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Instructions

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1		
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5		

FORMAT & STYLE OF ANSWER	MAXIMUM MARKS	MARKS AWARDED
<p>The answer is set out in the format demanded. Thus, if it is a letter, it will be properly set out as a letter with addresses, date, "Dear X" and conclude "Yours sincerely" etc. If it is a report, it will give some indication as to what it is about and who it is for.</p>	1	
<p>The report or letter should contain an introduction setting out the terms of reference, information being relied on etc. It should also contain a summary of the key findings and recommendations.</p>	2	
<p>The body of the letter or report should be laid out in a clear way with appropriate headings so that the reader can navigate around it easily and spot the key areas without reading the entire document to try to find a discussion of, for example, income tax on some employment related shares.</p>	1	
<p>The answer "flows" so that a logical chain of thought presented to the reader rather than a series of random comments (which may nevertheless be technically correct).</p>	1	
<p>The style of writing should be appropriate to what is being produced. For example, a report to a client or lay person (which will always be the main element of a question) should not contain large numbers of legislative references whereas a technical note to the tax partner should. Technical advice should be conveyed in style appropriate to the reader.</p>	2	
<p>RELEVANCE OF ANSWER</p>		
<p>The answer does not contain large amounts of irrelevant material which would only serve to confuse a client.</p>	2	
<p>Technical knowledge (which will be rewarded through the technical marks and should not affect the awarding of these marks) has been directly applied to the specific circumstances of the reader and has this resulted in an answer tailored to their circumstances.</p>	3	
<p>The question(s) posed has/have been answered.</p>	2	
<p>PROVISION OF ADVICE</p>		
<p>The report gives advice. This means that where possible it should come off the fence and suggest the best option rather than simply giving a list of unweighted possibilities which fail to give the client an answer to their real problem: what should I do?</p>	4	
<p>Advice should include relevant and appropriate planning for the future.</p>	2	
<p>Advice should be commercial. This means that candidates should consider the bigger picture rather than narrowly focussing on saving tax.</p>	2	
<p>TOTAL HIGHER SKILLS AND PRESENTATIONAL MARKS</p>	22	

Report on the tax affairs of Bismfield Paperes (BP)

FAO: Board of DP Group

Author: Laura T. He

1.0 Introduction and Executive Summary

Based on the information ~~provided~~ available, being the approved restructuring report and letters from the Audit manager and HMRC, this report outlines the capital allowances and VAT implications of the proposed capital expenditure effects of the letter from HMRC and advises on structuring of the new business with the Enterprise Investment Scheme in mind.

1.1 Executive Summary

- Much of the capital expenditure will be eligible for capital allowances, with the exception of that on buildings.
- This is with the exception of the industrial units in the Enterprise zone of Tees for which a 100% allowance of the £1.5m is available.
- Remaining eligible expenditure may claim 18/8% allowances with a £200k ~~annual~~ ^{100%} annual investment allowance available across the group.

- Soliminate will be partially exempt for VAT purposes making some input VAT irrecoverable. It should be agreed with HMRC that this should be calculated based on rental amounts received rather than floors rented.
- Tax is likely to be repayable in relation to the main unboxed credit in the 2016 return, along with interest and penalties.
- Any discovery assessment opened by HMRC into years 2012-2014 should be contested as no relevant information was provided.
- The enquiry window into the 2015 return remains open and due to the General Anti Abuse Rules the credit is likely to be deemed taxable.
- ~~These~~ Enterprise Investment Scheme relief should be available to the four individual investors provided certain conditions are met.
- Principal among these is the use of a separate new company to run the business and potential exclusion of the Blockson property.
- 30% income tax relief and Capital Gains Tax deferral will therefore be available.

2.0 Proposed Capital Expenditure

As outlined in the restructuring report significant capital expenditure is planned

for which capital allowances may be available and VAT implications

should be considered. It should be noted as a general corporation tax

issue that the payments in respect of the £20m loan to fund this will

be eligible for a trading deduction for corporation tax purposes. ~~The~~ This

external debt may also trigger ^{however} Worldwide Debt Cap restrictions, or ~~in~~ restrictions

under the incoming interest deductibility rules which are to be introduced as part

of the BERJ project, taking effect from April 2017. It is unlikely that

the group is excessively debt funded as the only material element

is Wallhampton Ltd, however confirmation of this should be sought.

2.1 ~~Substantive~~ Capital Allowances

For corporation tax purposes no relief is available for depreciation of capital assets. ~~Instead~~ Instead 'capital allowances' are available which provide deductions at various rates where applicable.

2.1.1 Plant and Machinery Allowance

~~Provision~~ All expenditure on plant and machines used in the trade of the company may be pooled and an 18% writing down allowance

claimed per year. This is calculated at the year end and so is not

~~reduced~~ ^{reduced} for when in the year the purchase occurred. 'Plant and machinery'

is not further defined in the legislation but much case law on this issue

has served to clarify what qualifies, although some items are specifically

included and excluded. With regards to the latter expenditure on buildings

is specifically excluded.

2.1.2 Integral features

Following the same 'pooling' pattern of plant and machinery allowances

integral features an 8% deduction may be claimed on 'integral

features' expenditure. The legislation specifically defines these as:

- An electrical system
- A cold water system
- A space or water heating system
- A lift, escalator or moving walkways
- external solar shading

2.1.3 Other allowances

100% first year allowances are available for expenditure on specified

environmentally beneficial plant and machinery, as well as those that

qualify as being for 'research and development'. In addition

Long life assets (those with a useful economic life of at least 25 years) which qualify as plant and machinery may be separately pooled and only an 8% of writing down allowance is permitted. where there is expenditure on Equally, short life assets (with a useful economic life of less than 8 years) notably on electronics may be made to pool each individual asset (or part of assets if identified and with HMRC's agreement) separately.

A balancing allowance will then be available when the asset is disposed, as opposed to a deduction from the overall overall pool (thus accumulating relief).

2.1.3 Annual Investment Allowance (AIA)

The AIA allows for a 100% first year deduction on, from November 2016, the £200,000 of ~~each~~ qualifying capital expenditure. This must be

shared across the group and would be usually allocated to expenditure on integral features as relief on these costs is often more shown than other plant and machinery.

2.1.4 Saliminder

The proposed expenditure, as per the above brief outline of reliefs, ~~is~~ would ~~be~~ qualify for capital allowances is follows:

£1.3m on structural alterations - As expenditure on buildings it is unlikely that any of this amount would qualify for capital allowances.

£2.2m on aircon/lighting - As listed in 2.1.2 both space cooling and lighting (ie electrical) systems are integral features and therefore an 8% writing down allowance would be available. AIA should also be probably allocated to these amounts.

Further some lighting systems also benefit from the enhanced capital allowances 100% deduction for environmentally friendly plant, and this should be considered by the purchasing team.

£900k on sanitary appliances - As confirmed in case law (see Hetherington case) such appliances qualify as plant, and so the 18% allowance.

£400k on partitions - Provided these partitions are not fixed and it is intended they will be moved as part of the trade they will be eligible for the 18% allowance.

£500k on furniture - Furniture is eligible as plant and the 18% allowance although consideration should be given to the expected life of the assets. If this is less than 8 years a short life asset election should be considered.

2.1.5 Wallhampton Ltd

Wallhampton is Jersey resident, but though the site is London and Teeside

there is a fixed place of business and there is UK Permanent Establishment (PE).

This will be ~~then~~ subject to UK tax on the 'separate enterprise' principle

which ~~is~~ treats the PE as separate to the overseas company, and in

calculating the tax nominal capital allowances are available.

Advice should be sought in Jersey as to any double tax relief

available to Wallhampton for corporation tax ~~is~~ suffered in the UK.

£2m electrical systems - As outlined in 2.1.2 Electrical systems are specifically defined as integral features and so an ~~eligible~~ 8% allowance may be claimed.

£800k restaurant - This expenditure is likely to include items eligible as plant (e.g. furniture, cooling equipment etc) as well as integral features

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(e.g. lighting and electrical systems). A full analysis should be done on the expenditure to assess which allowances may be specified for.

The above is subject to the allowances available due to the buildings being within 'Enterprise Zones', see section 2.3.

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2.2 VAT implications

2.2.1 Solminster

Insurance companies are an exempt supply for VAT purposes, and therefore

Solminster will be considered to be 'partially exempt' to the

extent that it provides lettings to the insurance company. An

element of input tax will therefore be irrecoverable: this will be all

which directly relates to supplies of ~~to~~ flows 1-11, and a

pro rata amount to any which relates to the building business as

a whole.

For example 100% of the VAT incurred on the partitions and furniture

for flows 19 and 20 ~~will be~~ may be reclaimed as the rental of these

floors is a taxable supply. The VAT incurred on the air-con, lighting etc for the whole building will only be partially recoverable (note that the irrecoverable amounts ~~may~~ ^{will} be eligible for capital allowances relief as outlined above) for the asset to which it relates.

The extent to which the company is partially exempt should be agreed with HMRC. It would be preferable for Seliminder to argue that the exempt supplies percentage should be calculated on rent received as a reasonable indicator of the overall supplies of the company. Assuming say £1m of rent is received for the top two floors this would give a percentage of 40% ($\frac{4m}{10m}$) to ~~exclude~~ apply to residual input VAT. HMRC may argue that the number of floors rented, i.e. 12 of 20 and so

60% would be more appropriate. Given that on just the capital expenditure this equates to a difference of c.150k the argument should be strongly made for the farmer.

2.3 Enterprise Zones

Both Tees Valley and London Ports are designated Enterprise Zones.

Qualifying expenditure is that on a building used for purposes of a trade or as an office. As both are industrial units in the UK ^{qualifying} capital expenditure incurred will be able to be the subject of a 100% first year allowance.

This includes expenditure for the welfare of the workers (i.e. the restaurant and canteen), but only on the construction of the building.

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Therefore ~~the~~ only the £15m expenditure on the Tees Valley units would be eligible for such relief, although this claim must be made within 10 years of the building entering the zone.

The capital expenditure on the London Docks would therefore be eligible to allowances as set out above.

3.0 Impact of HMRC letter

The letter from HMRC dated 24 April 2017 has a number of implications, with regards to both tax and accounting, which should be considered as below. It should be noted that as a result of this enquiry it is likely that the group's relationship with HMRC has increased and increased scrutiny can be expected on future tax submissions.

3.1 Closure notice

A key element of the letter was the expression of the intention to issue a closure notice which would close the currently open HMRC enquiry. This will make amendments to the return in line with the conditions stated, i.e. an amendment to increase taxable profits by

£4.44m. It is assumed that this is an error and that the closure notice when received will in fact amend the return by £1.44m, being the amount equivalent to the non-trade debit claimed in Cavetto Ltd. This increase would result in tax payable at 20% is £288,000.

An appeal ~~may~~ may be made against the conclusion of the closure notice but this must be done within ~~the~~ 30 days. Advice should be sought on the likely cost and success of any appeal

~~be~~ before this is ^{acted} acted upon. See Appendix 1 for calculations of the potential maximum tax repayable (excluding penalties and interest), being

£1.59m.

3.2 Discovery Assessments

It is indicated that HMRC wish to open discovery assessments into years 2012-2015 to assess the taxation of ^{excluded} residents ~~included~~ in these years. It should be noted that such a power is only open to HMRC to the extent that the information has not been provided to HMRC in order to allow them to make an assessment within the usual enquiry window of 12 months, ~~and~~ ^{if}

The power also only extends back to account periods ending within 4 years of the point of the assessment, although this is extended to 6 where the omission was careless and 20 years where it was deliberate.

It should be submitted therefore that though the operation of the DATAS scheme and inclusion of the reference number HMRC have been supplied with sufficient information to allow them to make the appropriate assessment. Therefore the Returns may be ^{considered} considered final following 12 months after the submission date.

The returns for ~~the~~ the years ended 30 June 2012-14 are therefore out of time for an enquiry, and ~~an~~ HMRC has no power to raise a discovery assessment.

The deadline for submission of the return for the year ended 30 June 2015 was 30 June 2016 and therefore HMRC have until 30 June 2017 to raise an enquiry into this return, which they

may legitimately do. If this is the case all information should be provided to HMRC in a timely manner. Late provision of documents may be subject to a £300 fine, with a £60 per day additional fine for every subsequent days delay.

3.2.1 Appeal

It would be wise to seek full advice on the legal position of the proffered HMRC discovery assessments into the years 2012-14.

However an appeal would be advised on the basis that full information was provided to HMRC at the time of the submission of the Returns. This must be made within 30 days of the notice being given by HMRC of the discovery assessment.

3.3 2015 and 2016 Returns

Assuming an enquiry is opened into the 2015 year end it seems likely that a total of £672k (see Appendix 1) of additional tax would be payable

This is likely to be the case as it would appear that regardless of the ^{tax position} outcome of the Tax Counsel's opinion as to the ~~legality~~ in principle of the arrangement, it is likely to have been considered an 'abusive tax ~~arrangement~~ arrangement for the purposes of the 'General Anti Abuse Rules' (GAAR). This breach of the GAAR would allow HMRC to make any 'just and reasonable' adjustments, which ~~possibly~~ adjusting the returns to tax the excluded income would

appear to be.

~~Para~~ 3.4 Penalties and Interest

It is likely that interest will be charged on tax payable as a result of the adjustments from the date due to that paid.

Additionally as the error was not deliberate or careless, and was

disclosed to HMRC through the DOTAS scheme, a maximum penalty of

30% of the unpaid tax may be due.

3.5 Accounting Issues

As outlined above HMRC is no longer able to open an enquiry into the years ended ~~2012~~ 30 June 2012 to 2014 and so the accounting adjustments may be made to reorganise recognise the income not taxed. This would, as an estimated value, be reflected as a prior year adjustment.

It is likely that a provision will be required for the tax ~~is~~ payable as a result of the adjustment ~~of~~ of the 2016 return (including penalties and interest) as well as the 2017 return assuming an enquiry is similarly opened.

4.0 Enterprise Investment Scheme

The Enterprise Investment Scheme (EIS) allows eligible investors to claim a 30% income tax deduction for qualifying investments, up to a total of £1m (i.e. a maximum £300k deduction).

In addition for every £1 of qualifying investment, £1 of Capital Gains Tax may be deferred for gains arising on the disposal of the investment. It is these benefits which the structure of the investment should ideally allow.

4.1 EIS requirements

In order to qualify for the EIS reliefs a number of requirements must be met. The shares issued must be ordinary shares, and the total

amount raised by the company in the year in question through relevant investments must not exceed £5m. The shares issued must be in order to finance "business growth and development" in a qualifying business activity. There must be no tax avoidance motive (which does not appear to be the case).

In addition the value of the company's assets at the time of the share issue must not exceed £15m before the share issue. Ignoring the possibility of any asset stripping it would therefore be necessary to structure the investment in a new company ("Newco")

4.2 "Newco"

Initially Kidihull should create a subsidiary 'Newco' and transfer the properties to this company in exchange for shares of the value of £500k. As a 100% subsidiary at the time, ~~the new~~ and therefore a member of the same chargeable gains group, this will be carried out on a No gain No loss ~~per~~ basis.

When additional shares are issued and Kidihull's ownership falls to 33% and so Newco leaves the ~~the~~ Chargeable Gains group a degrouping charge would be calculated, but as the market value of the shares issued equals the value of the property no charge will arise.

4.3 Properties traded

As highlighted in 4.1 EIS is only available for 'qualifying activities'. A

lot of excluded activities which would breach this criteria is included

within the legislation and includes "operating or managing hotels or

comparable establishments". The guest rooms in the Blockbuster

property would satisfy this definition, ~~and~~ if it is considered the activity

is a 'substantial' part of the Newco trade EIS would not be available.

The extent to which these rooms ~~would~~ would provide income, take up

management time and generally contribute to the Newco trade will need to be

assessed. If this is substantial (likely to be over 20% as is often assessed

of corporation tax) then this property should be excluded from Newco to

~~avoid~~ avoid jeopardising EIS availability.

4.4 Qualifying Investor

As highlighted in 4.1 in order to claim EIS relief the investor must be

qualifying. This requires:

- no connection with the company
- no linked loans
- no tax avoidance.

The latter two criteria are clearly satisfied for all four individuals.

Mr and Mrs Corbell are not connected at all to Bimfield Papers they will

satisfy these first conditions on this point. It is also required that the individual

does not have control over 30% or more of the share capital. As the

overall share capital will be £1.5m, each of the four individuals will have

a 16.7% stake. ^{However} Although the couple will have over 30% combined ~~share~~

~~interest~~ ~~control~~ and as associates the joint holding is considered and

hope EIS would not be available. A slight reduction in their investment ^{would be} advised.

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	Peter and Paul Birmingham however will be considered as, presumably, directors	
	of the company. There are however circumstances when directors may still	
	claim EIS, but these do not extend to employees and so this distinction	
	should be maintained.	
	Such EIS relief will still be available to Peter and Paul provided they	
	are appointed as directors after the issuing of the shares, and the remuneration	
	for managing the business.	
	They must receive is reasonable for the services rendered.	
	It is assumed they have no previous connection to Birmingham Properties other	
	than their joint ownership, which at 30% would not constitute ^{constitute} control ^{control} .	
	Therefore Peter would not be considered associated for the purposes of the 30%	
	holding requirement.	

4.5 Conclusions

EIS will, following the above, be available to the four individuals

- provided:
- A new company is established to operate the business
 - Individual shareholdings do not exceed 30%
 - If the guest house ~~was~~ ^{would be a} significant part of the business this is excluded
 - Peter and Paul receive only reasonable remuneration.

A total of £75,000 of income tax relief will therefore be available for

each individual, and a deferral of £250,000 of Capital Gains Tax on

disposal. It should be noted that the Substantial Shareholding Exemption

is likely to exempt Kidshull Ltd from any future chargeable gains on

the disposal of its £500k investment in shares in Newco. Note it

is important that if Newco, following the issue of the shares to the individuals, becomes a

51% subsidiary of Kidshull EIS will no longer be available.

<u>Appendix 1</u>		
Potential tax payable, excluding penalties, per year.		
Note that based on estimated blended tax rates and are provided as a guideline only.		
<u>2012</u>	480k @ 23.5%	£112.8k
<u>2013</u>	1920 @ 21.5%	412.8k
<u>2014</u>	1920 @ 20.25%	388.8k
<u>2015</u>	1920 @ 20%	384k
<u>2016</u>	1440 @ 20%	288k
		} 672k
	Total	<u>1,586.4k</u>

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