The Chartered Tax Adviser Examination

May 2020

Application and Professional Skills

Taxation of Larger Companies and Groups

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 start writing your answer. The Presiding Officer will inform you when you can start writing.

- In order to secure a pass in this paper, 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.

- Write on one side of the paper only. Do not write in the margins.

- 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 tick the appropriate box on the cover sheet.

- 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, you may assume that 2019/20 legislation (including rates and allowances) continues to apply for 2020/21 and future years. Candidates answering by reference to more recently enacted legislation or tax cases will not be penalised.

You are Bobbie Brown, a tax manager at LMN LLP, a large firm of UK-based accountants and tax advisers. A major client of the firm, Big Brands Europe plc, is a large, listed company based in London with numerous food-manufacturing operations in the UK.

Your tax partner, John Smith, has passed to you a letter (**EXHIBIT A**) from the client's Chief Financial Officer, Jill Jones, following a telephone call he had with her two days ago. In the letter, Jill Jones asks for tax advice on a new business that Big Brands Europe plc proposes to set up.

John has asked you to draft a report, for his review, in response to the client's request. He has said that there is no need to cover the rules to determine tax residence as the client is familiar with these and if further information is required, he will cover this separately.

The following exhibits are provided to assist you:

EXHIBIT A: Letter from Jill Jones to John Smith

EXHIBIT B: Summary business plan for the new business

EXHIBIT C: Information about the corporate tax regimes in Middleland and Commercia

EXHIBIT D: Pre-seen information

Requirement:

Prepare a draft report to Jill Jones, for review by John Smith, advising and making recommendations on the issues raised in Jill Jones's letter of 1 May 2020.

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EXHIBIT A

Letter from Jill Jones to John Smith

LMN LLP London Road Anytown ZZ10 9YY	Big Brands Europe plc City Street London WC00 1ZZ

1 May 2020

Dear John

New business proposal

I refer to our telephone call this morning and can now provide further details of the proposed new business.

The Board has taken the decision to build and operate a new factory to increase our capacity to manufacture processed frozen foods in Europe. To date we have based our manufacturing facilities in the UK, but the more flexible employment laws in Middleland and Commercia, make those countries potentially attractive. We have identified potential sites for the new factory in the UK, Middleland and Commercia, and now need to choose the best site.

The new business will be carried on through a new company that will not undertake any other activities. The initial capital investment and start-up losses will be funded by an investment by our holding company, Big Brands Europe plc, which in turn will be funded by external loans taken out by that company.

We have obtained legal advice to the effect that both Middleland and Commercia allow wholly-owned foreign investment in manufacturing businesses. However, there is a legal requirement, in Middleland only, that such ownership must be through a Middleland-incorporated limited company.

I enclose:

1) an outline business plan for the new business (**EXHIBIT B**), and

2) information about the corporate tax systems in Middleland and Commercia (**EXHIBIT C**).

We are currently taking further advice on the commercial, financial and political implications of trading in and from each of Middleland and Commercia but anticipate that there will be nothing in those areas that will make them more or less attractive than the UK.

We do, however, require your recommendations on:

1) whether the initial investment should be by way of debt or equity;
2) the legal form of the trading entity; and
3) the most attractive of the three locations from a UK tax perspective.

We are also taking separate tax advice from advisers in Middleland and Commercia about other local tax rules.

Yours sincerely

Jill Jones
Chief Financial Officer
Big Brands Europe plc

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EXHIBIT B

Summary business plan for the new business

Our overall objective is to purchase land and construct a factory in order to manufacture and sell foodstuffs throughout Europe.

We anticipate having to make an initial investment of £50 million in order to:

1) Purchase the land (£14 million);
2) Construct the factory (£15 million);
3) Purchase plant and machinery (£20 million); and
4) Fund the cash expense of the first-year loss (£1 million) (the accounting loss of £5 million less non-cash depreciation of £4 million).

Expected trading results

	£ million
Year 1 accounting (loss) (pre-interest)	(5)
Year 2 accounting profit (pre-interest)	3
Year 3 accounting profit (pre-interest)	7
Year 4 accounting profit (pre-interest)	15

Notes

1) Local currencies in Middleland and Commercia have been converted into £ sterling at current exchange rates, which are expected to remain unchanged.

2) All accounting profits/losses are stated after 20% straight-line depreciation of £4 million per annum on the original cost of plant and machinery. No depreciation is charged on land or buildings.

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EXHIBIT C

Information about the corporate tax regimes in Middleland and Commercia

	Middleland	Commercia
Rate of tax on profits	15%	10%
Relief for capital expenditure	10% fixed per annum for 10 years on factory. No relief on cost of land. 25% fixed per annum for four years on plant and machinery.	10% fixed per annum for 10 years on factory. 10% fixed per annum for 10 years on land. 25% fixed per annum for four years on plant and machinery.
Relief for interest	Relieved up to 30% of accounting profits. Unrelieved amounts carried forward and added to the following years' interest. No thin capitalisation restrictions.	Relieved up to 30% accounting profits. Unrelieved amounts carried forward and added to the following years' interest. No thin capitalisation restrictions.
Relief for tax losses	Full relief against future profits. Surplus losses carried forward indefinitely.	Full relief against future profits. Surplus losses carried forward for up to three following years. Losses used on first in, first out basis.
Tax deductions for dividends	None	None
Withholding taxes:		
Interest	10%	20%
Dividends	5%	20%
Royalties	Nil	20%
Double Tax Agreement with the UK?	OECD model	None

Notes

1) Both countries disallow depreciation in computing taxable profits.

2) There are no other significant tax disallowances in either country.

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EXHIBIT D

Pre-seen information

Client:

Big Brands Europe plc

Background

The Big Brands Europe plc group comprises a holding company (Big Brands Europe plc) and 20 wholly-owned subsidiary companies that manufacture and sell a wide variety of food products. All companies are incorporated in and tax-resident in the UK.

The group has been listed on the London Stock Exchange for many years.

All manufacturing is undertaken in the UK although raw materials are sourced from around the world. Products are sold to independent wholesale distributors mainly in the UK and Europe.

The group is profitable, making pre-tax profits of £90 million per annum. This is expected to continue in the foreseeable future.

Corporation Tax

All company tax returns for the accounting period ended 31 December 2018 were submitted on 22 December 2019. All previous returns were submitted within the statutory deadlines. There are no open enquiries with HMRC into any of the returns.

The group is highly-geared. It has entered into several fixed interest borrowing facilities and its interest expense is not expected to change materially in the next five years, unless there are additional borrowings. The group is able to access borrowings at an interest rate of 5%.

Any Corporation Tax losses in an individual entity are group relieved against other profitable companies' profits within the year. There are no losses carried forward at 31 December 2018 and none are anticipated in respect of the company tax returns for the year ended 31 December 2019.

The group's interest expenses fall within the Corporate Interest Restriction rules. When preparing draft computations for audit purposes at 31 December 2019, the position was as follows:

1) Group accounting profits before interest and tax, £150 million;
2) Depreciation/amortisation charge, £10 million included in pre-tax profits;
3) Total group interest expense, £60 million;
4) Total Taxable Profits, £140 million (after all other adjustments) less unrestricted interest of £48 million, i.e. £92 million; and
5) Interest restricted and carried forward in group companies, £12 million.

VAT

There is a VAT group registration in place for all companies within the group. No option to tax has been made in respect of any of the properties owned within the group.

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Summarised group financial information

Accounts are prepared annually to 31 December for all companies.

Consolidated Income statement for the year ended 31 December

	2019	2018
	£ million	£ million
Revenues	3,167	3,004
Operating profit	150	148
Finance expense	(60)	(60)
Profit before tax	90	88
Tax expense	(17)	(16)
Profit after tax	£73	£72

Consolidated Statement of Financial Position at 31 December

	2019	2018
	£ million	£ million
Assets	1,865	1,810
Liabilities	(1,325)	(1,290)
Net assets	540	520
Equity	£ million	£ million
Share capital	200	200
Reserves	340	320
Total equity	540	520