The Chartered Institute of Taxation

Advanced Technical

Taxation of Major Corporates

May 2021

Suggested answers

ANSWER 1

For year ended 31 December 2021

Camlann UK Ltd is, prima facie, UK tax resident by virtue of being incorporated in the UK.

Camlann UK Ltd is also Badon tax resident by virtue of place of effective management (POEM). The POEM is where key management and commercial decisions that are necessary for the conduct of the company's business are, in substance, made. This will ordinarily be where the directors meet to make decisions relating to the management of the company. The POEM is a question of fact, dependent on the specific circumstances on a case-by-case basis.

Camlann UK Ltd is therefore dual tax resident. Under the OECD model tax convention, the competent authorities shall determine in which country the company is tax resident by mutual agreement, taking into account the POEM, incorporation and other relevant factors. This includes the location of board meetings, where the senior executives carry out their business, where the day-to-day management is carried on and where the headquarters are located.

Given that all board meetings and operational decisions are being made in Badon, the competent authorities are likely to conclude that Camlann UK Ltd is treaty resident in Badon.

Assuming that Camlann UK Ltd is tax resident in Badon, the company should consider whether it has a permanent establishment (PE) in the UK. A UK PE is created if an overseas company has (a) a fixed place of business in the UK, or (b) if contracts are substantially concluded in the UK.

As the registered office facility is a third party's office and will not provide any rights of access for Camlann UK Ltd, the premises could not be considered to be at the disposal of Camlann UK Ltd, and therefore would not constitute a fixed place of business in the UK.

As the directors and staff (of Camlann Group SA) only undertake their duties in Badon, the contracts are not substantially concluded in the UK and no PE arises.

It is therefore unlikely that Camlann UK Ltd has a PE in the UK and as such has no exposure to UK Corporation Tax.

From 1 January 2022

The tax residence of Camlann UK Ltd is unlikely to change as a result of the appointment of the new Director as this will not affect the POEM, because the bulk of the company's activities will remain in Badon.

However, as the new director is expected to work from home, it is possible that their home would constitute a fixed place of business for the company. If the activities carried out by the new director were wholly preparatory or auxiliary in nature, it would not constitute a fixed place of business.

Given, however, that the new director will be dialling into board meetings from their home, and assuming that decisions will be made at those board meetings, it is likely that their home would constitute a fixed place of business and a PE in the UK would arise. This means that profits would be assessable on the activity carried out in the UK.

MARKING GUIDE

TOPIC	**MARKS**
31 December 2021:	
Company is UK tax resident	0.5
Explaining POEM	1.0
Concluding company is also Badon tax resident	0.5
Determining treaty residence by competent authorities	2.0
Consideration of UK PE	2.0
Concluding no exposure to UK corporate tax	1.0
1 January 2022:	
Confirming tax residence will not change	1.0
Explaining that home could be a fixed place of business	1.0
Concluding UK PE and CT exposure	1.0
TOTAL	**10.0**

ANSWER 2

Capital allowances claim:

Detail	Amount	Notes
Main pool	£1,215,000	Note 1
Main pool – annual investment allowance	£600,000	Note 1
Assets transferred in	£135,000	Note 2
Special rate assets	£6,000	Note 3
Special rate assets – annual investment allowance	£400,000	Note 3
Buildings allowance	£30,000	Note 4
Total	**£2,386,000**	

Other deductions to taxable profits:

Detail	Amount
Finance lease – depreciation is claimed as the asset is not owned (£2m x 20%)	£400,000
R&D allowances can be claimed at 100%	£250,000
Decorating – this is revenue expenditure – claim for depreciation (£100,000 @ 20%)	£20,000
Land remediation claim at 150% (£50,000 x 150%)	£75,000
Profit on disposal (£250,000 - £150,000 - £275,000)	£175,000
Total	**£920,000**

Additions to taxable profits:

Detail	Amount
Depreciation	£4,000,000
Capital gains on machinery sold for in excess of cost (£275,000- £250,000)	£25,000
Total	**£4,025,000**

Notes	Detail	Amount
Note 1	Main pool written down value brought forward	£1,070,000
	Manufacturing equipment	£5,000,000
	Computer equipment	£500,000
	Hire purchase (owned asset so capital allowances are available)	£1,000,000
	No claim for moveable partitions as no confirmation intended to be moved	£0
	No claim for the new walls or painting of them as considered non qualifying	£0
	Fire alarm system are qualifying for plant	£20,000
	Doors are non qualifying as part of building irrespective of their use as fire doors	£0
	Portable air conditioning units are not part of the structure of the building	£10,000
	Proceeds from sale are limited to original cost	(£250,000)
	AIA balancing amount (£1m - £400k)	(£600,000)
	Total main pool balance	£6,750,000
	Capital allowance claim @ 18%	**(£1,215,000)**
Note 2	£1,500,000 TWDV @ 18% = £270,000 x 6/12	**£135,000**
Note 3	Cars as emissions > 110 g/km	£100,000
	Electrical & water system (named integral feature)	£250,000
	Air conditioning (named integral feature)	£100,000
	Lift (named integral feature)	£50,000
	Total special rate pool balance	£500,000
	AIA limited to £400,000 as AIA cannot be claimed on cars	(£400,000)
	Total special rate pool after AIA	£100,000
	Capital allowance claim @ 6%	**(£6,000)**
Note 4	£1,333,333 building costs only is eligible for buildings & structures allowance as land does not qualify and the other three items qualify for capital allowances and therefore do not qualify for SBAs. SBAs are available from the later of the date that the building was paid for and when brought into use, so SBAs are available from 1 April 2020 @ 3% (9/12 x £1,333,333)	**£30,000**

MARKING GUIDE

TOPIC	MARKS
Main pool	
Including WDV of plant brought forward	0.5
Including £5m plant additions and computer equipment	0.5
Including £1m hire purchase additions with explanation	1
Not claiming for partitions as no intention to move	1
Not claiming for walls or painting new walls with explanation	1
Claiming for fire alarm system	0.5
Not claiming for fire doors as still considered part of the building	0.5
Claiming for A/C units as are portable	1
Deducting proceeds from sale and limiting to cost	1
Claiming correct AIA of £1m in total	1
Assets transferred in	1
Special rate assets	
Claiming for cars with explanation	1
Claiming for all integral features	1.0
Claiming AIA on SRA in priority	1
Not claiming AIA on cars	0.5
Buildings allowance	
Confirming SBAs only available on building costs	1
Confirming correct date that SBAs are due from	0.5
Using the new rate of 3%	0.5
Calculating the SBA	0.5
Adjustments to taxable profits	
Claim for depreciation on finance leases	1
R&D allowances claim	1
Revenue expenditure claim for depreciation	1
Qualifying land remediation claim	1
Deducting profit on disposal & adding capital gains on proceeds in excess of cost	1
TOTAL	**20.0**

ANSWER 3

	Alder Ltd	Aspen Ltd	Juniper Ltd	Rowan Ltd	Whitebeam Ltd
Taxable trading profits/(losses)	(£2,112,500)	£5,000,000		£1,000,000	£4,000,000
Non trade loan relationships			(£1,000,000)	£3,000,000	
RDEC	1,912,500				
DTR			(£500,000)		
NTLR deficits b/f pre 1.4.17				(£2,000,000)	
NTLR deficits b/f post 1.4.17				(£1,000,000)	(£500,000)
Group relief - NTLR deficits b/f post 1.4.17					(£1,000,000)
Group relief – in year	£200,000	(£1,500,000)	£1,500,000		(£200,000)
Taxable profits		£3,500,000		£1,000,000	£2,300,000
CT payable	**£0**	**£665,000**	**£0**	**£190,000**	**£437,000**
DTR		(£550,000)		(£190,000)	
RDEC		(£115,000)			(£248,375)
Total	**£0**	**£0**	**£0**	**£0**	**£188,625**

R&D calculations

Wages & salaries	£8,500,000
EPW = £10 million x 65%	<u>£6,500,000</u>
	£15,000,000

RDEC: £15 million x 3/12 @12% = £450,000

x 9/12 @ 13% = £1,462,500

Total RDEC of £1,912,500

- £1,549,125 is repayable to the company (£1,912,500 x 81%)
- £363,375 is available for offset against the corporation tax liability (£1,912,500 x 19%). £115,000 is group relieved to Aspen and the balance of £248,375 is group relieved to Whitebeam Ltd.

It is assumed that there is no restriction of the repayable RDEC due to PAYE/NIC payable. It is assumed that the R&D costs accrued evenly throughout the year.

WHT calculations

Aspen Ltd

	Gross income	Net profit	WHT	Creditable DTR
NTLR (note a)	£2,000,000		£300,000	£200,000
Trading royalties (note b)	£1,000,000	£1,000,000	£100,000	£50,000
Trading income (note c)	£6,000,000	£1,800,000	£600,000	£300,000
Total				£550,000

Notes:

(a) Credit is limited to the domestic and treaty rate of 10%. Aspen Ltd may wish to explore what the additional £100,000 of WHT relates to and whether a claim for deduction can be made for this if it is a separate tax.

(b) Credit is limited to the treaty rate of 5%. Aspen Ltd can seek a treaty clearance in the source country and attempt to recover the additional 5%, which is not creditable. As the profits are the same as the income there is no further restriction on the DTR credit.

(c) Credit is limited to the domestic rate of 5% as a treaty cannot increase the WHT rate. The creditable taxes are therefore £300,000 and not £600,000. However, for trading income, credit is only available on the net profit of the income after taking into account direct and indirect costs. The net profit on the income is £1,800,000 and thus the DTR credit is restricted to the lower of the UK tax payable (£1,800,000 x 19% = £342,000) and the creditable taxes of £300,000.

Juniper Ltd

Juniper Ltd cannot claim credit as the company is loss making and so must claim a deduction against profits. A deduction has been claimed on the basis that no reclaim has yet been made. If in the future Juniper Ltd is able to reclaim the WHT then the computation should be amended.

Rowan Ltd

DTR credit can only be claimed on the lower of the WHT paid in accordance with the treaty and the UK corporation tax rate. It is assumed that the accounting profits have been calculated under UK GAAP. It is assumed that there are no tax adjustments to the accounting profits. Credit relief is therefore only available of £190,000 and the remaining £10,000 is carried forward.

Losses

Rowan Ltd would seek to utilise pre 1 April 2017 losses in priority as there is less flexibility over the use of those losses. The company would then utilise £1,000,000 of post 1 April 2017 losses to leave £1,000,000 of taxable trading profits to utilise the DTR of £190,000.

As the general deductions allowance of £5 million has not been utilised, there is no restriction on the use of brought forward losses, but a Group Deductions Allowance statement will be required to be submitted by the nominated company.

Whitebeam Ltd has non-trading loan relationship deficits brought forward. It can only claim post 1 April 2017 losses against the trading profits. £750,000 of NTLR losses is therefore carried forward.

The £1,000,000 of post 1 April 2017 brought forward losses in Rowan Ltd can then be surrendered to Whitebeam Ltd.

MARKING GUIDE

TOPIC	MARKS
R&D	
Multiplying EPWs by 65%	0.5
Calculating the RDEC at 12% for 3 months	1
Calculating the RDEC @ 13% for 9 months	1
Assumption about PAYE/NIC	1
Calculating the repayable element & non repayable	1
Taxing the RDEC	1
DTR	
Calculating the DTR credit available for the three types of income with explanations: NTLR Trading royalties Trading income	 1 1 2
Offsetting DTR against CT in Aspen Ltd	1
Confirming that no credit is available on the interest of £5m with explanations & claiming deduction	1
Mentioning assumption that no adjustments to the branch profits, calculating restriction to £190,000 & showing EUFT of £10,000 carried forward	1.5
Group relief & losses	
Surrendering RDEC credit to Aspen Ltd & Whitebeam Ltd	1
Rowan Ltd – utilising pre 1.4.17 losses first	1
Rowan Ltd – mentioning GDA allowances and statement	1
Leaving sufficient profits in Rowan Ltd to be covered by the DTR	1
Utilising post 1.4.17 NTLR losses in Whitebeam Ltd & unable to utilise & c/f remainder amount	1
Surrendering losses b/f from Rowan Ltd to Whitebeam Ltd	1
Calculate the final liability	1
TOTAL	**20.0**

ANSWER 4

Antelope Ltd's acquisitions

A parent company forms a chargeable gains ('CG') group with any companies that are:
- its 75% subsidiaries, or a 75% subsidiary of such subsidiaries, etc., and
- effective 51% subsidiaries of the parent company.

From 1 January 2021, there is a CG group comprising: Zebra plc, Propco 1 Ltd, Impala Ltd and Antelope Ltd.

Transfers within a CG group of assets that are subject to the CG regime are deemed to take place for consideration that results in no gain or loss ('NGNL') for the seller.

No chargeable gain or loss therefore arises on Impala Ltd's disposals of office buildings, pre-2002 IFAs or the Allenby plc shares on 1 February 2021. The stock, cash and trade creditors do not fall under the CG regime; separate rules will apply.

NGNL treatment does not apply to Antelope Ltd's purchase of the Swindon factory from Propco 2 Ltd, which is not part of the CG group. Those companies are related parties so the transaction is deemed to take place at market value ('MV'), which is £3m.

Propco 2 Ltd's chargeable gain is:

	£
Proceeds	3,000,000
Less: acquisition cost	(1,000,000)
Less: indexation (1,000,000 x (278.1 – 186.8)/(186.8))	(489,000)
Gain	1,511,000

Indexation allowance uplifts the acquisition cost by RPI up to 31 December 2017, at which point it was abolished.

Antelope Ltd disposal

A gain of £65 million (£120m proceeds less £55m cost) arises on Impala Ltd's disposal of Antelope Ltd shares.

The substantial shareholding exemption ('SSE') exempts share disposal gains provided:

1. The disposing company owned more than 10% of the investee company's shares throughout a 12-month period within the six years before the disposal.

2. During the 12 months before the disposal, and immediately after, the investee company carried on a trade and did not have substantial non-trading activities. Testing this requires a multifactorial assessment, however a company is likely to qualify if less than 20% of its assets, income and staff resources relate to non-trading activities.

If assets, which were used in a trade elsewhere in a CG group, are transferred to a newly incorporated group company, both requirements are deemed to be met at any time during the 12 months before the disposal when the assets were so used.

Both requirements are met during the 12 months before Impala Ltd's disposal because this deeming rule applies to Antelope Ltd's purchase of Impala Ltd's consumer goods trade.

Antelope Ltd's only non-trading asset is the Allenby plc shareholding. This represents less than 10% of the company's assets and is unlikely to require significant staff resources to manage. The second requirement is therefore met immediately after the disposal.

Impala Ltd's disposal of Antelope Ltd therefore qualifies for SSE.

If a company leaves a CG group within six years of acquiring an asset in an NGNL transfer a de-grouping charge will potentially arise in relation to the asset. The transferor is deemed to realise a chargeable gain equal to that which would have arisen had the asset in question been sold for MV at the time of the NGNL transfer.

If the transferee company leaves the group because of a share disposal then any de-grouping charges are added to the gain on that share disposal.

De-grouping charges will arise in relation to the land and buildings, pre-2002 IFAs and Allenby plc shares. Those charges are added to Impala Ltd's gain on disposal of the Antelope Ltd shares. As SSE applies to that disposal, SSE is also deemed to apply to the de-grouping charges.

Antelope Ltd's base cost for each asset will be uplifted to its MV at 1 February 2021.

10 York Street disposal

Propco 1 Ltd makes a chargeable gain of £7,500,000 on the disposal of 10 York Street.

Companies may use CG losses of the same or previous years to reduce chargeable gains they realise. Members of a CG group may transfer gains between each other by making a joint election.

The group can therefore reduce its taxable gains by transferring Propco 1 Ltd's gain to Zebra plc.
For accounting periods beginning on or after 1 April 2020 the corporate capital loss restriction applies. This limits the amount of losses that a company may use to reduce gains to 50% of the gain. It is subject to a £5 million allowance, shared with the corporate income loss restriction, which may be deducted without restriction.

Zebra plc may reduce its taxable gain as follows:

	£
Gain transferred from Propco 1 Ltd	7,500,000
Losses to deductions allowance	(5,000,000)
Further losses	(1,250,000)
Taxable gain	1,250,000

MARKING GUIDE

TOPIC	MARKS	SUBTOTAL
Intra-group transfers		
- CG grouping rules	1	
- Correctly identify CG group	0.5	
- NGNL treatment	1	
- MV rule for Swindon factory disposal	0.5	
- Correct treatment of Swindon factory disposal, including indexation allowance	1	4
Antelope Ltd share disposal		
- Gain on disposal	0.5	
- SSE substantial shareholding condition	0.5	
- SSE transfer of trade rule	1	
- SSE trading condition	1	
- Correct analysis and conclusion re SSE	1	
- De-grouping charge	1	
- DG charge added to SSE gain	0.5	
- DG charge base cost uplift	0.5	6
10 York Street property disposal		
- Relief available for b/fwd CG losses	1	
- Gains may be transferred within CG group, by joint election	1	
- CCLR cap	1	
- CCLR allowance and calculation	1	4
Presentation and higher skills		1
TOTAL		**15**

ANSWER 5

1)

Transfer Pricing (TP)

TP is relevant to the investor loans because both Mrs Alpha and Beta Ltd are participating in the management, control or capital of Nile Ltd. Although neither directly controls Nile Ltd, each is a 'major participant'.

TP should not apply to the £400 million loan because it is from an unconnected lender.

Both the amount of the investor loans and the interest rate must be compared to the provision that would have been made between a business in the position of Nile Ltd and an independent lender acting at arm's length (AL).

To determine the AL provision for Nile Ltd, a detailed factual analysis of its business should be considered. That information should then be used to identify comparable loans made between independent parties where the borrower is in a similar position to Nile Ltd (for example, in terms of the industry sector, business model or financial position). Those comparables will provide evidence indicating a range of outcomes that might be an AL provision for Nile Ltd but they will not provide a definite answer.

The TP rules counteract UK tax advantages. In this case, if the interest deductions in Nile Ltd's accounts exceed an AL amount, this will result in a UK tax advantage, and the deductions must be adjusted down to an AL amount. If the deductions are less than an AL amount, they will not be adjusted upwards.

Hybrid Mismatch

Each investor owns 50% of Nile Ltd. The hybrid mismatch rules could therefore apply in relation to the investor loans if either Nile Ltd or Beta Ltd is treated as fiscally transparent by the laws of any territory and this leads to a mismatch. There is no indication that this is the case here.

Unallowable Purpose

Interest deductions are disallowed for loans with a main purpose that is not a business or commercial purpose of the borrower (an 'unallowable purpose'). A main purpose of gaining a tax advantage - for example a main purpose of obtaining interest deductions to reduce taxable profits - is unallowable.

This rule requires careful consideration of the transaction's motive. It is unlikely to apply if Nile Ltd has a demonstrable commercial reason for borrowing, for example, to fund business expansion, and tax relief is merely incidental. The reasons for borrowing should be evidenced, for example by documentation of the directors' decision-making process.

Corporate Interest Restriction (CIR)

The CIR has two key rules:

First, the default fixed ratio rule (FRR), which limits a group's UK net interest deductions for a period of account to the lower of 30% of its UK tax-EBITDA and its worldwide net external interest expense.

Second, the alternative group ratio rule (GRR), which applies by election, limits a group's UK net interest deductions for a period of account to the lower of:

a) a proportion of its aggregate tax-EBITDA corresponding to the ratio of its QNGIE to its worldwide group-EBITDA; and
b) QNGIE.

Thus highly leveraged groups that may be restricted under the FRR may be unrestricted under the GRR.

Tax-EBITDA is the group's UK taxable profits before deductions for interest, capital allowances or amortisation of intangibles.

Group-EBITDA is the group's worldwide earnings before interest, taxes, depreciation and amortisation. It is based on the 'profit before tax' figure in the consolidated accounts of the worldwide group parent, subject to adjustments.

QNGIE is the worldwide group's net group-interest expense, excluding interest expense due to related parties.

The first £2 million of a group's net interest expense for each period of account is deductible without restriction.

A group's CIR disallowance must be allocated to individual companies which can carry forward any restricted interest indefinitely for future 'reactivation'. Unused deduction capacity may be carried forward, at group level, for up to five years.

Nile Group's total interest expense for the year ended 31 March 2021 was £36 million. Given no brought forward capacity, the allowance under FRR would be £27 million (30% x £90 million). Therefore £9 million would be disallowed and carried forward by Nile Ltd.

The group could make the GRR election. However, the £200 million loans are from equity investors who collectively own more than 25% of the borrower and who lend in the same proportions as their shareholdings. The investors are therefore related parties of Nile Group, and the interest payable to them is disregarded for the purposes of the group ratio calculation. The group ratio will therefore be 22.2% (£20m / £90m), reflecting the group's third-party borrowings only. This is lower than the fixed ratio.

2)

Nile Group does not have to appoint a reporting company and submit an IRR but it may choose to in order to ease administrative burden, access carry forward provisions, and allocate the CIR disallowance in the most favourable way. Both these actions should be carried out within 12 months of the end of the group parent, Nile Ltd's, period of account.

Only an active UK CIR group company may be appointed as a reporting company, and an appointment requires the consent of at least 50% of eligible companies.

Nile Group's reporting company must file a full IRR rather than an abbreviated IRR since there is a CIR disallowance. Note that if no reporting company has been appointed before the submission of the IRR, the IRR will be invalid.

The IRR should:
- describe the composition of the group;
- contain any relevant elections; and
- include a statement of calculations providing:
    - the tax-EBITDA and net tax-interest expense or income for each company separately and in aggregate,
    - either a calculation of the fixed ratio debt cap or GRR percentage as appropriate, and
    - a calculation of the interest allowance for the period.

The IRR should also allocate any interest disallowance among the UK group companies. In the absence of an allocation by choice, the disallowance is allocated pro-rata to the companies' net tax-interest expenses. If a company is allocated a disallowance after it has submitted a company tax return, it must amend that return to give effect to the disallowance.

MARKING GUIDE

TOPIC	MARKS	SUBTOTAL
1. Tax treatment of interest expenses		
Transfer pricing/thin capitalisation: - Identify the loans that are in scope of TP/TC rules, and why - Explain nature of TP/TC comparison with AL provision - Explain when adjustment is required; TP is one-way street - Establish range of ALP by reference to comparables - Comparables must be uncontrolled and relate to businesses in similar situation, which requires detailed factual study of Nile	 1 1 1 0.5 1	4.5
Hybrid rules: - Control relationship means hybrid rules may apply, if Nile Ltd or Beta Ltd is a hybrid entity	1	1
Unallowable purpose: - Explain nature of s.442 CTA 2009 rule - Describe circumstances in which it is likely to be relevant/not relevant	 0.5 1	1.5
Corporate interest restriction: - Explanation of FRR - Explanation of GRR - Note GRR is elective - Explain when election is favourable - Define tax-EBITDA and Group-EBITDA - £2 million de minimis interest allowance - Explain carry-forward rules - FRR calculation - Identifying that the investors are related parties - GRR calculation	 1 1 0.5 0.5 1 0.5 0.5 0.5 1 0.5	7
2. Admin		
Interest restriction return: - Appointment of a reporting company - Filing of an IRR - Return invalid if no reporting company appointed - Filing dates - Contents of return - Rules for allocation of interest disallowance	 1 1 0.5 0.5 1 1	5
Presentation and higher skills		1
TOTAL		**20**

ANSWER 6

1)

From 1 July 2020, intangible fixed assets (IFAs) acquired from an overseas related party are included in the corporate intangibles regime even if they were originally created or acquired before 1 April 2002. Thus any IFAs acquired by Archer UK Ltd from Archer IP Ltd will be dealt with under the corporate intangibles regime.

The regime gives deductions for the cost of acquiring IFAs based on the amounts recorded in a company's accounts, subject to certain adjustments. There is no distinction between capital and revenue.

Accounting

Archer UK Ltd recognised the individual assets and liabilities acquired from Archer IP Ltd in its accounts at their combined value of £150 million. The purchase price of the whole business acquired exceeds the aggregate value of those assets and liabilities by £1,000 million (£1,150m less £150m). Archer UK Ltd will therefore also recognise goodwill of £1,000 million.

Valuation

Archer UK Ltd and Archer IP Ltd are under common control and are therefore related parties. The IFA purchase is treated for tax purposes as having taken place at market value (MV).

The patents and trademarks are already recognised at MV per the expert report. The overall purchase price of the business was also at MV. By implication, therefore, the goodwill is recognised at its MV of £1,000 million (£1,150m less £150m).

Eligible assets

The patents and trademarks are eligible for writing-down relief.

Goodwill acquired on or after 1 April 2019 is eligible for writing-down relief where it is acquired as part of a business acquisition and 'qualifying IP assets' are also acquired. The amount of goodwill that attracts relief is limited to six times the value of the qualifying IP assets purchased as part of the business acquisition. Qualifying IP assets include patents but not trademarks. Here the qualifying assets are £100 million so only £600 million (£100 million x 6) of the goodwill will attract writing-down relief.

Writing-down relief

Archer UK Ltd's deductions for the year ended 31 December 2020 are as follows:

- For the patents, relief follows the accounts: £100m x 10% p.a. = £10 million.

- The trademarks are not amortised in the accounts. The company may maximise its deductions by electing irrevocably for fixed rate relief at 4% p.a.: £50m x 4% = £2 million.

- £600 million of goodwill will attract writing-down relief at a fixed rate of 6.5% p.a.: £600m x 6.5% = £39 million.

The remaining £400 million of the goodwill MV may be deducted in the calculation of the gain or loss on any future disposal of the goodwill, but must be treated as a non-trading debit.

2)

Y/E 31 December 2020

Because the trademarks are not amortised in Archer UK Ltd's accounts, tax deductions are received before debits are recognised in its income statement. This is accounted for by recognising a deferred tax liability (DTL) equal to the temporary difference between the book value of the trademarks and their tax basis, multiplied by the 19% CT rate.

The temporary difference is £2 million (£50m book value less £48m TWDV). At a 19% CT rate this gives rise to a DTL of £380,000 which the company should recognise as follows:

DR income statement tax charge	£380,000
CR DTL on balance sheet	£380,000

Y/E 31 December 2021

Archer UK Ltd impairs the trademarks to zero, recognising a loss of £50 million in its income statement. For tax purposes, the trademarks continue to be written-down at 4% p.a. As at 31 December 2021, they will have a tax written down value of £46 million yet to be relieved.

The company has now recognised income statement deductions in advance of the corresponding tax deductions. It should reverse out the DTL carried on its balance sheet as follows:

DR DTL on balance sheet	£380,000
CR income statement tax charge	£380,000

It should then recognise a deferred tax asset (DTA) reflecting the value of the tax deductions it will receive for the trademarks in the future, but only to the extent that it is probable those deductions will be relieved against future profits.

If it is probable all the deductions will be relieved the DTA will be £46 million x 19% CT rate = £8,740,000:

DR DTA on balance sheet	£8,740,000
CR income statement tax charge	£8,740,000

Archer UK Ltd's accounts should reconcile its current tax charge with its accounting profit, explaining that the DTLs/DTAs arise because tax rules recognise deductions at a different time to the accounts.

MARKING GUIDE

TOPIC	MARKS	SUBTOTAL
1. Tax treatment of business acquisition		
- Which regime applies - pre-FA02 rule not relevant	1	
- Treatment of IFAs follows the accounts, subject to adjustments	0.5	
- No capital/revenue distinction	0.5	
- Purchase price exceeds asset value therefore goodwill recognised	1	
- Related parties therefore market value rule applies	0.5	
- Correct application of market value rule	0.5	
- Goodwill eligible because acquired after 1/4/19	0.5	
- Goodwill capped at 6x qualifying IP	1	
- Correctly identifying qualifying IP and applying cap	1	
- Rates of writing-down relief, including 4% fixed rate election	1.5	
- Treatment of goodwill value in excess of cap	0.5	
		8.5
2. Accounting presentation of tax relief		
Deferred tax treatment:		
y/e 31 December 2020		
- Tax deduction given in advance of a/c debits	0.5	
- Accounted for with DTL representing reconciliation between actual tax and accounts	1	
- Correct calculation of DTL	0.5	
- Correct accounting entries	0.5	
y/e 31 December 2021		
- accounting debits now in advance of tax deductions	0.5	
- reversal of b/fwd DTL and correct accounting entries	0.5	
- correct calculation of new DTA resulting from impairment and accounting entries	1	
- principle for recognition of DTA	0.5	
- reconciliation in notes to accounts	0.5	
		5.5
Presentation and higher skills		1
TOTAL		**15**