The Chartered Institute of Taxation

Advanced Technical

Taxation of Larger Companies and Groups

May 2026

Suggested answers

Answer 1

Administrative

For corporate interest restriction (CIR) purposes, Newco plc is the ultimate parent company of the newly formed worldwide group. All of its subsidiaries will be members of the CIR worldwide group as they are consolidated by Newco plc under IFRS. The first period of account to which CIR applies to this new group is the year ended 31 December 2025.

Groups should appoint a reporting company for the purpose of the CIR legislation within 12 months of the end of the period. As the group is subject to the CIR in 2025, they should appoint a company that is subject to UK Corporation Tax to be the group's reporting company for that period.

Where a reporting company has been appointed, it must submit an interest restriction return (IRR) within 12 months of the end of the period. If no restriction applies a group can submit an abbreviated return but for Newco plc a full return will be required. As a new group for CIR purposes has been formed there will be no brought forward interest allowance.

The IRR should:

1. identify the ultimate parent,
2. identify the period
3. identify the UK group companies,
4. contain any relevant elections, and
5. include calculations of:
    a. Tax-EBITDA and net tax-interest expense or income,
    b. either the fixed ratio debt cap or group ratio percentage as appropriate, and
    c. the interest allowance for the period.

The interest allowance for the period is calculated by reference to either the fixed ratio method or the group ratio method, however in this case the group ratio method is not advantageous. The fixed ratio method calculates the interest allowance as 30% of the earnings before interest, tax, depreciation and amortisation as computed for tax purposes (Tax-EBITDA). This will identify the maximum allowable interest deduction for the period. The interest allowance is compared to the aggregate net tax interest expense (ANTIE) to identify any disallowance.

Both Tax-EBITDA and ANTIE are calculated using the loan relationship debits and credits and similar financing costs for tax purposes after any disallowances for such items as unallowable purposes, the hybrids legislation or transfer pricing.

Public Infrastructure Exemption

To qualify for the public infrastructure exemption a company which is carrying on a UK property business must satisfy the following conditions:

1) The buildings which the company lets out must have an expected economic life of at least ten years and must be let on a short-term basis (less than 50 years) to unrelated parties.
2) Income test: All but an insignificant proportion of its income must come from that business.
3) Asset test: All but an insignificant proportion of its assets recognised on the company's balance sheet must relate to that business.

4) The company must be fully taxed in the UK. This means that all the activities of the company must be within the charge to UK Corporation Tax. For example, a claim to double taxation relief would mean that the company did not meet this condition.

5) The company must make an election for the special treatment to apply. The election must be made before the end of the accounting period to which it is to apply and is automatically carried forward to subsequent accounting periods. The election can be revoked but only after a minimum of five years.

Calculation of CIR disallowance

	Note	£ million
Pre adjustment tax-EBITDA		225
Increase due to disallowance of management services charge	1)	10
Decrease due to QIC election	2)	(15)
Revised Tax-EBITDA		220
Pre adjustment ANTIE		110
Reduction due to interest adjustment	3)	(20)
Reduction due to QIC election	4)	(20)
Revised ANTIE		70
Interest allowance for the period	5)	(66)
CIR disallowance	6)	4

1) The disallowance of the management services charge in Belroy UK Trading Ltd increases the earnings of the UK group by £10 million.

2) As Julkel Ltd is classified as a QIC its Tax-EBITDA is excluded from the CIR calculations.

3) The disallowance of the interest decreases the ANTIE of the UK group by £20 million.

4) As Julkel Ltd is classified as a QIC its Tax-interest expense is excluded from the CIR calculations.

5) The interest allowance under the fixed ratio method is found by applying 30% to the revised Tax-EBITDA (£220 million at 30%, which is £66 million).

6) The disallowance for the period is found by comparing the ANTIE (£70 million) with the interest allowance (£66 million), resulting in a disallowance of £4 million.

MARKING GUIDE

TOPIC	MARKS	MARKS
Administration		
New group formed for CIR purposes	1.0	
CIR will apply in 2025	1.0	
Appointment of a reporting company	1.0	
As there is a restriction, an interest restriction return (IRR) has to be submitted	1.0	
New group therefore no carry forward of unused allowance	1.0	
Contents of IRR	1.5	
Explain fixed and group ratios	1.0	
Explain interaction with other legislation	0.5	
		8.0
Public infrastructure exemption (PIE)		
Significantly all assets relate to UK property business.	1.0	
Significantly all income derived from that business	1.0	
Conditions for the let buildings (third party, short-term let, property expected economic life greater than 10 years	1.5	
Fully taxed in the UK NO DTR claims	1.0	
Election required applies for subsequent periods	1.0	
Election only revocable after five years	0.5	
		6.0
Calculations		
Management service charge transfer pricing adjustment will increase tax-EBITDA	1.0	
Loan relationship (LR) transfer pricing adjustment will decrease ANTIE	1.0	
LR transfer pricing adjustment will not affect tax-EBITDA	1.0	
PIE will reduce both tax-EBITDA and ANTIE	2.0	
Correct calculation of the restriction	1.0	
		6.0
TOTAL		**20**

Answer 2

1. Capital Allowances

	Notes	Main Pool	Special Rate Pool	Allowances claimed
		£'000	£'000	£'000
Tax written down value (TWDV) at 1 January 2025		6,000	1,000	-
Additions				
Warehouse integral features	(a)		1,000	
New Plant plus costs of installation	(b)	3,300		
Full expensing	(c)	(3,300)		3,300
Second-hand plant	(d)	2,000		
Office integral features	(e)		200	
New Plant office	(f)	500		
Full expensing	(g)	(500)		500
Vans	(h)	2,500		
Full expensing	(i)	(2,500)		2,500
Disposals				
Plant A	(j)	(150)		
First Year Allowance @ 50%	(k)		(600)	600
Annual Investment Allowance	(l)	(1,000)		1,000
Totals before writing down allowances		6,850	1,600	
Writing down allowance (18% and 6%)		(1,233)	(60)	1,293
TWDV at 31 December 2025		5,617	1,540	
Allowances claimed		-	-	£9,193

(a) The expenditure on the integral features which are part of the warehouse is added to the special rate pool.

(b) The cost of the new plant and the expenditure incurred to install this plant is added to the main rate pool.

(c) Full expensing can be claimed on both the expenditure on the plant and the installation costs.

(d) The expenditure on second-hand plant is added to the main pool, however full expensing is not available on second-hand plant.

(e) The expenditure on the integral features which are part of the office is added to the special rate pool.

(f) The expenditure on office equipment is added to the main rate pool.

(g) Full expensing is available on the expenditure on office equipment.

(h) The capital element of the hire purchase contract is:

	£000
Deposit	600
Instalments £50,000 x 48	2,400
Total	3,000
Finance costs	(500)
Capital cost	2,500

(i) The vans are plant and therefore the expenditure is added to the main rate pool and full expensing can be claimed.

(j) Disposal of Plant

Plant A	£000
Net book value	250
Loss on disposal	(100)
Proceeds	150

As full expensing would not have been available on this item the disposal proceeds are deducted from the main pool.

Plant B	£000
Net book value	500
Profit on disposal	100
Proceeds	600

As a 100% FYA was claimed on this item the proceeds are not deducted from the main pool. Instead, a balancing charge of £600,000 is added to the Corporation Tax computation.

(k) Integral features - First Year Allowances

	£000
Warehouse	1,000
Office	200
Total	1,200

50% of £1.2 million is £600,000.

(l) The Annual Investment Allowance of £1 million can be utilised against the main pool additions as the second-hand plant has not attracted full expensing.

2. Structures and Building Allowances (SBA)

	Notes	£000	£000
Warehouse			
Purchase cost less land and integral features	(a)	8,000	
Annual amount	(b)	240	
Pro rata	(c)		80
Office			
Cost of alterations including planning permission	(d)	1,800	
Annual amount	(a)	54	
Pro rata	(e)		27
Total SBA for year			107

(a) Qualifying expenditure on warehouse

	£000
Purchase price	12,000
Land	(3,000)
Integral features	(1,000)
Qualifying expenditure	8,000

(b) The rate of SBA for the period is 3% per annum.

(c) Shellnic Ltd can only claim for the part of the year (4 months) that it owned the building, from 1 September 2025 to 31 December 2025. 4/12 of £240,000 is £80,000.

Qualifying expenditure on office. As the warehouse was purchased unused from a developer, the purchase price is eligible for the SBA. The cost of the land and the integral features are not qualifying expenditure and need to be excluded.

(d)

	£000
Alteration costs	2,100
Planning permission	(100)
Integral features	(200)
Qualifying expenditure	1,800

(e) Shellnic Ltd can only claim for the part of the year (six months) that it owned the building, from 1 July 2025 to 31 December 2025. 6/12 of £54,000 is £27,000.

(f) No SBA available on building constructed before 29 October 2018.

MARKING GUIDE

TOPIC	MARKS	
Warehouse– Structures and Buildings Allowances (SBA):		
Qualifying expenditure (QE) is cost paid to contractor not cost incurred by contractor	0.5	
QE doesn't include land or integral features	1.0	
Calculate annual SBA and pro rating	1.0	
		2.5
Warehouse – plant and machinery allowances:		
New plant plus installation costs fully expensed	1.5	
Second-hand plant added to pool but not fully expensed	1.0	
Add integral features to special rate pool (SRP)	0.5	
		3.0
Office – SBA:		
SBA not available on cost of building as pre-29 October 2018	0.5	
Alterations, not planning permission or integral features are QE	1.0	
Calculate annual SBA and pro rating	1.0	
		2.5
Office - plant and machinery allowances:		
Add integral features to SRP	0.5	
Office equipment is plant and fully expensed	1.0	
		1.5
Vans – plant and machinery allowances:		
Can claim capital element of hire purchase cost	0.5	
Calculate capital element	0.5	
Vans are plant and fully expensed	0.5	
		1.5
Disposals:		
Plant A: calculate proceeds and deduct from main pool	1.0	
Plant B: calculate proceeds and treat as a balancing charge	1.0	
		2.0
Computations		
AIA/50% FYA	1.0	
WDA	1.0	
		2.0
TOTAL		**15**

Answer 3

1. Disposal of factory

	Note	£	£
Proceeds		30,000,000	
Costs of sale		(250,000)	
			29,750,000
Purchase cost		20,000,000	
Incidental costs of acquisition		100,000	
			(20,100,000)
Indexation allowance on purchase cost	(a)		(3,015,000)
Enhancement expenditure			
First workshop	(b)		Nil
Second workshop			(3,000,000)
Indexation allowance on second workshop	(c)		(171,000)
Chargeable gain			£3,464,000

(a) Indexation on purchase cost

Factors: Dec 2017 = 278.1, June 2012 = 241.8

Calculation: (278.1 – 241.8)/241.8 = 0.150 x £20,100,000 = £3,015,000

(b) The £2m expenditure on the first workshop is not deductible as enhancement expenditure because it is not reflected in the state or nature of the asset at disposal.

(c) Indexation allowance on enhancement expenditure

Factors: Dec 2017 = 278.1, June 2016 = 263.1

Calculation (278.1 – 263.1)/263.1 = 0.057 x £3,000,000 = £171,000

2. Disposal of office

	Note	£	£
Proceeds			5,000,000
Cost of lease	(a)		(3,512,199)
Indexation allowance	(b)		(526,830)
Chargeable gain			£960,971

(a) Allowable cost

Factors: 40 years = 95.457, 27 years = 83.816

£4,000,000 x (83.816/95.457) = £3,512,199

(b) Indexation allowance

Factors: Dec 2017 = 278.1, June 2012 = 241.8

Calculation: (278.1 – 241.8)/241.8 = 0.150 x £3,512,199 = £526,830

3. Disposal of plant

	£	£
Proceeds on asset sold for more than cost		250,000
Cost		(200,000)
Chargeable gain		£50,000

Plant and machinery will always be regarded as having a useful life of less than 50 years. Moveable plant will be a chattel. Although wasting chattels are normally exempt from chargeable gains, that is not the case when capital allowances have been claimed on the asset. Therefore, the chattels exemption does not apply to the specialised plant and machinery and the gain accruing on its disposal is subject to Corporation Tax. No allowable loss arises on the disposal of the assets that were sold for less than their cost, as capital allowances will have been obtained instead.

4. Reinvestment

The most common type of assets qualifying for rollover relief are land and buildings that are used for the purposes of the trade such as factories, warehouses and office. Fixed plant and machinery may be a qualifying asset, but the acquisition of moveable plant does not qualify for this relief. Therefore, the gains made on the disposal of the factory, and the office are available for rollover relief but not the gain on the item of plant.

Part of the proceeds have been reinvested by purchasing a new office building. As the proceeds from the sale of the factory were £30 million and substantially more than the amount reinvested, the reinvestment is better considered in connection with the disposal of the office building. Subject to satisfaction of the following conditions, part of the gain on that disposal can be deferred by reducing the base cost of the new office for chargeable gains tax purposes:

(a) Both the leased office that was disposed of and the new office building were used in the trade of the company.

(b) Both offices are qualifying assets for the purposes of rollover relief.

(c) The new office building was acquired within the period beginning 12 months before and ending three years after the sale of the leased office.

	Note	£	£
Proceeds of sale		5,000,000	
Amount reinvested		(4,500,000)	
Chargeable gain in period	(a)		£500,000
Chargeable gain on sale of office		960,971	
Chargeable gain in period		(500,000)	
Reinvestment relief	(b)		£460,971
Cost of new office building		4,500,000	
Reinvestment relief		(460,971)	
Base cost of new office building			£4,039,029

(a) As the company has not reinvested the full amount of the sale proceeds, the amount retained is immediately chargeable to Corporation Tax as a chargeable gain.

(b) The balance of the chargeable gain is available as reinvestment relief against the cost of the new office building.

(c) The base cost of the new office building on any future disposal of that asset is, for chargeable gains purposes its cost (£4.5 million) less the reinvestment relief (£460,971).

5. Summary

	£	£
Gain on factory	3,464,000	
Gain on office	500,000	
Gain on plant	50,000	
Chargeable gains subject to Corporation Tax		4,014,000

MARKING GUIDE

TOPIC	**MARKS**	
Factory:		
Proceeds less costs of acquisition	1.0	
Original cost plus incidental costs and indexation allowance (IA)	1.5	
Cost of enhancement not allowed because not reflected in state or nature of asset at disposal	1.0	
Enhancement cost plus IA	1.0	
Chargeable gain calculation	0.5	
		5.0
Leased office:		
Calculate correct cost using lease tables	2.0	
Calculate IA	0.5	
Chargeable gain calculation	0.5	
		3.0
Plant:		
Gain subject to Corporation Tax on chargeable gains	1.0	
Chattels exemption not applicable	0.5	
Chattels exemption	1.0	
Chargeable gain calculation	1.0	
		3.5
Reinvestment:		
Qualifying assets for rollover relief	1.0	
Conditions for rollover relief	1.5	
Amount deferred and base cost of new office building	1.0	
		3.5
TOTAL		**15**

Answer 4

	Working		Ayleswood		Binley
			£		£
Trading profit	1)				250,000
Less brought forward losses					(250,000)
Non trade loan relationships			50,000		
Property income	2)		275,000		
Property trade capital allowances	3)		(2,400)		
Chargeable gain	4)		Nil		
Management expenses	5)		(273,000)		
Profits before group relief			49,600		Nil
Group relief	6)		(24,600)		
Taxable profits			25,000		
Tax payable at 19%			4,750		

Workings:

1) Trading profit.

	Note	Binley
		£
Profit per accounts		600,000
Depreciation		250,000
Client entertaining	N1)	20,000
Wine and chocolate bars	N1)	31,000
Capital allowances	N2)	(651,000)
		250,000

Notes

N1) Office costs and Marketing and advertising costs

The costs of the staff Christmas party are tax deductible although the benefit in kind rules must be considered.
Client entertaining is not tax deductible.
Gifts to customers are only tax deductible if they cost less than £50, include advertising and do not contain food, drink or tobacco. Hence the pens and notebooks are tax deductible but the wine and chocolate are not.

N2) Capital allowances – Binley

		Main pool	Special rate pool	Total allowances
	£'000	£'000	£'000	£'000
Brought forward		2,750	100	
Additions – Annual Investment Allowance	150			
Allowances – 100%	(150)			150
Allowances – 18%/6%		(495)	(6)	501
Carried forward		2,255	94	
Total				651

Although the final payment for the plant is payable after the year end on 1 June 2026 this is within 4 months of the obligation to pay. Accordingly, all of the expenditure is treated as incurred in the year ended 31 March 2026.

N3) Loss memorandum – Binley

	£
Brought forward loss	500,000
Utilised in year	(250,000)
Surrendered as group relief	(24,600)
Carried forward	225,400

2) Net property income

Income 650,000 less costs 375,000 = £275,000.

Reconciliation of Ayleswood result

	Ayleswood
	£
Net rental income	275,000
Non trade loan relationship income	50,000
Accounting Profit on grant of lease taxed as chargeable gain	100,000
Management expenses	(273,000)
Non deductible Depreciation	(50,000)
Disallowable legal fees – shareholder matters	(25,000)
Disallowable legal fees – capital relating to lease	(2,000)
Profit per accounts	75,000

3) Capital allowances – Ayleswood

	Special rate pool	Total allowances
	£'000	£'000
Brought forward	50	
Disposal	(10)	
Subtotal	40	
Allowances – 6%	(2.4)	2.4
Carried forward	37.6	

4) Chargeable gain

Grant of lease.

This is the grant of a long lease (more than 50 years). The allowable cost is determined using the part disposal formula.

			£
Gross premium			150,000
Less legal fees			(2,000)
Net proceeds			148,000
Less allowable cost		300,000 x 150,000/(150,000+200,000)	(128,571)
Unindexed gain			19,429
Less indexation	January 1991 (130.2) to Dec 2017 (278.1)	1.136x128,571=146,057 Capped at 19,429 as indexation cannot generate a loss	(19,429)
Chargeable gain			Nil

5) Management expenses

Deductible management expenses comprise:

	£000
Staff costs	150
Legal and professional – 100 less grant of lease and shareholder matters (27)	73
Office costs	50
Total	273

6) Group relief and losses.

As there are two associated companies, the threshold for the small companies' rate is £25,000 with marginal relief available on profits up to £125,000. Surrendering brought forward losses from Binley to Ayleswood to bring the taxable profits down to £25,000 will, therefore, save tax at 26.5% and any further surrender would only save tax at 19%. As the group is prioritising tax saving rather than cashflow, surrendering only £24,600 of losses is the most beneficial approach to the use of Binley's losses. Should the anticipated profits not arise in the 2027 year, the group relief claim can be revised until 31 March 2028.

As both companies will be utilising brought forward losses, a deductions allowance nomination must be completed, splitting the permitted deduction of brought forward losses appropriately. As the allowance is £5 million there will be no restriction on the use of the brought forward losses.

MARKING GUIDE

TOPIC	MARKS	
Adjustments to trading profit - Binley		
Depreciation	0.5	
Client entertaining disallowed	0.5	
Chocolate and wine disallowed, pens allowed and explanation	1.5	
No adjustment for Christmas party	0.5	
Offset brought forward trading losses	0.5	3.5
Management expenses - Ayleswood		
Legal disallowances – shareholder, lease	1	
Profit on disposal through CGT	0.5	
Exclude rental income and expenses	1	
Exclude Non-trading loan relationships	0.5	3
Grant of lease		
Net proceeds	0.5	
Part disposal formula - calculate allowable cost	1.5	
Indexation allowance capped to nil gain	0.5	2.5
Capital Allowances		
Final instalment due within 4 months so full amount incurred in year	1	
Ayleswood Disposal value	0.5	
Binley - Calculation for each pool	1	
Ayleswood – total allowances	0.5	3
Total taxable profits (TTP) and corporation tax calculation		
Ayleswood net property income	0.5	
TTP – Ayleswood (management expenses, group relief, TTP)	1.5	
TTP - Binley	0.5	
Tax payable at 19%	0.5	3
Group relief and losses		
Consider group relief of brought forward losses most efficient level with explanation (thresholds, small profits rate, marginal relief) recognise savings vs cashflow	0.5 2	
Able to amend group relief claim if beneficial	0.5	
Brought forward losses deductible, as under £5million, but nomination required	1.5	
Loss memorandum	0.5	5
TOTAL		**20**

Answer 5

Permanent Establishment (PE)
A taxable presence is likely to arise in an overseas country if Doncar Ltd carries on its activities through a permanent establishment in accordance with local law and the OECD model treaty. This could occur if it has a fixed place of business in that country or if an agent acting on behalf of Doncar has and habitually exercises authority such as the conclusion of contracts in that country on behalf of the company.

A fixed place of business includes a branch, warehouse, factory or place of management. Hence expansion overseas to the extent of such premises would result in a permanent establishment.

Whilst a building or construction site can sometimes also be considered a permanent establishment, this is typically only if it exists for more than a set period – one year in the OECD model treaty.

The anticipated timescale of each proposed construction contract should be reviewed to determine whether a taxable presence will arise, together with any other activities undertaken beyond the actual projects (for example, whether staff are based in the relevant country with an office or similar base allowing them to identify and market other construction opportunities) as this could also give rise to a permanent establishment, although certain exemptions exist relating to the activities of independent agents or auxiliary activities.

If Doncar Ltd's activities do not give rise to a permanent establishment, its profits from those activities will remain liable to UK Corporation Tax and no overseas tax liability will be permitted under the OECD model treaty.

Permanent establishment or subsidiary
Subsidiary
If a UK company incorporates a subsidiary under local law in an overseas jurisdiction, the subsidiary will be liable to tax in that jurisdiction. The profits of the subsidiary will not be immediately liable to UK Corporation Tax (or equivalent) unless either:

- The subsidiary is UK resident by virtue of its central management and control being located in the UK. This risk can be mitigated by ensuring it is managed locally as otherwise there is a possibility of taxation both in the UK and overseas territory unless the tie breaker clause in the relevant tax treaty determines its tax residence.
- The Controlled Foreign Companies (CFC) anti-avoidance rules apply to apportion is chargeable profits and creditable taxes to Donar Ltd.

The CFC rules will apply if the overseas company is controlled by Doncar Ltd (likely to be the case if it is a subsidiary), none of the exemptions (exempt period (not applicable for a newly incorporated subsidiary), excluded territories, low profits, low profit margin or tax exemption) apply and some (or all) of its profits fall through one of the specified gateways.
Given the adoption in many key European and overseas countries of equivalents to the multinational top-up tax, the tax exemption from the CFC rules (requiring a local tax liability of 75% of the UK tax that would arise) may apply to a subsidiary established in one of these territories. However, this must be verified and other CFC exemptions considered if appropriate.

The only CFC gateway that might apply to profits from construction operations is profits attributable to UK operations, but the motive test is likely to exempt bona fide commercial operations from this gateway.

If the subsidiary were to pay dividends these would be likely to be exempt from UK Corporation Tax provided that the necessary conditions for the dividend exemption are met. It is also important to consider any withholding taxes that might be levied by the local taxing authority.

Permanent establishment
If Doncar Ltd's activities result in it having a permanent establishment overseas, both the UK and overseas jurisdictions have the right to tax the profits arising from that permanent establishment, potentially giving rise to double taxation. Unless the election described below has been made, relief is available (under the relevant tax treaty or unilaterally) by claiming credit against the UK tax on the

relevant profits for the overseas tax suffered. If the overseas tax rate is lower than that in the UK, UK tax will be payable equal to the difference between UK and overseas tax rates on the overseas income. However, if the overseas tax rate is higher than the UK Corporation Tax Rate no further UK tax arises. Accordingly, if the UK Corporation Tax rate (25%) is higher than the overseas tax rate, operating through a permanent establishment potentially results in more tax, overall, being payable than if the operations were undertaken by a subsidiary undertaking.

Companies can elect to exempt from UK Corporation Tax the profits earned through a foreign permanent establishment. The election, which must specify the accounting periods to which it will apply, must be received by HMRC before the start of the first accounting period to which it relates. The election becomes irrevocable after the start of the first accounting period to which it applies and will apply to all of the company's permanent establishments.

Profits of an elected overseas permanent establishment will remain subject to UK Corporation Tax if the equivalent of the CFC rules become relevant.

Relevance of losses to choice of subsidiary or permanent establishment
Should losses be anticipated overseas, relief will generally be available in the UK for losses arising from an overseas permanent establishment (unless an exemption election has been made) whereas no UK relief will be obtained for losses made by an overseas subsidiary giving a potential benefit to falling within the UK tax net.

Whilst it is often desirable to commence operations through a branch (in order to benefit from UK tax relief on any losses arising in early years of operations) and then incorporate that branch into an overseas subsidiary, the nature of the construction work may result in a different profit profile and hence the key consideration for Donar Ltd may be the tax rate of the relevant jurisdiction.

MARKING GUIDE

TOPIC	MARKS	
Permanent establishment (PE)		
Existence of PE, OECD treaty	1	
Fixed place of business or agent exercising authority	1	
Examples of fixed place and application	1	
Construction site – exceeds one year	1	
Review each contract	0.5	
Consider other activities such as marketing/premises and exemptions	1	
If no PE, no overseas tax (no direct, no WHT under OECD treaty)	1	6.5
Taxation of subsidiary		
Subsidiary taxable overseas	0.5	
Subsidiary not UK taxable unless resident (through central management and control in the UK) – reference to tie breaker or controlled foreign companies (CFC) rules	1 0.5	
CFC requires control and attributes chargeable profits and creditable tax	1	
Exemptions available including tax exemption	1	
Only likely gateway is UK profits and motive test should exempt bona fide commercial	1	
Repatriation – dividend exemption/withholding	1	6
Taxation of permanent establishment		
Overseas and potentially double taxation	1	
Treaty or unilateral relief	1	
Impact of local rate	1	
Additional tax may be payable compared with operation as subsidiary	0.5	
Possible PE exemption election, timing	0.5	
Election irrevocable and applies to all Pes	1	
Election overruled if equivalent of CFC rules apply	0.5	
PE allows relief for losses unless election made	1	6.5
Conclusion		
If losses in early years generally beneficial to start as a PE and then incorporate	0.5	
However if individual contracts anticipated to be profitable, local tax rates may be deciding factor	0.5	1
TOTAL		**20**

Answer 6

Deferred tax arises on timing differences between accounting and tax treatment such as depreciation and capital allowances.

The net book value of the fixed assets is:

	£'000
Total additions	2,000
Less depreciation	(300)
Net Book Value	1,700

There is no tax basis to offset so the temporary difference associated with fixed assets is £1,700,000.

Full provision should be made for all deferred tax liabilities unless there is a specific exemption such as the initial recognition exemption which is not applicable in this case.

Potential deferred tax assets exist in connection with:

- Unpaid pension contributions (temporary difference) - £5,000.
- Trading losses - £2,645,000.

It is appropriate to recognise deferred tax assets if and only if it is probable that taxable profits will be available allowing the attributes giving rise to the potential asset to be utilised. As this is the first year of trading and a loss has arisen strong evidence would be required such as detailed forecasts to show sufficient profits are anticipated to support the recognition of an asset.

However, because a deferred tax liability arises on the accelerated capital allowances, it is reasonable to recognise an asset to the extent of the deferred tax liability. This is valid as the loss could be offset against profits arising from the reversal of the temporary difference associated with the fixed assets.

Therefore in the absence of strong evidence of future profitability, the position would be

Deferred tax provision	Gross £	Tax £
Accelerated capital allowances	1,700,000	425,000
Less losses	(1,700,000)	(425,000)
Total	Nil	Nil

Deferred tax is provided at the expected rate when the difference is expected to reverse so the full 25% rate is appropriate. No income statement entries would arise in this case.

An unrecognised asset exists as follows which could be recognised if suitable evidence of future profitability were provided resulting in a credit to the income statement:

Potential deferred tax asset	Gross £	Tax £
Losses (£2,645,000-£1,700,000)	(945,000)	(236,250)
Unpaid pensions	(5,000)	(1,250)
Total		(237,500)

MARKING GUIDE

TOPIC	MARKS
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Deferred tax relates to timing differences with examples	1
Identify ACA as timing difference	0.5
Calculate NBV	0.5
Nil tax basis so temporary difference of £1.7million	1
Full recognition unless exemption	0.5
Potential deferred tax assets for losses and pensions	1
Asset recognition criteria	1
First year of trading so strong support would be necessary	1
Recognition to offset liability appropriate	0.5
Position if no asset recognised	1
Explain use of 25% rate	1
Calculation of asset if supported	1
TOTAL	**10**