

# THE CHARTERED INSTITUTE OF TAXATION

## APPLICATION AND PROFESSIONAL SKILLS

### Taxation of Larger Companies and Groups

**November 2022**

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TIME ALLOWED  
3 HOURS 30 MINUTES

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- In order to secure a pass in this exam, you will be required to demonstrate competence in each of three skills.

You will be assessed across your answer as a whole for Structure. A pass or fail grade will be awarded.

You will be assessed for competence in a number of broad topics for the following skills:

- Identification and Application
- Relevant Advice and Substantiated Conclusions

For each topic for each of these two skills, a grade will be awarded. The grades for those topics will be weighted and averaged to produce a final grade for each skill of 0, 1, 2, 3 or 4. A grade of 3 or 4 is required to demonstrate competence.

- All workings should be shown and made to the nearest month and pound unless the question specifies otherwise.
- Candidates who answer any law elements in this paper in accordance with Scots law or Northern Ireland law should indicate this where relevant.
- Scots law candidates may provide answers referring to Land and Buildings Transaction Tax rather than Stamp Duty Land Tax.
- Unless otherwise indicated by the provision of additional information in the question, you may assume that 2021/22 legislation (including rates and allowances) continues to apply for 2022/23 and future years. Candidates answering by reference to more recently enacted legislation or tax cases will not be penalised.
- You must type your answer in the space on the screen as indicated by the Exam4 guidance.

You are a tax manager at Langston Adams LLP, a firm of Chartered Tax Advisers. One of your longstanding clients is Baffin Hood plc, the parent company of a large group that operates a number of automotive repair centres. Baffin Hood plc is quoted on the Alternative Investment Market and is currently controlled by its founder and his family.

Your tax partner, James Langston, has received an email (**EXHIBIT A**) from Michelle White, the Finance Director at Baffin Hood plc concerning the potential acquisitions of two businesses operating in the same industry, Beneke Orr Ltd and M&D Garages.

James has asked you to prepare a report to the board of Baffin Hood plc.

The following exhibits are provided to assist you:

**EXHIBIT A:** Email from Michelle White to James Langston

**EXHIBIT B:** Minutes of Baffin Hood plc Board of Directors meeting

**EXHIBIT C:** Pre-seen information

**Requirement:**

**Prepare a report to the board of Baffin Hood plc advising on the acquisitions of Beneke Orr Ltd and M&D Garages.**

Continued

## EXHIBIT A

### Email from Michelle White to James Langston

To: james.langston@langstonadams.co.uk  
From: michelle.white@baffinhood.com  
Date: 1 November 2022  
Subject: Potential acquisitions

James

As you are aware, our group has been highly successful at acquiring underperforming businesses in the automotive repair industry, turning them around and integrating them into our existing business operations. In line with our continued drive to expand our group, we have identified two potential businesses that we could acquire: Beneke Orr Ltd and M&D Garages. Should we proceed with the purchases we would expect to complete by 31 December 2022.

#### Beneke Orr Ltd

This UK tax resident company operates in the North of England. It has made losses in the last two years as the shareholders, who are all UK resident individuals, have lost interest in the business and no longer wish to be involved in the running of the business.

If we were to purchase this company, we anticipate a swift return to profitability under our ownership, which would allow us to benefit from the tax losses.

Baffin Hood plc's share price should increase in the medium to long term due to our continuing successful strategy of acquiring under-performing businesses and adding value by improving the performance of those businesses. Given that we have previously provided a good level of return through dividends, we think the vendors may be prepared to accept consideration in the form of shares in Baffin Hood plc. However, Simon Green and his family might wish to retain a majority shareholding in Baffin Hood plc.

The vendors have also indicated that they would prefer consideration in the form of loan notes over cash because of the potential tax advantage. The loan notes would be classified as Qualifying Corporate Bonds for both Corporation Tax and Capital Gains Tax purposes. The current share price is £6.25 and this is a reasonable value to use in any calculations regarding the acquisition.

We would like your advice, from a tax perspective, on whether the consideration for Baffin Hood plc's acquisition of Beneke Orr Ltd should be in the form of cash, loan notes or an issue of shares.

#### M&D Garages

This is an unincorporated business which operates in the Republic of Ireland. It is owned by two Irish residents, Sandy Maskell and Jess Dunne, who will only consider a cash offer for the assets of the business. Both owners are looking to retire and will not want any continuing involvement in the business.

Although we have advisers in Ireland who will advise in detail on any Irish tax issues, we are keen to receive your advice on how best to structure the acquisition of M&D Garages. We are confident that we can significantly improve the performance of M&D Garages.

#### Financing

In relation to the two potential acquisitions, any cash consideration will need to be sourced by bank loans. However, we are mindful that we are already subject to Corporate Interest Restriction disallowances and this seems likely to continue for at least the next four years.

Attached to this letter are notes of a recent board meeting (**EXHIBIT B**) where we discussed the two potential acquisitions.

Please contact me if you have any questions.

Regards

Michelle White  
Finance Director  
Baffin Hood plc

Continued

**EXHIBIT B**Minutes of Baffin Hood plc Board of Directors meeting

Date: 28 October 2022

Directors present:

Simon Green, Chief Executive Officer  
 Michelle White, Finance Director  
 Steve Taylor, Operations Director

Review of potential acquisitionsBeneke Orr Ltd

The following details regarding the potential purchase by Baffin Hood plc of all the shares of Beneke Orr Ltd were discussed.

Purchase price: £25 million

The fundamentals of this business are sound. However, in recent years the senior managers have underperformed due to the lack of day-to-day involvement by the vendors. The business can be turned around very quickly to generate the following results:

Current (2022) performance and forecast following the acquisition:

<u>31 December</u>	<u>2022</u>	<u>2023</u>	<u>2024</u>	<u>2025</u>	<u>2026</u>
	£ million	£ million	£ million	£ million	£ million
Sales	40	42	45	48	50
Cost of Sales	(30)	(28)	(27)	(25)	(25)
Administration	<u>(10)</u>	<u>(13)</u>	<u>(9)</u>	<u>(8)</u>	<u>(8)</u>
EBITDA*	0	1	9	15	17
Depreciation	<u>(5)</u>	<u>(6)</u>	<u>(6)</u>	<u>(6)</u>	<u>(6)</u>
EBIT**	<u><u>(5)</u></u>	<u><u>(5)</u></u>	<u><u>3</u></u>	<u><u>9</u></u>	<u><u>11</u></u>

\*Earnings before interest, tax, depreciation and amortisation

\*\*Earnings before interest and tax

We do not expect the EBITDA projections in the forecasts to be materially different from the "tax-EBITDA" Corporate Interest Restriction amounts.

The company is currently projected to have Corporation Tax trading losses of £10 million to carry forward as at 31 December 2022, all of which were incurred post 1 April 2017.

M&D Garages

The following details regarding the potential purchase of this unincorporated business were discussed.

Purchase price: £15 million

The main issue with this business is that the two owners had a dispute a number of years ago and now refuse to cooperate together. Indeed, in certain locations two garages (one being run by Sandy Maskell and the other being run by Jess Dunne) actually compete for the same customers. There is considerable scope of cost savings and rationalisation, albeit the changes will take a couple of years to implement and the full benefits will not materialise until the fourth year.

Continued

Current (2022) performance and forecast following acquisition:

<u>31 December</u>	<u>2022</u>	<u>2023</u>	<u>2024</u>	<u>2025</u>	<u>2026</u>
	£ million	£ million	£ million	£ million	£ million
Sales	30	31	32	35	38
Cost of sales	(25)	(23)	(21)	(20)	(18)
Administration costs	<u>(7)</u>	<u>(10)</u>	<u>(7)</u>	<u>(5)</u>	<u>(5)</u>
EBITDA*	(2)	(2)	4	10	15
Depreciation	<u>(3)</u>	<u>(5)</u>	<u>(5)</u>	<u>(5)</u>	<u>(5)</u>
EBIT**	<u>(5)</u>	<u>(7)</u>	<u>(1)</u>	<u>5</u>	<u>10</u>

\*Earnings before interest, tax, depreciation and amortisation

\*\*Earnings before interest and tax

### Funding

Michelle has explored the options for obtaining the finance required for both these acquisitions. She is confident that a bank loan can be arranged at a fixed interest rate of 4% per annum.

From her discussions with the vendors of Beneke Orr Ltd, an issue of loan notes at an interest rate of 7% for the purchase price would be acceptable. This interest rate is considerably higher than the vendors could obtain on a long-term bank deposit account because it takes account of the additional risk over receiving cash consideration.

### Next steps

It was agreed that both acquisitions showed great promise and the next steps are to proceed to the due diligence stage. Michelle is to arrange for tax advice on the potential acquisitions.

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**EXHIBIT C**

Pre-seen information

Client Information

Baffin Hood plc and subsidiaries

Baffin UK Ltd was incorporated in the UK in 1993 with Simon Green holding 90% of the shares and close family relatives holding the remaining 10%.

When the company decided to pursue a strategy of growth in 2015, Baffin Hood plc was incorporated to be the holding company and was listed on the Alternative Investment Market in 2016. Simon Green and his family retain an 80% shareholding in Baffin Hood plc.

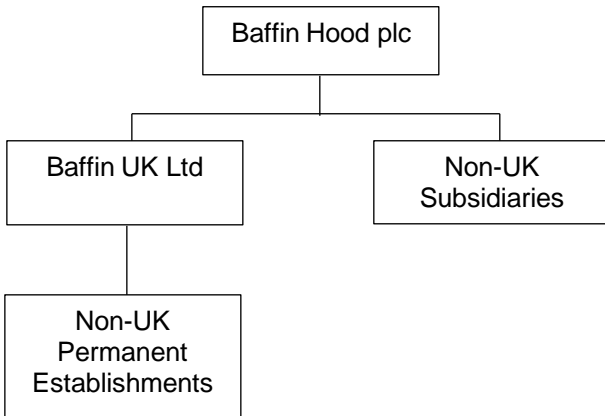
The principal activity of the Baffin Hood group is the operation of automotive repair centres. The group operates mainly in the UK with all UK trading activity within Baffin UK Ltd. It has several operations in France, Germany and other jurisdictions; some are structured as local companies while others are permanent establishments of Baffin UK Ltd. In recent years, the group has pursued a successful strategy of growth, both organically and by acquisition of similar businesses.

Directors

Managing Director – Simon Green  
Operations Director – Steve Taylor  
Finance Director – Michelle White

Except for Simon Green, none of the directors hold any shares in Baffin Hood plc.

Summarised group structure



Baffin Hood plc and Baffin UK Ltd are tax resident in the UK. All other companies in the group are incorporated and tax resident outside the UK.

All subsidiaries are wholly owned by Baffin Hood plc.

All group companies prepare accounts to 31 December.

The group employs approximately 600 staff.

Continued

Continuation

Financial information

Financial information for Baffin UK Ltd

Income statement

Year ended 31 December	<u>2021</u>	<u>2020</u>
	£ million	£ million
Revenue	1,560	1,540
Cost of sales	<u>(933)</u>	<u>(878)</u>
Gross profit	627	662
Administrative expenses	<u>(577)</u>	<u>(620)</u>
Operating profit	50	42
Finance expense	<u>(20)</u>	<u>(19)</u>
Profit before tax	30	23
Tax expense	<u>(6)</u>	<u>(4)</u>
Profit after tax	<u><u>24</u></u>	<u><u>19</u></u>

Statement of Financial Position

At 31 December	<u>2021</u>	<u>2020</u>
	£ million	£ million
Fixed assets:		
Land and buildings	1,105	1,105
Plant and machinery	420	412
Intangibles	<u>45</u>	<u>45</u>
	1,570	1,562
Current assets	45	42
Current liabilities	(500)	(450)
Long term creditors	<u>(945)</u>	<u>(1,008)</u>
Net assets	<u><u>170</u></u>	<u><u>146</u></u>
Equity:		
Share capital	1	1
Retained earnings	<u>169</u>	<u>145</u>
Total equity	<u><u>170</u></u>	<u><u>146</u></u>

Summarised group financial information for Baffin Hood plc

Consolidated income statement

Year ended 31 December	<u>2021</u>	<u>2020</u>
	£ million	£ million
Revenue	1,780	1,750
Cost of sales	<u>(1,013)</u>	<u>(988)</u>
Gross profit	767	762
Administrative expenses	<u>(680)</u>	<u>(690)</u>
Operating profit	87	72
Finance expense	<u>(50)</u>	<u>(51)</u>
Profit before tax	37	21
Tax expense	<u>(8)</u>	<u>(4)</u>
Profit after tax	<u><u>29</u></u>	<u><u>17</u></u>

Continued

Consolidated Statement of Financial Position

At 31 December	<u>2021</u>	<u>2020</u>
	£ million	£ million
Fixed Assets	1,620	1,610
Intangibles	104	99
Current assets	96	101
Current liabilities	(500)	(450)
Long term creditors	<u>(1,000)</u>	<u>(1,050)</u>
Net assets	<u>320</u>	<u>310</u>
Equity:		
Issued share capital	50	250
Share premium	200	–
Retained earnings	<u>70</u>	<u>60</u>
Total Equity	<u>320</u>	<u>310</u>

Issued share capital consists of 50 million shares of £1 each.

Baffin Hood plc paid a dividend of £20 million in the year to 31 December 2021.

Corporation Tax information

All company tax returns for the group for the accounting period ended 31 December 2020 were submitted on 22 December 2021. All previous returns were submitted within the statutory deadlines.

There are no open enquiries with HMRC into either of the UK companies.

There are no trading or other losses carried forward as at 31 December 2022.

VAT

Baffin UK Ltd is the representative member of a VAT group comprising itself and Baffin Hood plc. No options to tax have been made.