credit)	<u>40,250</u>
Deferred tax charge / (credit)	<u>109,310</u>
Tax on profit on ordinary activities	<u>(1,360)</u>
	<u>107,950</u>

Deferred tax (W6)	
Liability brought forward	8,306.25
Charge/(credit)	<u>(1,360)</u>
Liability carried forward	<u>6,946.25</u>

Made up as:

Fixed asset timing differences	7,065
Short term timing differences	<u>(118.75)</u>
Total deferred tax (asset)/liability	<u>6,946.25</u>

(W6) Deferred tax calculation

<u>Fixed asset timing differences</u>	Brought forward	Carried forward
	£'000	£'000
Net book value per accounts	132,000	123,250
Less non qualifying assets	<u>(95,000)</u>	<u>(92,000)</u>
Assets eligible for capital allowances	37,000	31,250
Tax written down value	<u>(3,500)</u>	<u>(2,990)</u>
Temporary differences	<u>33,500</u>	<u>28,260</u>
Deferred tax liability at 25%	8,375	7,065
Charge/(credit)		<u>(1,310)</u>

<u>Short term timing differences</u>	Brought forward	Carried forward
	£'000	£'000
Tax provisions	<u>(275)</u>	<u>(475)</u>
Deferred tax asset at 25%	(68.75)	(118.75)
Charge/(credit)		<u>(50)</u>

Explanations (E)

- 1) Third-party hospitality costs are disallowable as they are not wholly and exclusively for the purposes of the business, but staff entertaining costs are deductible.
- 2) Gifts are deductible provided they do not comprise alcohol or food, bear the company's brand or other conspicuous advertising and in total in the year are less than £50 to the same supplier.
- 3) Penalties are disallowable as they are not wholly and exclusively for the purposes of the business.
- 4) Website costs are deductible provide they are running costs only and not set up costs.
- 5) Sponsorship costs that are for business purposes are deductible.
- 6) Dividends from a UK subsidiary are exempt.
- 7) Equipment is eligible for main pool capital allowances, with full expensing being available.

- 8) Machinery is eligible for capital allowances within the main pool on long-funding leases.
- 9) The air conditioning unit is assumed to be integral to a building.
- 10) A lift qualifies for capital allowances within the special rate pool.
- 11) Liamie Ltd has no fixed assets so the annual investment allowance is fully allocated to Jomar Ltd. It is beneficial for this to be allocated against capital expenditure eligible for capital allowances within the special rate pool.

MARKING GUIDE

TOPIC	MARKS	SUB-TOTAL
Adjustment to profits		
Depreciation	0.5	
Dividend received	0.5	
Fines	0.5	
Non-trading loan relationship (NTR) into total taxable profits	0.5	
Donation into total taxable profits	0.5	
Third party hospitality	0.5	
Prosecco – alcohol gifts	0.5	
Dividend paid ignored	0.5	
Pension contribution	1	
LTIP – bonus add back	1	
RDEC income	1	
		7
Allowable expenses		
Website running costs	0.5	
Advertising costs	0.5	
Gifting totals <£50 – Branded items	0.5	
		1.5
Capital allowances		
Allocation of AIA against special rate pool	1	
Long funded lease – main rate pool	0.5	
Full expensing	0.5	
Air-conditioning – special rate pool	0.5	
Lift – special rate pool	0.5	
Machinery – main pool	0.5	
Computation and calculations	1	
		4.5
Double taxation relief		
Pooling royalties	1	
Restrict to UK tax	1	
		2
Corporation tax liability		
Deduction of DTR	0.5	
Deduction of quarterly instalment payments made	0.5	
Computation and calculations	1	
		2
Total tax charge		
Current tax charge	1	
Deferred tax charge	2	
		3
TOTAL		20

Answer to Question 2

Part 1

As the group companies have been undertaking business activity in Barcello and Mumbar, permanent establishments (PEs) may arise. The 2017 OECD Model Tax Treaty determines how these activities will be treated for tax purposes. The initial exploration of business opportunities using an independent agent who does not habitually conclude contracts does not constitute a PE. Renting office space for temporary activities typically does not establish a PE. However, the managing director's role in habitually concluding contracts in Barcello suggests a PE as a dependent agent, as these activities go beyond preparation or auxiliary activities.

Contract 1 (LEG Ltd): This creates a fixed place of business through which the business of LEG Ltd is wholly carried on. This is supported by the contract length, placing a certain degree of permanence, and the quantity of personnel required to conduct the business in Barcello.

Contract 2 (Philo Ltd): The rented warehouse in Mumbar used for maintenance of a stock of goods does not constitute a PE. The PE definition PE specifically excludes facilities used for storage, display, or delivery only.

Contract 3 (Philo Ltd): The installation project lasting four months does not create a PE by itself as it does not meet the 12-month threshold for construction or installation projects.

Contract 4 (Dugo Ltd): The construction of a bridge by Dugo Ltd, if under twelve months, does not meet the PE threshold under general principles.

The activities under contracts 3 and 4 might trigger anti-fragmentation rules, which seek to prevent PE avoidance in a jurisdiction through the fragmentation of business activities among closely related entities, due to the shared management and shared location.

Given the managing director negotiated the relevant contracts for all entities, this constitutes habitually concluding contracts for all entities, contracts 1,3 and 4 therefore constitute a PE in Barcello.

Part 2

If any of the group companies have an overseas PE in Barcello, they will be subject to both UK taxation and Barcello taxation on any profits arising from the PE, leading to potential double taxation. This can be mitigated through:

1. Credit relief, which is available for the lower of the UK tax due on the same profits and the overseas tax due,
2. PE exemption election, which exempts the profits arising in Barcello from UK tax. The exemption is effective from the start of the first accounting period after it is made, and is irrevocable affecting all PEs of the company.

Given the initial expected losses from contract 1, it might be beneficial to delay the PE exemption election until the project becomes profitable, maximising loss relief opportunities against UK profits. Once profitable, claiming the PE exemption would be advantageous as Barcello's corporate tax rate is lower than the UK's.

Another option would be to incorporate the PE into a Barcello resident company, which would exclude the profits from UK taxation provided that the Barcello company is not UK centrally managed and controlled. Profits could be returned to the UK via dividends that would be exempt from UK tax under the dividend exemption, but could be subject to Barcello withholding taxes. This may be tax neutral.

Incorporating a PE into a non-UK resident company would result in a cessation of trade for UK tax purposes where a separate trade is being carried out, whereby plant, machinery and stock would be treated as disposed of at market value, resulting in a chargeable gain or taxable profit if that exceeds the base cost if those assets/stock.

The chargeable gains arising in respect of capital assets transferred to the non-UK resident company may (by claim) be postponed if all the following apply:

- A UK resident company has been carrying on a trade outside the UK through a PE.
- The trade and assets (excluding cash) used in the trade (or a part thereof) are transferred to a non-UK resident company.
- The transfer is wholly or partly in exchange for securities (shares, or shares and loan stock) issued by the transferee to the transferor.
- Following the share issue, the transferor holds at least 25% of the transferee's ordinary share capital.
- A net chargeable gain arises on the assets transferred.

For intangible fixed assets, similar tax deferral is available if the transfer is effected for genuine commercial reasons and not part of a scheme or arrangement to avoid tax.

Where part of the consideration for the transfer is shares, that proportion of the gain is postponed. The postponed gain can be chargeable to UK Corporation Tax on disposal of those consideration shares or, by the non-UK resident company, the assets it acquired.

Where multiple PEs have been created, activities can be combined into one company in Barcello to reduce the tax administrative burden.

MARKING GUIDE

TOPIC	MARKS	SUB-TOTAL
Assessment of activities		
Independent agent – no PE	0.5	
Rent office space should not be a PE, but the managing director is habitually concluding contracts	0.5	
Contract 1: involves a fixed place of business	1	
Contract 2: The rented warehouse used for storage unlikely on its own	1	
Contract 3: Preparatory on its own	1	
Contract 4: On its own no PE < 12 months	1	
		5
Anti-fragmentation rules		
Explanation	0.5	
Application	0.5	
		1
Implications of permanent establishment		
UK companies subject to tax on worldwide income	0.5	
PE exemption election	0.5	
Irrevocable	0.5	
Starts from first accounting period after made	0.5	
Credit relief	0.5	
Lower of UK or foreign tax	0.5	
Recommendation for PE election when profitable/ delay to use losses	1	
Beneficial if CT rate lower than in UK	0.5	
		4.5
Other options		
Incorporated foreign subsidiary outside scope of UK tax	0.5	
Provided no central management and control in the UK	0.5	
Repatriate profits through non-taxable dividends	0.5	
Can't surrender losses	0.5	
Exit charge arising on assets	0.5	
Conditions for chargeable gain postponement	1.0	
Additional condition for postponement of profit on IP	0.5	
Combine activities for reduced administrative costs	0.5	
		4.5
TOTAL		15

Answer to Question 3

Tax residence

A company's tax residence is primarily determined by its place of incorporation or the location of its central management and control.

Peralta Ltd, being UK-incorporated, is prima facie UK resident. To change its tax residence, Peralta Ltd should identify an overseas jurisdiction which will treat it as resident there (other than because of its place of incorporation) and has a double tax treaty with the UK. If the double tax treaty follows the OECD Model Tax Treaty, the tie breaker allows the competent authorities to agree residence based on a number of factors, including the place of effective management which usually determines the company's residence. Peralta Ltd should be able to change the place of effective management through ensuring all business operations are managed from the overseas jurisdiction.

Alternatively, management could incorporate a new non-UK resident company to be the holding company for Peralta Ltd and the overseas expansion. This can be achieved on a UK tax neutral basis through a share for share exchange. However, this structuring would not remove any existing operations from UK tax and gives rise to additional considerations, such as the overseas tax position, whether tax treaty benefits apply, and whether there is withholding tax on dividends payable to the new holding company. The non-UK holding company should ensure its management and control is not exercised in the UK, so that it does not become UK tax resident.

Exit charge

When Peralta Ltd migrates, its accounting period ends on the migration date. However, if it retains a UK permanent establishment, it will remain within the charge to UK Corporation Tax in respect of the UK.

The migration will still trigger deemed disposals of certain assets, subject to exceptions for assets used in the UK PE's as follows:

- Intangibles are treated as being sold at market value.
- Balancing allowances and charges will arise on plant and machinery.
- Stock is treated as disposed of at market value.
- Loans are realised at fair value.
- Derivatives are treated as assigned at fair value.

Any gains arising will be subject to Corporation Tax and is essentially an exit charge.

As Peralta Ltd purchased the UK land after 5 April 2019, the gain on the deemed disposal will be automatically postponed until an actual disposal of the land, unless Peralta Ltd elects for the gain not to be postponed. This election must be made within two years of the migration date.

The payment date for the exit charge is nine months and one day after the end of the accounting period in which Peralta Ltd ceases to be UK resident.

Peralta Ltd may be able to enter into payment plan to spread the tax payments over six equal annual payments where it migrates to an EEA state.

The amount that can be deferred is the difference between the total Corporation Tax which the company is liable to pay for the accounting period, and the amount of Corporation Tax which the company would have been liable to pay ignoring the exit charge.

The first payment is due nine months and one day after the end of the accounting period in which the migration takes place, and the remaining payments on the same date over the next five years.

However, the balance of outstanding tax will be due on the next instalment date if Peralta Ltd

- fails to pay any tax within a year of it being due;
- becomes insolvent, enters administration or appoints a liquidator (or similar under local law); or

- disposes of the relevant asset (or ceases to be party to a loan relationship or derivative contract).

Tax administrative issues

If Peralta Ltd chooses to migrate, the company should notify HMRC in advance of its intention to cease to be UK resident including:

- the date at which it will cease to be resident; and
- a statement of the amount of tax that is or will be payable.

The statement should include all taxes including PAYE as well as Corporation Tax, and should also include interest on overdue tax.

If HMRC is not notified, Peralta Ltd will be liable to a fine, up to the amount of unpaid tax. Penalties may also be due if a director commits any act resulting in Peralta Ltd failing to comply with the rules.

If any tax that is due remains unpaid after six months, HMRC have three years to issue a notice to any member of the same group and/or any controlling director to pay the unpaid tax.

MARKING GUIDE

TOPIC	MARKS	SUB-TOTAL
Changing tax residence		
Incorporation test	1	
Changing CMC / place of effective management	1	
Incorporating new non-UK holding company	2	
		4
Exit charge		
Cease of trade / end of accounting period	0.5	
Stock	0.5	
Machinery	0.5	
Derivatives	0.5	
Land	1	
Intangibles	0.5	
Continuing UK activities	0.5	
Payment of tax	1	
Payment plan	1	
Acceleration of payment	1	
		7
Tax administrative issues		
Notice to HMRC	1	
Statement of tax	1	
Penalties	1	
Unpaid tax	1	4
TOTAL		15

Answer to Question 4

1) A company comes into the charge to Corporation Tax on acquiring a taxable income source. Hence Cloverleaf Ltd's first accounting period commenced on 1 October 2025 when it was funded, giving rise to a taxable income source (interest arising on the funds until their utilisation). Companies must notify HMRC within three months of their first accounting period starting. Hence by 31 December 2025, Cloverleaf Ltd should provide the relevant details on form CT41G or another form of written notice, stating when the accounting period began and including:

- Company's name and registration number
- Registered office address
- Principal place of business address
- Nature of business
- Accounting date
- Directors' names and addresses

An accounting period ends and a new accounting period commences when trading commences. As the facility is expected to be brought into use in the period with production commencing on 1 June 2026, the initial accounting period will end then (when trading commences) and the second accounting period will start. Two returns are required for the period of account, with 30 June 2027 filing deadline for both (12 months after the accounting period end).

2) No tax relief will be available for the capital expenditure until trading commences on 1 June 2026.

	Note	General pool additions	General pool	Special rate pool additions	Special rate pool	Allowances in the period ended 30 June 2026
		£	£	£	£	£
Lifts, electrical works, hot and cold-water supplies, solar panels	2	-	-	525,000	-	-
50% FYA	-	-	-	(262,500)	262,500	262,500
Machinery	3	100,000	-	-	-	-
100% FYA	-	(100,000)	-	-	-	100,000
SBA's	4 and 5	-	-	-	-	<u>2,959</u>
Total	-		-		-	<u>365,459</u>

Notes

1. Land cost not deductible, until disposed of (in chargeable gains calculation).
2. Integral features are eligible for tax relief in the special rate pool. 50% first year allowance is available, with relief on the balance at 6% per annum.
3. Expenditure must be split for instalments due more than 4 months after the obligation to pay becomes unconditional. Accordingly, current period tax relief is restricted to £100,000 (the amount paid in the year and due three months after the year end). The £50,000 balance is eligible for relief in the year ended 30 June 2027.
4. Structures and buildings allowance (SBA) are available for non-residential property used in Cloverleaf Ltd's trade. Eligible expenditure includes structural expenditure ineligible for other capital allowances: the structure, the mezzanine flooring, and the thermal insulation (new insulation added to the building subsequently would be eligible for the special rate pool, but not that incurred in the construction). Other expenditure is relieved as integral features.

5. Relief is available at 3% per annum from 1 June 2026 (when the building is brought into use for the trading purposes), with time-apportionment of relief in the period to 30 June 2026 ($30/365 \times 3\% \times \text{£}1.2\text{million}$).
6. As Cloverleaf Ltd's activity includes product development, 100% research and development (R&D) allowances may be available on some or all the expenditure on the building if it is used for R&D activities (as defined in the R&D tax credits legislation). Further investigation as to the nature of the activities and the areas in which they will take place is therefore necessary – some apportionment based on floor space or similar may be appropriate.

3) Interest expense on the intragroup loan generates non-trading loan relationship (NTLR) debits to the extent it finances the deposits and, when trading commences, trading loan relationship debits to the extent used for the trade. The NTLR debits are automatically offset against NTLR income from the initial deposit of funds, likely resulting in a net NTLR deficit. An election can be made to treat the NTLR debits, where they would be attributable to the trade, as arising in the period in which trading commences.

On commencement of its trade Cloverleaf Ltd will also have net trading losses, being the excess of the capital allowances and other trading costs, such as staff and administrative costs, over the anticipated trading income of £1,000. Loss carry back is unavailable as Cloverleaf Ltd is a new company. The trading loss and the excess NTLR deficit can be carried forward, for potential set off against the company's future total profits.

A £5 million group-wide deductions allowance is available, after which (if any is allocated to a company) loss offset is restricted to the relevant maximum (50% of the company's taxable profits). Any use of the deductions allowance against brought forward losses in other group companies precludes its use by Cloverleaf Ltd, thereby restricting its use of carried forward losses to 50% of the taxable profits arising each year.

Group (or consortium) relief may give immediate relief for the losses (including trading losses and NTLR deficits), by surrender between 75% subsidiaries (of the other or a third company). The losses must be used by the claimant company in the current period.

The maximum relief is the lower of the available loss and the profit arising in the claimant company for the overlap period (available profit). As Cloverleaf Ltd has two relevant accounting periods (1 October 2025 to 31 May 2026 and the 30-day period to 30 June 2026) any surrender is restricted to other group companies' profits arising in these periods (rather than by reference to all of their profits for the year ended 30 June 2026).

If losses are carried forward, they can be surrendered through the group relief rules in later periods, but any utilisation may be restricted (depending on the allocation of the deductions allowance) to the relevant maximum.

The most tax efficient use of the losses depends on the level of profits in each entity and the marginal tax rate applicable to the profits. The timing is also important as it may be preferable to obtain immediate (and certain) relief, perhaps through group relief in the current period, rather than potentially a more beneficial rate in future periods if the losses are carried forward.

MARKING GUIDE

TOPIC	MARKS	SUB-TOTAL
1) Administrative requirements		
Written notification, by 31 December	1	
Other elements of notification (0.5 each max 2)	2	
Return for short period(s), filed by 30 June 2027	1	
		4
2) Tax relief for expenditure		
No relief for land – Corporation Tax on chargeable gains only	0.5	
SBA on structure of building if no other relief. 3% per annum from date brought into use calculation	1.5	
Identify integral features and special rate pool items – lift, hot water system, electric lighting, solar panels	2	
50% allowance on this, then 6%	1	
Possibility of R&D allowances – research and development expenditure credit (RDEC) definition	1	
Machinery – split expenditure if due more than 4 months after obligation to pay becomes unconditional	1	
£100,000 eligible for pool (first year allowances) 2026 year-end	0.5	
£50,000 2027 year-end	0.5	
		8
3) Loss relief		
Current period offset against interest income. No carry back available in company	1	
Carry forward both types of losses – against any profits	1	
Can elect for NTLR deficit to arise in period when trading commences	0.5	
Deductions allowance - explanation	1	
Group relief in current period	1	
Contemporaneous accounting period	0.5	
Carry forward and group relieve	1	
Deductions allowance – application to group relief	0.5	
Choose based on profit levels/marginal rate and timing	1.5	
		8
TOTAL		20

Answer to Question 5

Sale of Head Office lease

This is a chargeable disposal subject to Corporation Tax. As, on sale, less than 50 years (48 years and three months) of the 55-year lease remained, this is the disposal of a short lease which is a wasting asset. Accordingly, only part of the original cost is deductible in the chargeable gains calculation.

The base cost is a fraction of the original base cost, given by S/P where S is the percentage from the lease depreciation tables for the years remaining at sale, and P, at purchase.

As the lease term exceeded 50 years at purchase, P is 100%.

For S, 48 years and three months is 99.382% ($99.289 + 3 \times 0.031$).

			£
Proceeds		March 2025	220,000
Cost	$200,000 \times 0.99382$	July 2018	(198,764)
Gain			21,236

Grant of short lease (30 years)

Premiums received on the grant of short leases (less than 50 years) must be split into capital and income elements:

Capital: £29,000 ($2\% \times (30-1) \times £50,000$).

Property income: £21,000 ($£50,000 - £29,000$).

			£
Proceeds		May 2025	29,000
Disposal costs	Legal costs		(2,000)
			27,000
Cost (Note 1)	$150,000 \times (29,000 / (50,000 + 200,000))$	May 1995	(17,400)
Unindexed gain			9,600
Indexation (Note 2)	$0.859 \times 17,400 = 14,947$	$(278.1 - 149.6) / 149.6 = 0.859$ May 95 to Dec 2017	(9,600)
Gain/(loss)			<u>Nil</u>

Notes:

- Part disposal formula: $a/(A+B) \times$ acquisition cost where a is the premium's capital premium, A is the premium's gross value and B is the reversionary interest's value.
- Capped at £9,600 because indexation cannot create a loss.

Factory sale / purchase

			£
Proceeds		April 2025	5,000,000
Acquisition cost (NGNL transfer)		April 2005	(1,312,000)
Enhancement expenditure		November 2018	(1,200,000)
Unindexed gain			2,488,000
Indexation on NGNL transfer	April 2005 to December 2017	$(278.1 - 191.6) / 191.6 = 0.451$	(591,712)
Chargeable gain			1,896,288

The factory was transferred within a capital gains group (that is, a principal company and all its 75% subsidiaries) from Norwood plc to Southpool Ltd in April 2005, which is deemed for tax purposes to occur on a no gain/no loss basis. Accordingly, the indexed cost is £1,312,000 (Indexation (191.6-146)/146 = 0.312 to 3 decimal places). No indexation arises after December 2017.

As the property included integral features, the appropriate disposal value must be included in the capital allowances pool. The fixed value requirement ensures that the disposal value matches the purchaser's claim.

A joint election should be made within two years completion (that is, by April 2027) agreeing the value, which must not exceed the £0.6 million original cost. Agreeing the lowest possible value improves Southpool Ltd's position. If a joint election is not made, there will be a just and reasonable apportionment.

Stamp Duty Land Tax of £214,500 arises on the Norwood plc's purchase of the new building:

Band	Rate	£
0-150,000	0%	0
150,001-250,000	2%	2,000
250,001-4,500,000	5%	212,500
Total		214,500

Norwood plc can claim capital allowances on the building's fixtures, again subject to the fixed value requirement and agreement with the vendor. It is beneficial to maximise the election value, subject to the original value restriction. A claim for structures and buildings allowances (SBA) might be possible, if the property's construction began after 29 October 2018.

Possible rollover relief

Rollover relief is available where a company sells a business asset and reinvests the proceeds in another qualifying business asset.

Qualifying business assets include land and buildings or fixed plant and machinery, if used for the purpose of the company's trade and immediately brought into use for the trading purposes. The reinvestment must be made within the period from 12 months before the sale of the old asset to 36 months afterwards.

Companies within the same capital gains group are treated as one unit for the purpose of rollover relief. A gain arising in one group company can therefore be rolled over against a reinvestment by another company.

Both factories are land and buildings used in Southpool Ltd's trade. The new factory was acquired within the 12-month period before the sale of the old factory, so the group reinvestment relief provisions will apply. If the head office premises were also used for trading purposes, rollover relief may also be available in respect of this gain.

If not all the proceeds are reinvested, any proceeds retained are immediately chargeable. Considering the factory sale and purchase, £4.5 million was reinvested so the £0.5 million not reinvested is immediately chargeable. £1,396,288 can be rolled over against the cost of the new building, so the base cost on a future disposal will be £3,103,712.

Gains can also be deferred against expenditure on fixed plant and machinery. Plant and machinery are always regarded as having a useful life of less than 60 years, so are depreciating assets. Hence the gain is not rolled over against the cost of the replacement asset but frozen until the earliest of:

- The replacement asset being sold
- That asset no longer being used for trading purposes
- 10 years after the acquisition of that asset.

£150,000 of the gain not rolled over can be frozen against the expenditure on the plant.

A provisional claim is possible for the remaining gain if a qualifying asset is to be purchased within 3 years. Further qualifying investment of £500,000 would be required to fully roll over the gain arising on the factory disposal. Eligible investment can replace the held over gain, giving a more permanent tax deferral.

If the head office lease disposal is eligible for relief, a further £220,000 investment would be required, into land and buildings or fixed plant and machinery.

Rolling over the gain from the factory should be prioritised as the gain from the lease is only £21,236.

MARKING GUIDE

TOPIC	MARKS
Sale of short lease (short lease, S, P, no indexation, calculation)	2.5
Assignment of lease – short lease - split property/capital	1
Assignment of lease - calculate gain – disposal costs, apportion cost/correct, calculate indexation, cap	2
Factory disposal – chargeable gain (no gain/no loss transfer, calculation, enhancement, indexation, answer)	2.5
Capital allowances on disposal – fixed value requirement, joint election, level	2
SDLT and calculation on acquisition	1
Capital allowances on acquisition – election, possible SBAs, date	1.5
Rollover relief – possibility, trade, including group, nature of asset, timing	2.5
Rollover relief – applies to factories, maybe lease	1
Rollover relief – partial reinvestment, application, gain chargeable, impact on base cost	2
Holdover relief against plant – 10 years	1
Provisional claim possible, can replace holdover	1
TOTAL	20

Answer to Question 6

Hybrid entities and financial instruments

A hybrid entity is one which is recognised and taxed as an opaque entity in one jurisdiction, but is considered to be transparent, and therefore not a taxable entity, in another jurisdiction. Its members/partners/parent are instead considered to be the taxable entities by that other jurisdiction and the results of the hybrid form part of their taxable result.

Hence if Subco is tax transparent (for example, a partnership) in the UK but opaque in Ruritania, it would be a hybrid entity. Similarly it could also be a hybrid entity if the opposite were the case.

A hybrid financial instrument exists where the debtor (the payer) makes payments (for example, interest) that are potentially tax deductible, while the creditor (the recipient) is treated as receiving a non-taxable payment (for example, a dividend) in its jurisdiction. This potentially results in a mismatch in tax treatment: a taxable deduction for the payer without taxable income for the recipient.

Hybrid entity mismatch counteraction

If Subco were a hybrid entity and EastDene plc were to lend money to Subco, EastDene plc would not be taxed on any interest income in the UK because it would be considered an intra-company receipt. However, if the interest payment by Subco is tax deductible in Ruritania, this would be a 'deduction/non-inclusion mismatch'. If Ruritania had similar rules to the United Kingdom, the interest payments would not be tax deductible. If it does not have those rules EastDene plc would be subject to tax on the interest as a secondary response under the UK anti-avoidance rules.

Another type of mismatch is a 'double deduction mismatch'. If Subco takes out a loan with a third party and the interest payments on that loan are tax deductible in Ruritania, this mismatch would arise if Subco is a hybrid entity because those same interest payments are potentially tax deductible in the UK since the UK regards EastDene plc (rather than Subco) as having taken out the loan. In this situation, the UK rules will deny the deduction to EastDene plc.

UK administrative requirements

Where hybrids are used, a supplementary form CT600B must be completed, answering questions such as if the company is a hybrid entity or has had transactions with hybrid entities in the same control group. If a mismatch has occurred, the relevant counteraction must be included in the computation and disclosed on form CT600B together with other details including any dual inclusion income.

MARKING GUIDE

TOPIC	MARKS
Hybrid entity – definition and mismatch	2
Hybrid financial instrument – definition and mismatch	2
DNI mismatch – primary response (overseas) and secondary response (UK)	2
DD mismatch – primary response (UK)	2
Admin – CT600B, adjustment	2
TOTAL	10