The Chartered Institute of Taxation

Advanced Technical

Taxation of Major Corporates

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Suggested solutions

ANSWER 1

There are two options for the property disposals – the sale of the shares in Jessamyn Ltd or the sale of the assets by Jessamyn Ltd. Ultimately the decision may come down to purchasers' preferences. For example, if a single buyer can be found for all of the properties then a sale of shares would become feasible. The decision may also be influenced by stamp taxes, which are the responsibility of and payable by the purchaser.

A property disposal gives the flexibility to sell to different purchasers, which may optimise the total consideration receivable. However, for illustrative purposes, the Corporation Tax consequences of the alternative options for the disposals are set out below on the assumption that there will be no difference on the consideration paid.

The group will be taxed on a higher chargeable gain (£889,250 rather than £820,428) on a disposal of the separate properties rather than the shares in Jessamyn Ltd. A property disposal will also result in an adjustment to the results based on the capital allowances position, which could result in additional taxable income or deductions as discussed below. Numerically, therefore, the share sale is a better route to pursue but, as referred to above, it depends on identifying a single purchaser for all of the properties.

Share sale

Disposal of a subsidiary is, prima facie, subject to Corporation Tax on chargeable gains. Any gain arising may be exempted from tax if the Substantial Shareholdings Exemption (SSE) applies. In order for the SSE to apply, certain conditions must be met, including a 12-month ownership requirement and the nature of the activities undertaken by the company being sold.

Although Robalex Ltd has held the shares in Jessamyn Ltd since 2014, meaning that the ownership criteria is met, the SSE will not apply as the activities of Jessamyn Ltd represent investment activity rather than trading activity and hence any gain will be taxable.

In addition to the chargeable gain arising on the sale of the shares, it is necessary to consider whether a degrouping charge arises. This occurs when a company leaves a group holding an asset transferred to it on a no-gain-no-loss basis (for tax purposes) from a group company in the past six years. As the Beachside Café would have been held as trading stock (rather than a capital asset) in the books of Metcalf Developments Ltd, this would have already been treated as being transferred at its market value for tax purposes at the time of the transfer in April 2018, and as such no degrouping charge will arise on this property.

However, Wye View Office will have been transferred on a no-gain-no-loss basis when it was transferred from Newline Ltd, so a degrouping charge may apply – see Appendix 1 for the calculation. This degrouping charge will be added to the proceeds when calculating the gain on the disposal. It should be possible, however, to make a claim to reduce the degrouping charge by £50,000 in accordance with s179ZA TCGA 1992. This is because the office was originally transferred into Jessamyn Ltd at a discount of £50,000 to its market value. Hence when the shares are sold, there would be double taxation on £50,000 of the gain and accordingly a reduction should be sought.

Taking this into account, the chargeable gain on the disposal will be £820,428.

If the company is sold, any tax attributes such as the value of the capital allowance pool or any capital losses will transfer with it.

Sale of assets

Alternatively, Jessamyn Ltd can sell the properties. Chargeable gains will arise on the disposals, taxable within Jessamyn Ltd. The total chargeable gain will be £889,250 (see Appendix 2).

As the properties have been held as part of an investment business rather than as part of a trade, it is not possible to claim rollover relief to defer the tax arising on the gains despite the ongoing investment by group companies.

When the properties are sold, there will also be an adjustment arising in the capital allowances pools. The value of fixtures and fittings within the buildings should be agreed between the parties in the form of a joint election. The adjustment could be a balancing allowance or charge dependent upon the current balances and the agreed allocation of proceeds.

Following the disposal of the final property, consideration would need to be given to future activities of Jessamyn Ltd. In the absence of any new activities, the final disposal will result in the end of an accounting period. A final company tax return will be required, but if the company remains dormant, it may not be necessary to file future company tax returns.

Appendix 1
Calculation of gain on disposal of shares in Jessamyn Ltd

Degrouping charge

	£
Market value of property at time of transfer	800,000
Original cost	(525,000)
Unindexed amount	275,000
Indexation June 2012 (241.8) to December 2017(278.1) 0.150	(78,750)
Degrouping charge	£196,250
S179ZA TCGA 1992 reduction	(50,000)
Revised degrouping charge	**£146,250**

Gain on disposal of shares

	£
Estimated proceeds	3,000,000
Degrouping charge	146,250
Cost – acquisition May 2015	(1,000,000)
Cost – additional investment April 2018	(1,250,000)
Unindexed gain	896,250
Indexation on £1,000,000 (May 2015 (258.5) to Dec 2017 (278.1))	(75,822)
Chargeable gain	£820,428

Appendix 2
Calculation of gain on disposal of properties by Jessamyn Ltd

	River View House	Wye View Office	Beachside Cafe	Note
	£	£	£	
Estimated proceeds	1,500,000	850,000	650,000	
Cost	(750,000)	(525,000)	(550,000)	(1), (2)
Unindexed gain	750,000	325,000	100,000	
Indexation -Jan 2010 (217.9) to Dec 2017 (278.1) 0.276	(207,000)			No indexation post 31 December 2017
Indexation -June 2012 (241.8) to Dec 2017 (278.1) 0.150		(78,750)		
Chargeable gain	543,000	246,250	100,000	£889,250 total

Notes

1. Beachside Cafe would have been deemed to be appropriated from trading stock at market value in the hands of Metcalf Developments Ltd immediately before being transferred to Jessamyn Ltd for that value. No indexation arises on acquisition in May 2018.

2. Wye View Office would have been a no gain no loss transfer and thus original cost and indexation used to calculate the gain arising.

MARKING GUIDE

TOPIC	MARKS
Consideration of alternatives and impact of purchasers' preference Relevance of stamp taxes Ability to split if sold seperately	1 0.5 0.5
Share sale - gain arises, SSE possibility SSE conditions – ownership met, trading not Pool etc. transfers with shares Post disposal position	1 1.5 0.5 0.5
Degrouping charge Beachside Café trading stock and hence appropriation so no charge Charge on Wye View and calculation Consideration of s179ZA claim	0.5 1.5 1.5 1
Share gain calculation	2
Sale of assets: Gains taxed in Jessamyn Ltd and then extract profits River View gain Beachside gain Wye View gain	 1 1 1 1.5
Unable to rollover as non-trade	1
Capital allowances, balancing adjustment, election to agree, charge or allowance	2
Conclusion	0.5
TOTAL	**20**

ANSWER 2

Proposed acquisition of the MBH group.

UK Corporation Tax will be payable on the profits of UK resident companies, on the profits of overseas companies to the extent that they relate to trade through a UK permanent establishment (PE) and in certain other circumstances as explained below.

Where there are transactions with UK companies, consideration is required under the UK transfer pricing rules as to whether these take place on an arm's length basis. Where a transaction between associated companies is not undertaken on an arm's length basis resulting in a reduction in the UK tax liability, adjustments must be made in the UK company tax return to reflect the arm's length charge.

Contemporaneous documentation must be maintained to support the pricing.

Overseas subsidiaries

Post-acquisition, the MBH group companies will become direct or indirect subsidiaries of the UK parent company. Subject to the Controlled Foreign Company (CFC) rules, designed to prevent companies artificially diverting profits away from the UK, no UK tax charge arises on profits earned by the non-UK resident subsidiaries provided there are no UK operations. Any profit extraction by way of dividend would be exempt, subject to anti-avoidance rules which could tax the distribution of pre-acquisition profits. No further tax would arise on the extraction of post-acquisition profits.

A CFC is a non-UK resident company controlled by UK resident persons. If the Fairchester group acquires MBH SA, then Fairchester Ltd would be considered to exercise control of all the acquired companies.

The profits of a CFC are apportioned to and taxed on the UK parent company if some or all its profits fall within a gateway subject to the following exemptions:

- Exempt Period Exemption - a temporary exemption for foreign subsidiaries already carrying on a business coming under UK control for the first 12 months post acquisition where certain conditions are met. This allows time to restructure the operations to avoid a CFC charge meaning that no immediate charge would arise.

- Excluded Territories Exemption/ Tax Exemption – companies resident in countries on the excluded list are automatically excluded from the CFC legislation. Even if a country is not included in the list, an exemption is available if the local tax liability is at least 75% of the corresponding UK tax liability if the profits were computed according to UK tax law. Therefore, assuming there are no material differences in the tax base and computational rules, MBH SA should be exempted from a CFC charge under the tax rate provision although Spain is not on the Excluded Territories list. Bulgaria is not an Excluded Territory, but, the Bulgarian tax rate of 10% is highly likely to mean that the tax exemption will not apply to MBH Bulgaria Ltd.

- The Low Profits Exemption – no CFC charge arises on investment income profits below £50,000. Based on the Bulgarian profit levels, this exemption will not apply.

- The Low Profit Margin Exemption – applicable if the CFC has a profit margin of no more than 10% of its relevant operating expenditure. Further details are necessary to understand if this exemption would apply to MBH Bulgaria Ltd.

As it is possible that none of the exemptions apply to MBH Bulgaria, it is necessary to consider if any of the future profits pass through any of the gateways defined in the legislation. Only profits passing through one of the gateways are liable to the CFC charge.

Four of the five gateways (non-trading finance profits, trading finance profits, captive insurance business and solo consolidation for banking subsidiaries) are not applicable to the activities outlined hence we need only consider the ‘profits attributable to UK activities’ test.

This test is designed to identify profits where the CFC relies on the UK to take on and manage its risks in a commercially effective way. There are several automatic exclusions such as a motive test and an exclusion if there are no UK managed assets. Given that significant product development occurs in the UK and is recharged to Bulgaria, the activities should be reviewed further. It may be appropriate to realign activities following any acquisition, potentially ensuring that there is sufficient substance in Bulgaria to remove concerns about CFC charges. Otherwise, if profits are deemed to pass through the gateway they will be liable to tax in the UK. The UK parent will, however, be able to credit local tax suffered by the CFC against the UK corporation tax liability which should offer a degree of mitigation.

It may be possible to simplify the group structure and undertake the activity of the Bulgarian company in one of the UK companies if the profits fall within the charge to tax in the UK anyway. The Bulgarian implications would need to be reviewed.

Taxation of PE operations

In general PE profits are first taxable in the territory where they arise, and secondly in the territory of residence of the entity owning the trading activity if no exemptions apply. Tax suffered in the first territory is generally relieved against tax in the second territory under relevant double tax treaties.

If the PE operations were transferred to the new UK parent company, the UK rules would apply, although there may be Spanish tax issues to consider as part of any such transfer, along with local issues in France and Portugal. Tax efficient transfers will require the impact of the EU Mergers Directive to be assessed in the post-Brexit environment.

If there are no adverse tax issues involving such a transfer, then an election is available in the UK, on a company-by-company basis, whereby overseas PEs can be elected out of UK taxation. The principal benefit is when the overseas rate is lower than the UK rate and the overseas PE is profitable, as the election then prevents additional UK tax on the PE profits becoming due. However, as the election is irrevocable and applies to all PEs of the relevant company, careful consideration is necessary before making the election as relief for any PE losses would cease to be available in the UK.

It is also the case that the French PE has made losses within the last six years. This will trigger rules within the exemption to delay the French PE from coming within it until these losses have been matched against freshly generated profits. Having said that, the French rate of CT is currently 30% and as such the UK corporation tax on any French PE profits not subject to the exemption would be fully covered by credit relief, so this should no in itself be a reason not to make the exemption election.

The Portuguese PE is paying tax at 21%, and so the exemption would not deliver any immediate benefit in the UK as the UK tax liability would be covered by foreign tax credits. But given that the main rate of CT in the UK is scheduled to increase to 25% with effect from 1 April 2023, the exemption would be beneficial as it would prevent additional UK tax becoming chargeable above and beyond the foreign tax credits.

To ensure that the operation of the exemption works, it would be recommended to make a loss streaming election at the same time to stream the losses of the company against the French PE. This would enable the Portuguese PE to immediately benefit from the exemption and ensure there is no tax leakage when the rates go up in the UK.

As an alternative to the above, it might be advisable to leave the two PEs within the Spanish company. The French PE's losses would still be available in Spain, and once profitable, it would be a fair assumption that the French tax paid would be available to credit against any Spanish liability.

As for the Portuguese PE, it may be advantageous to incorporate it, so as to prevent additional tax being payable in Spain (due to the fact that the tax rate in Portugal is lower than in Spain). Thought should be given to the operation of the EU Mergers Directive to minismise taxes on such an incorporation, and local tax advice should be sought in the relevant jurisdictions.

MARKING GUIDE

TOPIC	**MARKS**
Overseas operations taxed in local jurisdiction and potential for UK tax	1
Transfer pricing to be considered and documented	1
Taxation of overseas subsidiary	
• No UK tax on profits or dividends	1
• Possible application of CFC rules	1
• Exempt period – applies following acquisition	1
• Excluded territories/tax rate – Excludes Spain not Bulgaria	1.5
• Low profits – not applicable to Bulgaria	1
• Low profit margin – unlikely to apply to Bulgaria	1
• DTR available on any profit apportionment	1
• Gateways – need more info	1.5
• Possibility of restructure	1
Overseas Pes	
• Double taxation with DTR	1
• Discussion of transfer of Pes to the UK and need to check if EU Mergers Directive is available – seek local tax advice	2
• PE exemption, irrevocable, impact on loss relief, not currently beneficial	2
• Discussion of impact of PE exemption upon French PE – losses, streaming and basically no benefit even after UK tax increase	2
• Consider transfer of Portuguese profits out from Spain by incorporation	1
TOTAL	**20**

ANSWER 3

Corporation tax computation

	£
Loss before tax	(269,000)
Add depreciation	215,000
Less capital allowances	(1,898,925)
Total	(1,952,925)

Hence no current tax provision is required as a loss arises and any group relief surrenders are for no charge

Capital allowances workings – Annual investment allowance used in full by other group companies

Additions	General Pool	Special Rate pool	Structures and buildings		Allowances
Building			2,500,000		
Mezzanine floor			160,000		
Electrics and water		330,000			
Air conditioning		150,000			
Floor reinforcement	120,000				
Solar panels		75,000			
Office equipment and plant	960,000				
Delivery vans	120,000				
Car		35,000			
SUB TOTAL	1,200,000	590,000	2,660,000		
Eligible for FYA @ 130%	(1,200,000)				1,560,000
FYA @ 50%		(277,500)			277,500
WDA @ 6% x 9/12		(1,575)			1,575
SBA @ 3% x 9/12			(59,850)		59,850
TWDV C/Fwd	NIL	310,925	2,600,150		1,898,925
Total TWDV for DT				2,911,075	

Deferred tax

Accelerated capital allowances	£
Net Book Value of qualifying assets	4,235,000
Tax written down value	(2,911,075)
Timing difference	1,323,925
Deferred tax liability at 25%	**330,981**

To the extent that the loss is not surrendered to other group companies, the trading loss can be carried against total profits of the company in the future subject to possible restrictions on utilisation if the group exceeds £5 million of brought forward losses. On this basis, it is reasonable to recognise a deferred tax asset in connection with the loss to the same level as the deferred tax liability arising on the accelerated capital allowances.

To the extent that the loss exceeds the timing difference on the ACAs, the projected results of the company need to be considered to determine whether the asset should be recognised. Given that this is the first period of business, there is no historical evidence of profitability. The presumption is likely to be that no asset should be recognised unless very strong audit evidence is provided. This would mean recognition of a liability of £330,981 on ACAs offset by a matching asset. The balance of the asset of £157,250 ((£1,952,925-1,323,925)@25%) is unrecognised and should be disclosed in the accounts if it is material.

However, if it can be shown that value is to be realised from the tax losses i.e. that profits will arise against which the losses can be set, an asset could be recognised in respect of the losses.

MARKING GUIDE

TOPIC	**MARKS**
Add back depreciation	0.5
Capital allowances Each asset 0.5 Correct rates, Restricted for short period Car WDA only	 4.5 1.5 0.5
No current tax provision on loss unless surrendered for charge	0.5
Deferred tax Identify (correct) qualifying NBV Tax WDV Timing difference at 25% Offset losses (inc discussion) Discuss recognition of loss in excess of ACA	 0.5 0.5 0.5 0.5 0.5
TOTAL	**10**

ANSWER 4

Part 1

		Cirrus Ltd	Cumulus Ltd	Stratus Ltd
		31 December 2021	31 December 2021	31 December 2021
		£	£	£
Profit / (loss) before tax		4,250,000	(150,000)	3,500,000
Bad debt	1)	750,000		
Dividend income	2)	(5,000,000)		
Bonus provision	3)		0	
Pension contribution	4)		50,000	
Non trade interest			(100,000)	
Gifts	6a)			250,000
Legal	6b)			20,000
Staff party	6c)			0
Capital expenditure	6d			50,000
Depreciation	6e)			500,000
Deduction for depreciation	7)			(20,000)
Capital allowances	8)			(775,000)
Trading (losses) / profits		**0**	**(200,000)**	**3,525,000**
Non trade interest			100,000	
Group relief	11)		150,000	(150,000)
TTP		**0**	**50,000**	**3,375,000**
Corporation tax at 19%		**0**	**9,500**	**641,250**
Double tax relief – interest	5)		(9,500)	
Double tax relief - trading	9)			(66,500)
Double tax relief - branch	10)			(57,000)
Tax payable			**0**	**517,750**

1) Bad debts on loans to connected companies are not deductible.

2) The dividend exemption would apply due to 100% control.

3) As the amount arising in the year of £2 million is to be paid within nine months of the year-end, a deduction can be claimed for this in full. £1.5 million of the brought forward amount of £2 million would have been claimed as a deduction in the prior year. The remaining £0.5 million cannot be claimed in the current year as it was not paid within the year.

4) Pension contributions are deductible on a paid basis and so the additional movement in the year would not be deductible.

5) The company has used £50,000 of its trading losses against the interest income to reduce the taxable interest income to £50,000, which will then be covered by the withholding taxes of £9,500.

6a) The gifts of £100,000 are food and so are not deductible. The gifts totalling £150,000 exceed £50 each and so are not deductible, despite both having the company logo.

6b) Legal fees of £20,000 relating to the new lease are capital costs and are disallowable.

6c) Costs of £10,000 relating to the staff party are wholly allowable despite the cost per head being in excess of £75 as this is dealt with under the PAYE rules and not the Corporation Tax rules.

6d) Office furniture would be added back as it is capital expenditure (assuming it has a useful economic life in excess of two years), irrespective of the company's internal materiality levels. The furniture should be added back in the computation and then included within the main pool.

6e) Depreciation is added back.

7) The analysis of the tangible fixed assets spend is as follows:

Expenditure	£	Treatment
Replacement of windows	100,000	Revenue (assuming like for like)
Erecting fencing	50,000	Non qualifying as it is a part of the building
Computer hardware & software	200,000	Main rate

The company is entitled to claim a deduction for the depreciation charged on the capitalised revenue expenditure of £100,000 during the year. As the rate was confirmed to be 20% straight line, £20,000 can be claimed.

8) Capital allowances

	Annual investment allowance	Main pool
	£	£
Brought forward	-	2,500,000
Capital expenditure (note 6d)	50,000	-
Computer hardware	200,000	-
Total	250,000	2,500,000
Superdeduction, including 30% uplift	(325,000)	
Written down allowances	-	(450,000)
Pool carried forward	-	2,050,000

9) Assuming the trading income of the company had the same net profit margin, the £1 million trading income produced net profits of £350,000. UK tax on these profits is £66,500 and thus credit for double tax relief is limited to £66,500. No relief is available for the remaining £33,500.

10) Overseas tax payable on the PE taxable profits of £300,000 is limited to the UK tax payable of £57,000. Eligible unrelieved foreign tax of £3,000 is carried forward.

    The £10,000 tax refund in respect of 2020 should not be netted off against the tax payable in respect of 2021. As the company is still in time an amended return should be submitted for 2020 reducing any claim for overseas tax by £10,000.

11) As Cumulus Ltd and Stratus Ltd are both 100% subsidiaries of Cirrus Ltd, Cumulus Ltd can group relieve its losses to Stratus Ltd.

Part 2

There is an overpayment of £132,250 (=£650,000 - £517,750) in respect of 2021. The company can request repayment of this amount or ask HMRC to reallocate it against 2022, which will reduce interest payable on the potential underpayments arising as explained below.

For accounting periods commencing after 1 April 2019 very large companies must make accelerated instalment payments. The threshold is £20 million divided by the number of 51% group companies, which gives a threshold for the companies in the Cirrus group of £3,333,333 each. If the group's profits in 2022 are all in Stratus Ltd again, its taxable profits are budgeted to exceed this so the company should have paid its first instalment for 2022 of £190,000 (£4m x 19% = £760,000 / 4) on 14 March 2022. In addition, the company should make further instalments of £190,000 on 14 June 2022, 14 September 2022 and 14 December 2022.

MARKING GUIDE

TOPIC	MARKS
Confirming related party bad debts are disallowable	0.5
Confirming dividend exempt due to control	0.5
Bonus: Calculating £500,000 was not paid in the year Confirming the amount arising in the year is paid within 9 months	1.0 0.5
Pension contribution allowed when paid	0.5
Claiming a deduction for WHT under s112 TIOPA 2010 due to losses	1.0
Gifts: Disallowing gifts as are food Disallowing gifts as in excess of £50	0.5 0.5
Legal: Disallowing fees for new lease as capital Allowing staff entertaining	0.5 0.5
Office furniture: Disallowing furniture as capital	0.5
Adding back depreciation	0.5
Additions: Treating windows as revenue assuming like for like Fencing non qualifying as part of building Computer main rate Calculating the depreciation on the windows and claiming as a deduction	0.5 0.5 0.5 1.0
Capital Allowances: Including office furniture Claiming superdeduction on all additions Calculating the written down allowance	0.5 0.5 0.5
Making the group relief claim	1.0
Corporation Tax calculation	0.5
DTR trading: calculating the net profit on the income calculating the UK tax on the income claiming the DTR on the correct amount	0.5 0.5 0.5
DTR branch: calculating the UK tax claiming the DTR on the correct amount calculating the EUFT confirming the EUFT is carried forward confirming the 2020 refund is not netted off suggesting the amended return for 2020	0.5 0.5 0.5 0.5 0.5 0.5
Part 1 total	**17.0**
Reallocation of overpayment QIPs: mentioning the very large QIPs regime for 2022 & commencement date calculating the threshold correctly correct payment dates & amounts	0.5 1.0 0.5 1.0
Part 2 total	**3.0**
TOTAL	**20.0**

ANSWER 5

Treatment of existing intangibles in 2021 computation

The Azalea goodwill amortisation is disallowable for Corporation Tax purposes as it was acquired before 1 April 2002. Up until this date, intangibles were dealt with under the capital gains regime and so amortisation or impairments were disallowed. The regime continues to apply for assets still held but which were acquired before 1 April 2002.

The corporate intangibles regime applies to intangibles acquired from 1 April 2002, which aims to align the tax treatment of intangibles to the accounting treatment. The rules tax receipts or allowed amortisation or impairments on trade related intangibles as trading profits or losses. The Begonia goodwill amortisation is therefore deductible for Corporation Tax purposes under these rules. The company did not elect for a 4% straight-line deduction on the cost of the goodwill. This regime continues to apply for assets still held, acquired after 1 April 2002.

There was a further change to the corporate intangibles regime, relating to goodwill and customer related intangibles acquired on or after 8 July 2015 so that amortisation or impairments related to these intangibles would not be allowable for Corporation Tax purposes. The Crocus goodwill amortisation would therefore be disallowed in accordance with this amended corporate intangibles regime. The Crocus registered trademarks amortisation would be allowable under the original corporate intangibles regime as these changes did not affect trademarks.

2019 rule changes

As of 1 April 2019 the corporate intangibles regime has been altered again, so that relief is available for goodwill and certain customer related intangibles acquired after this date, at a rate of 6.5% straight line in certain circumstances. The rules explained above will continue to apply to any assets acquired before 1 April 2019.

2022 software

There are two possible treatments of the software costs of £500,000:

1) The company can claim the amortisation as it is charged to the income statement under the corporate intangibles regime; or

2) The company can make an election to exclude, so that the software costs are instead treated under the capital allowances regime as qualifying for capital allowances at the main rate. Any amortisation would then be disallowed and any profit or loss on disposal would be dealt with under the capital allowances regime.

These options should be assessed based on i) the expected rate of amortisation versus the capital allowances main rate of 18% reducing balance, ii) whether the company is able to claim a 130% superdeduction or 100% Annual Investment Allowance in respect of the costs, and iii) the anticipated loss profile of the company as a company has more control under the capital allowances regime and can disclaim in full or part capital allowances.

Software development intangible

A claim can be made to deduct the £1 million costs in the computation under s1308 CTA 2009, and in addition a claim for the RDEC can be made. Consequently, all subsequent amortisation on the software would be disallowable as a deduction because it would otherwise represent double relief for the expenditure.

<u>2022 Intangible disposals</u>

The Azalea goodwill disposal will be dealt with under the chargeable gains regime. The net capital gain or net capital loss will be calculated, including indexation to 31 December 2017 (indexation was frozen as at 31 December 2017). Capital gains and losses arising in the year will be netted off against each other. An overall capital gain would be chargeable to tax at the Corporation Tax rate with any loss available to carry forward and offset against future gains.

Alternatively, it may be possible to roll over the gain on the Azalea goodwill into the acquisition of a post 1 April 2002 intangible, subject to certain provisions.

The Begonia goodwill disposal will be dealt with under the corporate intangibles regime. No indexation will therefore be allowed. The accounting profit or loss on disposal of the goodwill will be taxable or relievable as part of the trading profits of the company. In addition, roll over relief is available on the acquisition of post 1 April 2002 intangibles, subject to certain provisions.

MARKING GUIDE

TOPIC	**MARKS**
2021 computation treatment	
Azalea: amortisation is disallowable	0.5
New rules for intangibles post 1 April 2002	0.5
Begonia: amortisation allowable	0.5
Mentioning 8 July 2015	0.5
Application of new rules to Crocus goodwill & customer related intangibles	1.0
New rules commence 1 April 2019	1.0
6.5% SL deduction for goodwill & customer related intangibles	1.0
£500,000 software: amortisation available under intangibles regime	0.5
Consider election to exclude s.815 CTA 2009 & capital allowances regime	1.0
Then amortisation would be disallowable	0.5
Discuss basis for decision	1.0
Software development	
s1308 CTA 2009 election for the RDEC expenditure	1.0
deduction for the costs	0.5
amortisation would be disallowed as already claimed	0.5
Azalea disposal: capital gain tax regime	1.0
Referring to indexation	0.5
Treatment of capital losses and gains	1.0
Mentioning rollover relief	0.5
Begonia disposal: corporate intangibles regime	0.5
No indexation	0.5
Taxable as trading profits / losses	0.5
Possibility of rollover relief	0.5
TOTAL	**15.0**

ANSWER 6

Introduction

An overseas company such as Felix Inc would be liable to UK Corporation Tax if it trades in the UK through a permanent establishment or if it was found to be treaty resident in the UK.

Permanent establishment

Under Article 5 of the OECD model treaty, a permanent establishment (PE) means a fixed place of business through which the business of an enterprise is wholly or partly carried on (a fixed place of business PE) or where a person, other than an independent agent acting in the course of their business, acts on behalf of an enterprise and has and habitually exercises authority to conclude contracts in the name of the enterprise (deemed PE).

1) The staff on secondment from Felix Inc are not carrying out the business of Felix Inc but are carrying out the business of Hilari Ltd. This activity does not therefore give rise to a fixed place of business PE in the UK of Felix Inc.

2) The procurement staff are purchasing services whilst physically present in the UK. They have an office available to them and are concluding contracts. Paragraph 4 of Article 5 specifically excludes the maintenance of a fixed place of business solely for carrying on activities of a preparatory or auxiliary character. The office, although being a fixed place, could therefore be exempt from giving rise to a fixed place of business PE on the basis that the procurement activities are auxiliary to the company's main business. Further, paragraph 5 of Article 5 extends the "preparatory and auxiliary" exclusion to deemed PEs. The negotiation and conclusion of the procurement contracts in the UK might therefore not give rise to a deemed PE.

3) The office where staff worked for the three-month project would be considered a place of business. However, due to the length of the project this would not be considered a fixed place of business. This is because, to be "fixed" there must be a certain degree of permanence. The OECD commentary states that generally a period of less than six months would not be considered "fixed".

Taken together all of the above activities should not result in a PE, but careful consideration should be given to whether the procurement activities are genuinely preparatory or auxiliary in character. If they are not then it is likely that these activities would constitute a UK PE.

Residence

Under UK domestic law, the company would be considered UK resident if its central management and control (CMC) was found to be in the UK.

Given that half of the board members are UK tax resident there is a risk that Felix Inc could be considered UK resident dependent on the specific facts. This would include: whether CMC sits with the board or for example the shareholders, whether UK directors make decisions whilst in the UK and then only rubber stamp those decisions in board meetings outside of the UK, how many board meetings there are per year and where are they located, whether the UK directors dial into the meetings from the UK, whether one of the UK directors has the casting vote.

If Felix Inc was found to be UK tax resident under UK domestic law, then under the UK:Ruritania double taxation agreement tie-breaker in Article 4, the company would be considered resident in the country where the two Competent Autorities agree it is, having regard to its place of effective management, place or incorporation and other relevant factors. If Felix Inc were treaty resident in the UK, then the company would be liable to tax in the UK on all of its worldwide profits.

If the company was not found to be UK resident under domestic law there is also the possibility that HMRC would seek to tax the activities of the two UK resident directors as a UK PE if any activities of the company were carried out by the directors in the UK. If there was a PE in the UK the profits or losses attributable to the UK activities of the PE viewed as a separate enterprise would be taxable in accordance with UK tax law. In both cases, any profits arising would be taxable at the current Corporation Tax rate. If Felix Inc had a UK PE it would potentially be able to claim double taxation relief in Ruritania for taxes payable in the UK. If Felix Inc is considered UK resident there may be a PE in Ruritania due to a fixed place of business or a deemed PE. In this case double taxation relief would be available in the UK for taxes payable in Ruritania.

It would be necessary to register any UK PE or Felix Inc itself (if considered UK resident) with HMRC and file a computation and tax return annually in respect of the relevant UK activities, along with the balance sheet and profit and loss account of the PE (if relevant) and Felix Inc's accounts.

MARKING GUIDE

TOPIC	MARKS
Non residents liable if PE or central management and control	1.0
Definition of fixed place of business PE	1.0
Staff secondment: Mentioning not carrying out the business of Felix Company No fixed place of business PE	 0.5 0.5
Procurement staff: Specific exclusion for preparatory and auxiliary activities Mentioning deemed PE / conclusion of contracts No PE	 0.5 0.5 0.5
3 month contract: Mentioning length of time of place of business No fixed place of business PE	 0.5 0.5
Considering all activities together	0.5
UK residence: Central management and control under UK domestic law Discussion of factors which may affect residence	 0.5 2.5
Showing understanding of dual residence Mentioning the tie breaker Mentioning factors relevant to Competent Authorities' discussion	0.5 0.5 0.5
Mentioning profits/losses of PE would be taxed under UK law Confirming loss rules Mentioning group relief Confirming DTR may be given in USR	0.5 0.5 0.5 0.5
Resident – taxable on worldwide profits Mentioning a PE in Ruritania Mentioning DTR on the PE	0.5 0.5 0.5
Confirming registration with HMRC and submission of return computation & accounts for either option	1.0
TOTAL	**15.0**