



# The Chartered Tax Adviser Examination

May 2017

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## Advanced Corporation Tax

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### Advisory Paper

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TIME ALLOWED – 3 ¼ HOURS

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- The first 15 minutes is designated as reading time. During this time you may read your question paper and legislation and annotate your question paper. You are not permitted to write in the answer booklet. The Presiding Officer will inform you when you can start writing. Calculators may not be used during this time.
- You should answer all **SIX** questions.
- Start each answer on a fresh page and do not write in the margins.
- All workings should be shown and made to the nearest month and pound unless the question specifies otherwise.
- Marks are specifically allocated for presentation.
- Candidates who answer any law elements in this paper in accordance with Scots law or Northern Ireland law should tick the appropriate box on the front of each answer booklet.
- Unless otherwise indicated by the provision of additional table information, you may assume that 2016/17 rates and allowances continue to apply for 2017/18 and future years. Candidates referring to actual or pending rates and allowances for 2017/18 and future years will not be penalised.

1. You are a Tax Manager at a firm of accountants, Peters LLP. Your Tax Partner has received a telephone call from Louise Johnson, the Finance Director at Roberts Publishing plc. Roberts Publishing plc is a long-term client of the firm. All group companies have an accounting year end of 30 November.

Roberts Publishing plc has a number of UK subsidiaries including a book retailer, Stevens Books Ltd, which until November 2016 was trading through two bookstores. Roberts Publishing plc acquired a 90% shareholding of Stevens Books Ltd in 2005 with the remaining 10% being retained by the original owner, Paul Stevens.

Louise has explained that although Stevens Books Ltd was profitable for several years after acquisition, the growth of online book retailers has resulted in losses and a decision has been made for the company to cease to trade on 31 May 2017 and be liquidated.

In view of the downturn, the company had already assigned the lease on its London store on 23 November 2016 receiving consideration of £2 million. The company had acquired a 75 year lease on the property on 31 March 1975 for £2 million. The value of the lease at 31 March 1982 was £2.5 million.

The only significant asset now held by the company is a freehold property in Leeds, which comprises a retail store with significant storage facilities, part of which is currently sublet. Given its desirable location, the property could be sold at a substantial profit estimated to be in excess of £750,000, but only after the sub-lease expires in December 2017. If the property were to be sold immediately the gain is only anticipated to be £100,000.

Louise has provided the following financial information concerning the company:

	<u>Actual</u> <u>Six months ended</u> <u>31 May 2016</u> £'000	<u>Actual</u> <u>Six months ended</u> <u>30 November 2016</u> £'000	<u>Estimated</u> <u>Six months ended</u> <u>31 May 2017</u> £'000
Revenue	7,000	5,000	4,000
Gross profit	4,000	2,000	1,000
Admin expenses	(4,800)	(3,500)	(8,000)
Trading (loss)	(800)	(1,500)	(7,000)
Profit on assignment of lease		826	
Rental income	750	750	750
Interest receivable on surplus cash	100	100	0
Profit/(loss) before tax	<u>£50</u>	<u>£176</u>	<u>£(6,250)</u>

There are no significant differences between accounting and taxable profits other than in respect of the assignment of the lease.

Louise has also provided summary figures for taxable profits reported on tax returns:

<u>Taxable income</u>	<u>y/e 30</u> <u>November</u> <u>2012</u> £'000	<u>y/e 30</u> <u>November</u> <u>2013</u> £'000	<u>y/e 30</u> <u>November</u> <u>2014</u> £'000	<u>y/e 30</u> <u>November</u> <u>2015</u> £'000
Trading profit	6,000	4,000	2,000	500
Rental income	1,500	1,500	1,500	1,500
Non-trading loan relationships credit	1,000	750	600	500

Continued

1. Continuation

**You are required to prepare a briefing note for your Tax Partner explaining, with calculations:**

- 1) **The losses arising for tax purposes and the options available to utilise the losses.** (15)
- 2) **The tax implications of the alternatives available in connection with the disposal of the property in Leeds.** (5)

Total (20)

2. You are a Tax Manager in a firm of Chartered Accountants and have been asked to run a series of training sessions for colleagues in the audit department who are studying for their accountancy exams. These sessions are meant to provide the audit team with an awareness rather than in-depth technical knowledge of topical tax issues. One of the sessions will be on Diverted Profits Tax.

**You are required to prepare notes to be provided to your colleagues to accompany the Diverted Profits Tax training session.** (10)

3. You are a tax trainee at Smith and Jones LLP and are currently finalising the tax computations for your firm's client, Stuart plc and its subsidiary companies, for the year ended 31 December 2016.

As well as holding the shares in its subsidiaries, Stuart plc carries on a trade managing hotels and corporate hospitality operations, both in its own properties and for third parties.

You have been provided with the fixed asset note below and further information from the client.

Fixed assets – Stuart plc company accounts

	<u>Freehold property</u> £'000	<u>Leasehold property</u> £'000	<u>Plant and machinery</u> £'000
Cost			
Brought forward	6,500	4,500	6,500
Additions	2,300	0	0
Disposals	<u>(1,000)</u>	<u>0</u>	<u>(200)</u>
Carried forward	<u>7,800</u>	<u>4,500</u>	<u>6,300</u>
Depreciation			
Brought forward	1,300	2,500	3,250
Charge in year	150	200	1,250
Disposals	<u>(200)</u>	<u>0</u>	<u>(200)</u>
Carried forward	<u>1,250</u>	<u>2,700</u>	<u>4,300</u>
Net book value			
Brought forward	<u>5,200</u>	<u>2,000</u>	<u>3,250</u>
Carried forward	<u>£6,550</u>	<u>£1,800</u>	<u>£2,000</u>

Further information:

- 1) All properties held by Stuart plc are/have been used in its trade.
- 2) The freehold property disposal was of a pub in Liverpool to a third party for total consideration of £2.5 million on 25 February 2016. The property was originally constructed by a subsidiary of Stuart plc, David Ltd, which held it as trading stock and transferred it to Stuart plc in June 2012 at its cost of construction, £1 million, when the market value was £1.1 million.
- 3) The plant and machinery disposed of during the year was equipment in the Liverpool pub that was scrapped immediately before the sale of the pub.
- 4) In March 2016, Stuart plc acquired a new pub in Colchester from a third party for total consideration of £2.3 million.
- 5) In September 2016, Stuart plc granted a 20-year lease over its property in Exeter, receiving a premium of £25,000. The original cost of the property was £300,000. A 60-year lease was also granted over the company's property in Stevenage with a premium of £150,000. This property cost £1.2 million.

**You are required to explain how the above information should be reflected in the Corporation Tax computation for the year ended 31 December 2016, including details of any beneficial claims or elections that could be made and any further information required to finalise the computation.**

(20)

4. 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

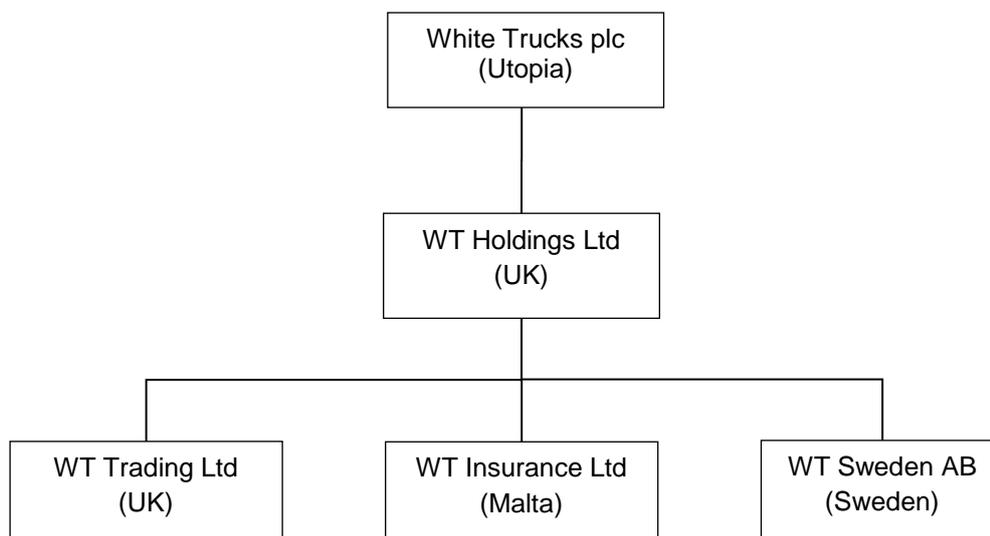
Arun

**You are required to draft an email response to Arun explaining the UK Corporation Tax consequences of the loan and derivative.**

(10)

5. You are a Tax Manager at a firm of Chartered Tax Advisers. One of your clients is Fast Cars plc, the UK resident parent company of a multinational group. Joanne Driver, the Finance Director of Fast Cars plc, is undertaking due diligence on the potential acquisition of White Trucks plc.

The structure of the White Trucks plc group, together with the country of incorporation and of tax residence for each company, is as follows:



The following information has been provided to you on the White Trucks plc group.

- 1) All companies are wholly owned.
- 2) White Trucks plc was incorporated five years ago as the vehicle for a group reorganisation to move the headquarters to Utopia. The shareholders of WT Holdings Ltd exchanged their shares for new shares in White Trucks plc. The shareholders of White Trucks plc comprise numerous unrelated individuals from around the world and only a small number are UK resident.
- 3) In the year to 31 December 2016 White Trucks plc received a dividend of £50 million from WT Holdings Ltd. It also received interest on two loans: £400 million lent to WT Holdings Ltd; and £300 million lent to WT Trading Ltd; both at an interest rate of 5%. It had no other sources of income.
- 4) WT Holdings Ltd is a non-trading holding company. It has used the £400 million borrowed from White Trucks plc to make a loan of the same amount and on the same terms to WT Sweden AB.
- 5) WT Trading Ltd is a trading company, involved in the manufacture and sale of commercial vehicles.
- 6) WT Insurance Ltd is a captive insurance company, providing insurance services for the other group companies.
- 7) WT Sweden AB is a trading company in Sweden which develops and manufactures engines. In the year to 31 December 2016 it had £40 million of trading profits.
- 8) All transactions undertaken between entities in the White Trucks group are undertaken on arm's length terms.

5. Continuation

You have established that:

- 1) Utopia does not impose any Corporation Tax on its residents and is outside of the European Economic Area.
- 2) Sweden is a member state of the European Union and has a corporate tax rate of 22%.
- 3) Malta is a member state of the European Union and has a corporate tax rate of 35%. It operates a system whereby a non-resident shareholder is entitled to a refundable tax credit on the distribution of profits to the shareholder of 6/7ths of the tax paid by a Maltese company on those profits.

Joanne has asked you about the UK's Controlled Foreign Company rules. White Trucks plc has suggested that those rules should have no application in respect of their companies as a result of the Cadbury Schweppes decision at the Court of Justice of the European Union.

**You are required to draft a letter to Joanne Driver explaining the UK Controlled Foreign Company risks for Fast Cars plc if it acquires White Trucks plc. (20)**

6. You are a Tax Manager at a firm of Chartered Tax Advisers and are preparing the Corporation Tax computations for Bidco Ltd, Robin Gyms plc and RGUK Ltd (the 'Group') for the period ended 31 December 2016.

Bidco Ltd was incorporated on 1 January 2016 to acquire a chain of gyms. It acquired Robin Gyms plc and its subsidiary, RGUK Ltd, on 1 July 2016. Robin Gyms plc and RGUK Ltd prepared their most recent accounts to 31 March 2016.

You have been provided with the following draft income statements:

<u>Period to 31 December 2016</u>	<u>Bidco Ltd</u> 12 months £	<u>Robin Gyms plc</u> Nine months £	<u>RGUK Ltd</u> Nine months £
Turnover			23,212,000
Cost of sales			<u>(944,000)</u>
Gross profit	<u>Nil</u>	<u>Nil</u>	<u>22,268,000</u>
Administrative expenses			
Depreciation – owned assets			(3,900,000)
Depreciation – leased assets	10		(1,500,000)
Amortisation of software costs			(16,000)
Staff costs	(100,000)	(770,000)	(7,563,000)
Royalties			(60,000)
Charitable donation	5	(10,000)	
Deal costs	2	(457,000)	
Other business costs		<u>(187,000)</u>	<u>(3,892,000)</u>
	<u>(557,000)</u>	<u>(967,000)</u>	<u>(16,931,000)</u>
Finance and other income			
Bank interest income	1	10	1,000
Royalty income	4		<u>60,000</u>
	<u>10</u>	<u>61,000</u>	<u>Nil</u>
Finance expense			
Interest on bank loans	3	(6,000,000)	(500,000)
Arrangement fee	3	(1,200,000)	
Interest on overdraft facility			(126,000)
Finance cost on leased assets	10		<u>(350,000)</u>
	<u>(7,200,000)</u>	<u>Nil</u>	<u>(976,000)</u>
Profit/(loss) before tax	<u>£(7,756,990)</u>	<u>£(906,000)</u>	<u>£4,361,000</u>

Continued

6. Continuation

You have also been provided with the following notes:

Bidco Ltd

- 1) Bidco Ltd was incorporated with £10,000 of share capital. This amount was immediately placed in an interest bearing deposit account which earned £10 of interest income in the year.
- 2) Bidco Ltd incurred the following deal costs in connection with the acquisition of Robin Gyms plc:

	£
Due diligence costs (legal, accounting and tax)	435,000
Legal fees – preparation of sale and purchase agreement	20,000
Legal fees – incorporation of the company	2,000
	<u>£457,000</u>

The due diligence costs were all incurred to assess whether to go ahead with the transaction to purchase Robin Gyms plc. It is estimated that 75% are directly attributable to meeting the requirements of the banks in order to raise the debt finance required.

- 3) Bidco Ltd borrowed £120 million on 1 July 2016 to finance the acquisition of Robin Gyms plc under a five-year loan from a syndicate of third party banks at an interest rate of 10%. It incurred £6 million of interest on this instrument in the six months to 31 December 2016. It also incurred arrangement fees of £1.2 million with the banks for entering into the loan.

Robin Gyms plc

- 4) Robin Gyms plc recognised £60,000 of royalties in 'other income' from RGUK Ltd for the use of the Robin Gyms' registered trademark.
- 5) Robin Gyms plc made a donation of £10,000 to a national charity.
- 6) In the year ended 31 March 2016, Robin Gyms plc had management expenses and non-trade loan relationship deficits, which were surrendered to RGUK Ltd by way of group relief.

RGUK Ltd

- 7) The main pool of capital expenditure within RGUK Ltd had a tax written down value of £27.2 million as at 31 March 2016.
- 8) RGUK Ltd incurred capital expenditure of £80,000 on computer software for a new website which is accounted for under intangible assets. This is being amortised on a straight line basis over four years.

Continued

6. Continuation

- 9) RGUK Ltd incurred the following expenditure in the period on the fit out of a new gym in Leeds. The fit out costs, together with details of the expected useful economic life of the assets, are as follows:

<u>Description</u>	<u>Expected Useful Life (years)</u>	<u>Cost £</u>
Building works	50	500,000
Air conditioning	20	75,000
Swimming pool	20	300,000
Heating system for pool	20	50,000
Fitness equipment (acquired under a finance lease – see Note 10 below)	10	365,000

The air conditioning units meets the energy-saving criteria specified on the Energy Technology Criteria List.

The heating system for the pool was purchased under a contract where 50% of the cost is deferred for six months and due in March 2017.

- 10) RGUK Ltd leases its fitness equipment under finance leases, which are long funding leases, from a third party leasing company. Total lease payments for the period were £950,000, which are accounted for as a reduction in the finance lease creditor of £600,000 and a finance cost expense of £350,000. The depreciation charge in respect of leased assets for the period is £1.5 million.

During the period, RGUK Ltd entered into new leases in respect of fitness equipment. The present value of the minimum lease payments under these new leases was £365,000.

- 11) In the year ended 31 March 2016, RGUK Ltd had significant taxable profits after claiming group relief from Robin Gyms plc.

- 12) The Group is under significant pressure to deliver cash and would therefore like to make all the available claims and elections to minimise the Group's overall Corporation Tax liability.

**You are required to prepare Corporation Tax computations for Bidco Ltd, Robin Gyms plc and RGUK Ltd for the accounting period ended 31 December 2016, with supporting explanations as appropriate.** (20)