Chartered Institute of Taxation

Excellence in Taxation

The Chartered Tax Adviser Examination

November 2019

Taxation of Major Corporates

Advanced Technical Paper

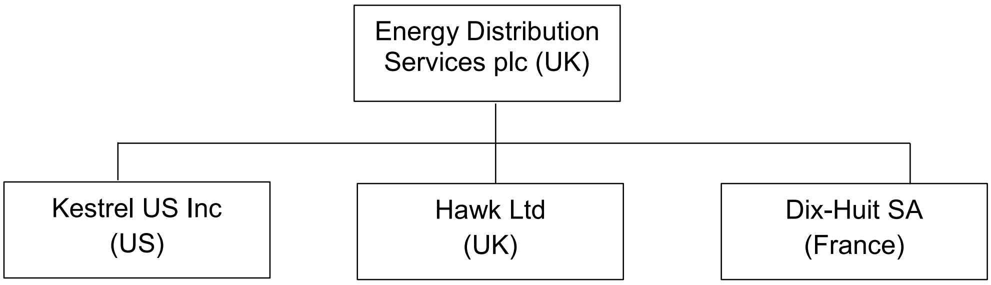
TIME ALLOWED – 3 ¼ HOURS

- The first 15 minutes is designated as reading time. During this time you may read your question paper and legislation, annotate your question paper and use your calculator. You are not permitted to write in the answer booklet. The Presiding Officer will inform you when you can start writing.
- 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.
- Questions may be answered with reference to Stamp Duty Land Tax or Land and Buildings Transaction Tax, as appropriate.
- 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 information, you may assume that 2018/19 legislation (including rates and allowances) continues to apply for 2019/20 and future years. Candidates answering by reference to more recently enacted legislation or tax cases will not be penalised.

1. You are Hiro Stein, the Tax Manager for Energy Distribution Services plc, the UK incorporated and tax resident non-trading holding company of a multinational utility group generating electricity for sale to consumers.

Energy Distribution Services plc prepares accounts under International Financial Reporting Standards and has a Sterling functional currency.

An abbreviated group structure, including the country of incorporation and tax residence, is as follows:



Kestrel US Inc, Hawk Ltd and Dix-Huit SA are all 100% subsidiaries of Energy Distribution Services plc.

Kestrel US Inc is a holding company for the group's US operations and owns, directly and indirectly, a number of US subsidiaries. Likewise, Dix-Huit SA is a holding company for the group's French operations, and owns, directly and indirectly, a number of French companies.

You report to Mary Falconer, the Group Finance Director and have just received the following email from her:

To: Hiro Stein
From: Mary Falconer
Date: X November 2019
Subject: Group financing

Hi Hiro

I would like your help with two financing issues.

Firstly, we are looking to provide finance to our US operations to make a new acquisition. The funds are currently sitting in Energy Distribution Services plc and we wish to lend the money to Kestrel US Inc.

However, we have been advised by the US tax manager that the loan must be denominated in US dollars. I am concerned that lending money in US dollars will give rise to volatility in our UK taxable profits. Would it help if we lent the money from Hawk Ltd, a UK incorporated and tax resident company owned by Energy Distribution services plc that is currently dormant?

Continued

1. Continuation

Secondly, we are concerned about the group's foreign exchange risk because a significant part of the group's revenues and costs are denominated in Euros and thus the group value is in Euros. We are looking to take out a Euro denominated loan as a hedge of Energy Distribution Services plc's Euro shareholding in Dix-Huit SA. Again, I am concerned that we might end up being taxed on the exchange volatility on the loan.

Please can you advise on the UK Corporation Tax treatment of the proposed loan to Kestrel US Inc and the loan in respect of our French operations?

Kind regards

Mary

Requirement:

Draft an email to Mary advising on the UK Corporation Tax treatment of the proposed loans. (15)

2. You are a tax manager at Statute LLP, a firm of Chartered Tax Advisers. You recently met with Erica Johnson, the Group Finance Director of Pop plc, an existing client of your firm. Pop plc is the parent company of a worldwide group that produces and distributes fizzy drinks. The group's annual turnover is £300 million and has over 5,000 employees. Pop plc is UK incorporated and tax resident.

Pop UK Ltd, the main trading company in the group, is also UK tax resident and is a wholly owned subsidiary of Pop plc. It produces all of the group's fizzy drinks in the UK, and distributes the drinks to third party wholesalers across the world. It also owns all of the intellectual property of the group.

Erica explained that they are looking at three ideas to restructure the group:

1) Set up a new Indian incorporated and tax-resident subsidiary. This would construct a bottling plant in India to serve that region. The concentrate for the drinks would still be produced in the UK and shipped over to India. The Indian company would take on the marketing in India and would distribute the product to local wholesalers for sale in the Indian market.

2) Set up a new Dutch-incorporated and tax resident subsidiary, which would arrange transport of the drinks from Pop UK Ltd to customers around the world (excluding India). It would sub-contract the transportation to local shipping and haulage companies.

3) Set up a new UK-incorporated and tax resident subsidiary to construct a carbon dioxide production facility, which would reduce the group's dependence on third party producers.

Erica is, however, unfamiliar with the tax rules governing the pricing of cross-border transactions from a UK perspective and has sought advice from your firm on this.

Requirement:

Draft a letter to Erica explaining how the UK transfer pricing legislation would apply to the proposed restructuring. (20)

3. You are an in-house corporate tax adviser for MS Pharma plc, a FTSE 250 listed UK incorporated and tax resident holding company of a pharmaceutical group with operations in the UK and overseas ("the Group"). All subsidiaries in the Group are wholly owned by MS Pharma plc including WTC Med Ltd.

WTC Med Ltd, a UK incorporated and tax resident company, commenced trading on 1 July 2018 as a research and development ("R&D") company and has created the means to develop two drugs for the treatment of neurological disorders.

You have been asked to prepare the Corporation Tax computations for MS Pharma plc and WTC Med Ltd for the year ended 30 June 2019. The Group has no other UK tax resident subsidiaries.

MS Pharma plc

The company recorded the following result for the year ended 30 June 2019:

	Notes	£'000
Income from property lease	1)	750
Dividend income	2)	17,300
Administrative expenses	3)	(3,660)
Impairment of loan	4)	(11,500)
Profit before tax		2,890

Notes

1) On 1 January 2019, MS Pharma plc granted a 10-year commercial lease to ODB Ltd, an unrelated property investment company, for an upfront premium of £5 million and an annual rent of £2 million. MS Pharma plc acquired the freehold interest in the property on 1 January 2017 for £35 million and incurred no further expenditure prior to letting.

   The £750,000 of property income recognised in the accounts comprises £1 million of rental income less an amortisation charge of £250,000 in respect of the lease premium. The reversionary interest is valued at £25 million and the right to receive future rent is valued at £15 million.

2) A dividend of £17.3 million was received from XTM Pharma Sarl. MS Pharma plc holds 25% of the ordinary share capital of the company as an investment.

3) Administrative expenses comprise the following:

	£
Legal fees – advice in relation to rights issue	342,700
Professional fees – establish employee share ownership trust	560,000
Due diligence fees – aborted acquisition	2,757,300
Total	3,660,000

4) The impairment relates to a £20 million loan advanced to MS Med GmbH, a wholly owned subsidiary, for the expansion of operations in Germany.

Continued

3. Continuation

WTC Med Ltd

The company recorded the following result for the year ended 30 June 2019:

	Notes	£'000
Turnover	1)	20,000
R&D Expenditure Credit	2)	1,045
Less:		
Operating expenses	3)	(11,500)
Depreciation and amortisation	4)	(600)
Profit before tax		8,945

Notes

1) Turnover is comprised of patent royalty income received from Group companies as follows:

	£'000
Income from Patent 1	12,000
Income from Patent 2	8,000
Total turnover	20,000

2) The R&D Expenditure Credit is calculated as 11% of the company's qualifying research and development expenditure incurred during the period of £9.5 million (see Note 3). The company is a large enterprise for R&D purposes in view of the results of other companies in the Group.

3) Operating expenses comprise the following:

	£'000
Qualifying R&D expenditure	8,000
Qualifying R&D staff costs	1,500
Rental of business premises	2,000
Total	11,500

4) Depreciation and amortisation is comprised:

	£'000
Depreciation of laboratory equipment	450
Amortisation of patent registration fees	150
Total	600

5) Included in staff costs is £500,000 of PAYE and Class 1 National Insurance Contributions paid in respect of employees.

6) The company spent £3 million during the year acquiring specialised machinery for use in the laboratory to blend base ingredients for drugs.

7) The company paid costs of £1 million to register Patent 1 and £2 million to register Patent 2.

8) A transfer pricing study undertaken by external advisers concluded that patent royalty rate for both patents should be equal to 4% of the turnover derived from related drug sales by Group companies. The relevant turnover was £500 million during the period.

9) On 1 October 2019, the company made an election under s.357A(1) Corporation Tax Act 2010 to take effect for the accounting period ended 30 June 2019.

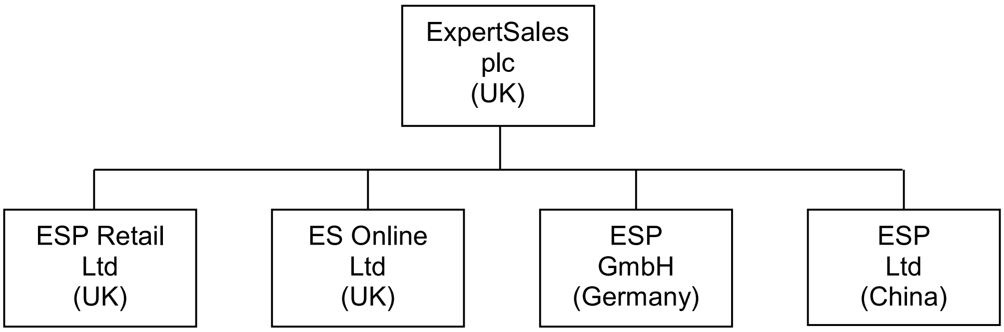
10) The company has not made an election under s.730 Corporation Tax Act 2009.

Requirement:

Prepare the Corporation Tax computations, including appropriate explanations, for MS Pharma plc and WTC Med Ltd for the year ended 30 June 2019. (20)

4. You are a tax manager at Superior Tax Solutions LLP, a firm of Chartered Tax Advisers and accountants that provides Corporation Tax advice to large companies. You recently met with Tim Fox, Group Head of Tax of ExpertSales plc, a FTSE 350 retail group with operations in the UK, Germany and China.

The ExpertSales plc group structure is set out below with the jurisdiction of incorporation and tax residency of each subsidiary company stated. All the subsidiaries are wholly owned. All companies in the group prepare accounts to 30 September annually.



Tim has requested your assistance in calculating the impact of the Corporate Interest Restriction when applied to UK group companies for the year ended 30 September 2019. He would also like to understand how the tax losses of UK group companies could be effectively utilised in the period.

Tim is also reviewing the group's transfer pricing policy, which does not currently specify the UK tax considerations that must be considered to ensure the terms of intra-group financing arrangements can be regarded as being at arm's length. He has asked you to provide an overview of the relevant issues.

The UK group companies recorded the following results for the year ended 30 September 2019:

	ExpertSales plc	ESP Retail Ltd	ES Online Ltd
	£'000	£'000	£'000
Turnover	-	88,000	37,000
Less: Cost of sales	-	(34,000)	(21,000)
Gross profit / (loss):	-	54,000	16,000
Less: Operating expenses	(3,000)	(18,000)	(11,500)
Operating profit / (loss)	(3,000)	36,000	4,500
Interest income / (expense)	(35,000)	10,000	(2,000)
Profit / (loss) before tax	(38,000)	46,000	2,500
Add: Depreciation	-	12,000	500
Disallowable costs	1,000		
Deduct: Capital allowances	-	(8,000)	(1,000)
Estimated taxable profit / (loss)	(37,000)	50,000	2,000

Continued

4. Continuation

You have been provided with the following information:

1) The estimated taxable profits and losses of UK group companies are stated before applying the Corporate Interest Restriction rules and assessing any claims for group relief or offset of brought forward tax losses.

2) ESP Retail Ltd has brought forward tax losses at 1 October 2018:

	Pre-April 2017 Losses	Post-April 2017 Losses
	£'000	£'000
Trading losses	11,000	4,500
Non-trade Loan Relationship Deficit	-	3,000
Capital losses	-	14,000

3) The following items are included within interest income / (expense) for the period:

	ExpertSales plc	ESP Retail Ltd	ES Online Ltd
	£'000	£'000	£'000
Interest on external debt	(45,000)	-	-
Interest on loan to ESP GmbH	8,000	-	-
Interest on loan to ESP Ltd		5,700	
Forex gain on currency forward related to stock purchase	-	4,300	
Interest on loan to ES Online	2,000	-	(2,000)
Total	(35,000)	10,000	(2,000)

4) The £5.7 million of interest income received by ESP Retail Ltd on its loan to ESP Ltd in China is the gross amount and was subject to a 10% withholding tax.

5) The adjusted net group-interest expense (ANGIE) and qualifying net group-interest expense (QNGIE) for the period are both £50 million calculated in accordance with s.413 and s.414 of the Taxation (International and Other Provisions) Act 2010, respectively.

6) The group's Earnings Before Interest, Taxation, Depreciation and Amortisation ("group-EBITDA") for the periods per the consolidated financial statements was £160 million.

7) The group does not have any restricted interest or unused interest allowance brought forward under the Corporate Interest Restriction regime.

Continued

4. Continuation

Requirement:

Prepare a report for Tim Fox incorporating your analysis of the following issues:

1) **The impact of the Corporate Interest Restriction rules to the tax position of UK companies for the year ended 30 September 2019.** (8)

2) **Optimising the utilisation of UK tax losses available for offset in the accounting period ended 30 September 2019.** (7)

3) **The UK tax issues to be considered when determining whether the terms of intra-group funding arrangements can be regarded as arm's length.** (5)

Total (20)

5. You are a tax manager at Athens LLP, a firm of Chartered Accountants. Your firm has been engaged to undertake tax due diligence for the Board of Olympian plc, the parent company of a property investment group, in relation to the potential acquisition of Titan plc.

Titan plc is a UK listed property company with a number of wholly owned UK subsidiaries, each of which owns the freehold of a shopping centre in the UK. Titan plc has agreed with HMRC that the activities of each company constitutes a property investment business. All companies have a 31 December year-end.

You have been asked by the Corporate Finance Partner to brief him on the Corporation Tax and Stamp Tax issues of the following transactions, which he has identified during his review.

<u>Delta Shopping Centre</u>

In March 2000, Titan Delta Ltd, a wholly owned subsidiary of Titan plc, acquired the Delta Shopping Centre from a third party for £100 million, which was funded through the issue of £100 million of ordinary shares to Titan plc.

On 1 November 2018, Titan Delta Ltd transferred the Delta Shopping Centre to Titan Delta 2 Ltd, a newly incorporated, wholly owned subsidiary of Titan Delta Ltd. The consideration for the sale was £250 million, the market value of the Delta Shopping Centre. Titan Delta 2 Ltd borrowed the funds from a third party bank to make the purchase.

On 8 November 2018, Titan Delta Ltd declared and paid a dividend of £150 million.

On 15 November 2018, Titan plc sold its entire shareholding in Titan Delta Ltd for £100 million to a third party.

<u>Chi Shopping Centre</u>

In 1995, Titan Chi Ltd built the Chi Shopping Centre at a cost of £10 million.

In 2015, Titan plc acquired Titan Chi Ltd for £40 million, when the Chi Shopping Centre was worth £40 million.

On 1 March 2018, Titan Chi Ltd sold the Chi Shopping Centre to a third party for £45 million.

On 3 April 2018, Titan Chi Ltd declared a distribution of £35 million, representing the overall accounting gain on the shopping centre (£45 million less £10 million).

On 2 July 2018, Titan Chi Ltd was placed into members' voluntary liquidation, with the remaining £10 million from the sale of the shopping centre being distributed to Titan plc on 1 October 2018.

Requirement:

Prepare a briefing note for the Corporate Finance Partner in respect of the Corporation Tax and Stamp Tax issues arising in 2018, including relevant calculations. (15)

6. You are the UK Tax Manager of Plastic Slicer Ltd, a UK incorporated and tax resident company that carries on a recycling trade specialising in reprocessing plastics and metals.

On 1 January 2019, Plastic Slicer Ltd entered into a 25-year lease over industrial machinery for breaking down plastics. The company prepares accounts under International Financial Reporting Standards and the lease is accounted for in accordance with International Financial Reporting Standard 16. Accordingly, an asset of £30 million was recognised together with a corresponding lease liability representing the net present value of the minimum lease payments.

The fixed monthly payment under the lease is £125,000 (of which £100,000 relates to lease payment and £25,000 relates to interest). The asset is depreciated on a straight-line basis at a rate of 4% per annum.

The lease has been accounted for as follows on the unaudited balance sheet of the company at 30 June 2019:

	£
Asset (machinery)	29,400,000
Liability (under lease)	(29,527,596)

The UK Finance Manager, Jack Dobson, has asked you to explain the UK tax treatment of the leasing transaction and calculate the deferred tax provision for the statutory accounts for the year ended 30 June 2019.

Requirement:

1) **Prepare a file note in advance of a meeting with Jack explaining the UK Corporation Tax treatment of the lease and calculating the related deferred tax asset or liability at 30 June 2019 together with the deferred tax movement during the period.** (8)

2) **Explain the general criteria for recognising a deferred tax asset.** (2)

Total (10)