



The Chartered Tax Adviser Examination

May 2017

The Application and Interaction of Taxes

TIME ALLOWED – 3 ¼ HOURS

For your convenience, the questions in this paper may be broadly categorised as follows:

- Question 1 Taxation of Individuals, Trusts and Estates
- Question 2 Taxation of Larger Companies and Groups
- Question 3 Taxation of Owner-Managed Businesses
- Question 4 Human Capital Taxes
- Question 5 VAT and other Indirect Taxes

- The first 15 minutes is designated as reading time. During this time you may read your question paper and legislation and annotate your question paper. You are not permitted to start writing your answer. The Presiding Officer will inform you when you can start writing. Calculators may not be used during this time.
- You should answer only **ONE** out of the five questions.
- Each question carries 100 marks.
- Each question includes 22 marks specifically allocated for presentation and higher skills including the format of your answer, layout, style and the suitability and relevance of your advice.
- 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.
- Unless otherwise indicated by the provision of additional table information, you may assume that 2016/17 rates and allowances continue to apply for 2017/18 and future years. Candidates referring to actual or pending rates and allowances for 2017/18 and future years will not be penalised.

1. You are James Reid, a Tax Manager in a firm of Chartered Tax Advisers. A client of your firm, John Brookes, currently works as an employee for a software firm but is planning to retire soon. Once retired, he and his wife Sarah are considering emigrating and he has requested advice in relation to the effect of this on his tax position. Your Tax Partner, Julie Wright, has passed to you a letter from John which sets out his requirements (**EXHIBIT A**).

John is a wealthy individual and has a substantial portfolio of properties which includes properties let on short assured tenancies and properties let as furnished holiday accommodation. The properties let as furnished holiday accommodation have always met HM Revenue & Customs' qualifying conditions.

John has an adult daughter, Emily, from a previous marriage. Emily suffers from a mental disorder within the meaning of the Mental Health Act 1983 and is incapable of administering her own affairs. John's ex-wife looks after her and Emily will remain in the UK.

John has provided you with a recent professional valuation of his properties (**EXHIBIT B**).

John inherited a number of his assets on his father's death a few years ago. An extract of the inventory from his late father's estate is available in your firm's files (**EXHIBIT C**).

John was born in the UK but worked abroad for several years and returned to the UK 10 years ago. He is UK resident and has a UK domicile of origin.

The following exhibits are provided to assist you:

EXHIBIT A: Letter from John Brookes

EXHIBIT B: Extract from professional valuation of properties owned by John Brookes

EXHIBIT C: Extract from the inventory of John's late father's estate

You are required to draft a report for John Brookes responding to his queries and commenting on any other issues relevant to the circumstances.

Marks will be allocated as follows:

Capital Gains Tax	(20)
Inheritance Tax and Trusts	(16)
Income Tax	(25)
Other tax issues	(9)
Law and Ethics	(8)
Presentation and higher skills	(22)
	Total (100)

Continued

1. Continuation

EXHIBIT A

Letter from John Brookes

Julie Wright
Wright Tax Advisers
99 Wright Road
Wrightston
WW9 9XX

Mr J Brookes
Brookes House
Daletown
DD1 1AA

1 May 2017

Dear Julie

As you are aware I am taking early retirement next month and in November my wife and I plan to move abroad to Goldenstien, which is not in the EEA. I would like your advice in relation to this and have noted my specific queries below.

In addition to my rental income, I will have annual income of £18,000 from my UK pension and £5,000 from my foreign pension. I intend to retain my rental properties. I will also receive dividends of around £25,000 per annum from listed UK companies and UK bank interest of £10,000 per annum. My wife will only have income from her UK pension of £50,000. My wife and I do not intend to work again. Will we have to pay UK tax on our income once we emigrate? We will not pay tax on this income in Goldenstien.

I plan to purchase a property abroad which will cost £700,000 and I must sell one of my assets to fund this which is likely to be my entire share portfolio or Daisy House or Cassa Sun. I plan to sell the asset prior to emigrating so that we can purchase a house ready for us to move into when we arrive however if there is a significant tax saving I may delay this and rent somewhere in Goldenstien in the short term. I have enclosed a recent valuation of my properties and I would advise that my share portfolio is worth in the region of £710,000.

As you will recall, I spent approximately £50,000 refurbishing Daisy House around two years ago and installed a new kitchen and bathroom. I also spent approximately £50,000 building an extension to Cassa Sun.

I plan to retain my current home in the UK (Brookes House) and will come back to visit for around eight weeks in the summer each year. I will spend the rest of my time in Goldenstien. I will also retain my flats at Station Road, Poppy House, Cassa Sea and Cassa Sand.

You will recall that my daughter Emily, who is now 36, suffers from mental health problems and although her mother, my ex-wife, takes care of her on a day to day basis, before I move to Goldenstien I would like to ensure Emily is financially secure. I plan to give her £500,000 but due to the nature of her illness I would not feel comfortable making an outright gift. I would like to explore the use of a trust and I would be grateful if you could provide more information on how to do this as I would like to set this up before I move. I have never previously established any trusts. I would like the trustees to be my ex-wife, who is resident in the UK, and my UK based lawyer but I do not wish to be a trustee. We have previously discussed Inheritance Tax but I assume once I emigrate I will no longer need to worry about it.

I look forward to hearing from you in due course and perhaps we can meet up to discuss this in the near future.

Yours sincerely

John Brookes

Continued

1. Continuation

EXHIBIT B

Extract from professional valuation of properties owned by John Brookes

Valuation dated 31 March 2017

UK Property

£

Brookes House

Large country house comprising sitting room, dining room, kitchen, two utility rooms, office, six family bedrooms, three bathrooms, entrance hall. Approx. one acre of garden grounds. Owner occupied.

950,000

1 – 8 Station Road

Eight two bedroom flats let on short assured tenancies, currently generating gross income of £40,000 per annum.

1,600,000

Poppy House

Detached three bedroom house currently let as furnished holiday accommodation. Currently generating gross income of £28,000 per annum.

450,000

Daisy House

Detached four bedroom house currently let on a short assured tenancy. Currently generating gross income of £10,000 per annum.

780,000

EEA Property

Cassa Sun

Detached five bedroom villa, located in Spain, currently let as furnished holiday accommodation. Currently generating gross income of £35,000 per annum.

720,000

Cassa Sea

Detached four bedroom villa, located in Italy, currently let as furnished holiday accommodation. Currently generating gross income of £29,000 per annum.

590,000

Cassa Sand

Detached five bedroom villa, located in Italy, currently let as furnished holiday accommodation. Currently generating gross income of £32,000 per annum.

600,000

Total Value

£5,690,000

Continued

1. Continuation

EXHIBIT C

Extract from the inventory of John's late father's estate

Assets distributed to John Brookes

Value at date of death – 31 March 2010

	£
Poppy House	395,000
Daisy House	550,000
Cassa Sun	550,000
Cassa Sea	475,000
Cassa Sand	500,000
Listed Securities (all UK resident companies)	400,000

2. You are Laura Tithe, the newly appointed in-house tax manager at Birmfield Properties plc, which is listed on the London Stock Exchange. Sir Warwick Birmfield, the founder of the company, owns 30% of the shares with the other 70% held by unconnected parties.

Pre-tax profits for the year ended 30 June 2017 are expected to be £15 million.

Birmfield Properties plc is the parent of a group of wholly owned subsidiary companies. It is UK tax resident as are all of its subsidiaries except for Wallhampton Ltd, which is Jersey registered and tax resident. The group's business is the letting of investment properties it owns in the office, commercial, industrial, retail and leisure sectors.

The Birmfield group is about to embark on a programme of capital expenditure that cannot be funded from reserves and will therefore be funded by way of a bank loan and new equity investment through the Enterprise Investment Scheme (EIS). The bank is currently reviewing an application from Birmfield Properties plc to borrow £20 million as the bank loan element of the funding. To enable it to consider the loan application, the bank required a copy of the latest consolidated statutory accounts of Birmfield Properties plc, which are for the year ended 30 June 2016. Subject to obtaining the necessary finance, the Board approved the capital expenditure programme as set out in a report to the Board in March 2017 (**EXHIBIT A**).

Two subsidiary companies have entered into a tax avoidance scheme, Project Pegleg, which has been issued with a Disclosure of Tax Avoidance Schemes (DOTAS) reference number. The accounting and tax treatments adopted have been set out in a letter of 17 April 2017 from the Group's auditors to you (**EXHIBIT B**). No enquiries were received into any submitted Company Tax returns until January 2017, when HM Revenue & Customs opened an enquiry into the accounting period for the year ended 30 June 2016 of the two companies involved in Project Pegleg.

Subsequent to the Board meeting in March 2017 and the submission of the loan application to the Bank, a further letter, dated 24 April 2017 was received from HM Revenue & Customs (**EXHIBIT C**).

The Group Finance Director, Lenny Leverage, has asked you to draft a report that he can present to the Board advising on the capital allowances and VAT implications of the proposed capital expenditure by Soliminster Ltd and Wallhampton Ltd; any tax and other impacts of the latest letter from HM Revenue & Customs; and how to structure the proposed new business of running pubs in order to obtain EIS relief for the investors.

The following exhibits have been provided to assist you:

EXHIBIT A: Report on proposed restructuring and capital expenditure, as approved by the Board in March 2017

EXHIBIT B: Letter from the Group's external auditors dated 17 April 2017

EXHIBIT C: Letter from HM Revenue & Customs dated 24 April 2017

You are required to draft a report for presentation to the Board by the Group Finance Director advising on the following:

- 1) **The capital allowances and VAT implications of the proposed capital expenditure;**
- 2) **The tax and other impacts arising from the latest letter from HM Revenue & Customs; and**
- 3) **The best way to structure the new trading business of running pubs so as to secure relief under the Enterprise Investment Scheme.**

You are NOT required to discuss the tax position of Kidihull Ltd.

Continued

2. Continuation

Marks will be allocated as follows:

Requirement 1	(27)
Requirement 2	(33)
Requirement 3	(18)
Presentation and higher skills	(22)
	Total (100)

EXHIBIT A

Report on proposed restructuring and capital expenditure, as approved by the Board in March 2017

Birmfield Properties Group

1) Capital expenditure programme during year ended 30 June 2018

The Board is asked to approve the following capital expenditure programme for the year ended 30 June 2018 by the following subsidiary companies, whose interests in the properties in question are as stated. All expenditure is stated net of VAT as applicable and none of the buildings has been subject to an Option to Tax.

Solminster Ltd

The company has a freehold interest in Kenbor House, a 20-storey office block in central London. The building has in recent weeks become unoccupied. There is a covenant on the building which requires that at least 50% of the property is let to or is available for rental by financial services sector businesses at all times.

It is proposed to undertake a refurbishment programme and the following lettings, to commence when the refurbishment programme is complete, have been agreed:

- (a) An insurance company (floors 1-11) for a rent of £4 million per annum for 25 years.
- (b) A UK retail group head office (floors 12-18) for a rent of £5 million per annum for 10 years.

Floors 19 and 20 will be converted into serviced office accommodation to be marketed as a technology hub incubator, aimed at small technology companies.

The estimated costs of the work are:

- (a) On the building as a whole: £1.3 million on general structural alterations; £2.2 million on new air-conditioning and lighting systems; and £900,000 on replacement sanitary appliances (toilets etc.).
- (b) On floors 19 and 20: £400,000 on partitions, etc. and £500,000 on new office furniture.

Continued

2. Continuation

Wallhampton Ltd (Jersey resident)

This company has a freehold interest in industrial units in Enterprise Zones in Tees Valley (North East England) and London Docks. These are both designated assisted areas attracting 100% first year allowances on qualifying expenditure.

At the Tees Valley site it is proposed to build additional industrial units at an estimated cost of £15 million.

At London Docks, the plan is to refurbish the existing industrial units with new electrical systems and a new staff restaurant. The upgrading of the electrical systems is expected to cost £2 million and the staff restaurant to cost £800,000.

2) Refurbishment of pubs and new trading activity

Kidihull Ltd, a wholly owned subsidiary of Birmfield Properties plc, holds a portfolio of investment properties which it lets out. It has net assets of £20 million. It currently owns three empty pubs in Aldershot, Blackburn and Cardiff. The pubs were previously rented to tenants, but were closed down about three years ago and are now in a state of disrepair. Their total market value is currently £500,000 and refurbishment is required.

It is therefore proposed to refurbish these pubs and then run them as a new trading activity. The business will be managed by Peter Birmfield and Paul Birmfield, who are the two adult sons of Sir Warwick Birmfield. The trading business will employ about 30 staff.

The refurbishment programme, costing an estimated £1 million, will:

- (a) Convert the Aldershot property into a pub with restaurant;
- (b) Upgrade the Blackburn property and add two extra guest bedrooms to the two existing ones. It will then be run as a pub with guest rooms; and
- (c) Convert the Cardiff property into a city-centre wine bar.

As a result of the relatively high-risk nature of this project, the bank will not provide funding and therefore it is proposed to raise the full £1 million refurbishment costs through the Enterprise Investment Scheme (EIS) as follows:

- (a) Peter and Paul Birmfield will each subscribe £250,000 for shares; and
- (b) Mr and Mrs Corbell will each subscribe £250,000 for shares.

Mr and Mrs Corbell (husband and wife) are neither connected to the other investors, nor do they have any shareholdings, or associates with shareholdings, in Birmfield Properties plc.

This new venture can either be structured through an investment by Peter and Paul Birmfield and Mr and Mrs Corbell in Kidihull Ltd, or by way of a new company. If a new company is used, Kidihull Ltd would also become an investor and would subscribe £500,000 for shares, paid for through the transfer of the three pubs to the new company. If Enterprise Investment Scheme relief is not available, none of the individual investors will wish to invest.

Continued

2. Continuation

EXHIBIT B

Letter from the Group's external auditors dated 17 April 2017

Ms Laura Tithe
Group Tax Manager
Birmfield Properties Ltd
London

Pennies & Pounds LLP
London

17 April 2017

Dear Laura

Project Pegleg

I refer to our recent telephone conversation when you asked for an update and background report on Project Pegleg.

History

Sheffham Ltd and Carcastle Ltd undertook the following transaction several years ago. Our role has been limited to auditing the tax and accounting consequences.

A group company, Sheffham Ltd, advanced £38.4 million by way of a structured finance loan at a fixed rate of interest of 5% for four years to another group company, Carcastle Ltd, on 1 April 2012. The purpose of the advance was to fund a property development by Carcastle Ltd. The interest rate was independently confirmed as being a market rate. The loan was repaid on 31 March 2016.

Tax Treatment

The tax effect of the scheme, as supported by a leading Tax Counsel's opinion, was that the interest due on the loan was tax deductible in the borrowing company but the corresponding receipts were not taxable in the lending company. Accordingly, a one-sided tax deduction was obtained with no corresponding taxable receipt.

The DOTAS number of the scheme has been entered on CT600s for both companies for all years, as is required. In the tax computations, the interest payable has been claimed as a non-trade debit in Carcastle Ltd and the receivable has been treated as not taxable in Sheffham Ltd. All Company Tax returns, together with accounts and computations, have been submitted within the statutory deadlines. The computations, which we have seen in the course of our audit work, are summarised in the Appendix below.

Accounting Treatment

The group decided, in discussion with ourselves as auditors, that the tax advantage would only be recognised in statutory accounts once HM Revenue & Customs were no longer able to overturn the advantage. Therefore, in the statutory accounts of Sheffham Ltd and Carcastle Ltd, the transaction was initially treated as tax neutral i.e. in the tax provisions of Carcastle Ltd tax relief has been recognised in respect of the interest payable and the tax provisions of Sheffham Ltd have included tax liabilities in respect of the receivables.

Continued

2. Continuation

As the time limit for HM Revenue & Customs to open an enquiry for an accounting period has closed without an enquiry having been made, the tax provision has been adjusted in the following years' statutory accounts of Sheffham Ltd to treat the relevant receipt as not taxable.

Please let me know if I can be of any further assistance in this matter.

Yours sincerely

Audit manager

Appendix: Summary Corporation Tax computations as submitted

<u>Year end</u>	<u>30 June</u> <u>2012</u>	<u>30 June</u> <u>2013</u>	<u>30 June</u> <u>2014</u>	<u>30 June</u> <u>2015</u>	<u>30 June</u> <u>2016</u>
	£'000	£'000	£'000	£'000	£'000
<u>Sheffham Ltd</u>					
UK property business	<u>2,000</u>	<u>2,100</u>	<u>1,800</u>	<u>2,600</u>	<u>3,000</u>
Taxable total profits	<u>2,000</u>	<u>2,100</u>	<u>1,800</u>	<u>2,600</u>	<u>3,000</u>
<u>Carcastle Ltd</u>					
UK property business	1,100	2,200	2,000	2,400	2,500
(Non-trade debit)	<u>(480)</u>	<u>(1,920)</u>	<u>(1,920)</u>	<u>(1,920)</u>	<u>(1,440)</u>
Taxable total profits	<u>620</u>	<u>280</u>	<u>80</u>	<u>480</u>	<u>1,060</u>

EXHIBIT C

Letter from HM Revenue & Customs dated 24 April 2017

Ms Laura Tithe
Group Tax Manager
Birmfield Properties Ltd
London

24 April 2017

Dear Ms Tithe

Carcastle Ltd
Sheffham Ltd

I have now concluded my enquiries into the returns of the above named companies for the year ended 30 June 2016 and have also determined the implications for earlier years' returns.

Inter-company loan £38.4 million

HM Revenue & Customs are of the opinion that the loan arrangement entered into between Carcastle Ltd and Sheffham Ltd gives rise to allowable deductions in Carcastle Ltd and taxable receipts in Sheffham Ltd. It is noted, however, that in the computations of Sheffham Ltd, no taxable receipts are included for these amounts.

Furthermore, a review of earlier years' computations reveals that the same treatment has been adopted in all accounting periods since the loan was made.

Continued

2. Continuation

It is our intention to:

- 1) Issue a closure notice for the accounting period ended 30 June 2016 and amend the computation of Sheffham Ltd for that accounting period to charge the receivable to Corporation Tax; and
- 2) Make further assessments on Sheffham Ltd to charge to Corporation Tax the receivables for earlier years which ought to have been charged, by virtue of the discovery powers at Finance Act 1998 Schedule 18 Paragraph 41(1).

The effect of the forgoing will be as follows for Sheffham Ltd:

Y/e 30 June 2012 - further assessment £480,000

Y/e 30 June 2013 - further assessment £1,920,000

Y/e 30 June 2014 - further assessment £1,920,000

Y/e 30 June 2015 - further assessment £1,920,000

Y/e 30 June 2016 - amendment to self-assessment to increase to £4,440,000

The penalty position is still under consideration.

Yours sincerely

A Tax Inspector

3. You work for Bowham on Sea Tax Consultancy, a firm of Chartered Tax Advisers based in the town of Bowham on Sea.

The principal partner with your firm, Edgar Eagle, acts for a local restaurant in the town called Masies. The restaurant is run in partnership and commenced trading on 1 January 2012. The partnership comprised three otherwise unrelated partners, Aaron Amies (aged 62), Bill Bowles (aged 48) and Chloe Cowen (aged 49) until Aaron retired on 31 March 2017. On 1 April 2017, Davina Davies (aged 43), an unrelated friend, became a partner. The partners are planning to relocate the restaurant to larger premises but the new premises they have identified will require refurbishment before opening.

The partners of Masies have recently written to Edgar (**EXHIBIT A**) asking for advice in respect of the recent changes in the partnership constitution and their relocation plans. Edgar has agreed that he will send the partners a report dealing with the issues raised and he has asked you to prepare this in draft form for his attention.

The following exhibits are provided to assist you:

EXHIBIT A: Letter from the partners to Edgar Eagle

EXHIBIT B: Profit and loss accounts of Masies for the year ended 31 October 2016 and forecast for the year ended 31 October 2017

EXHIBIT C: Extracts from client files/partnership agreement

EXHIBIT D: Extract from the builder's quote for the refurbishment works

You are required to prepare a draft report, following the instructions given to you by Edgar Eagle, to be sent to the partners of Masies, addressing the issues raised in their letter.

Marks will be allocated as follows:

Closing position for Aaron Amies/profit allocations	(21)
Partnership changes/disposal of 12 Front Street	(20)
Purchase of 34 Sea View	(31)
Other matters	(6)
Presentation and higher skills	(22)
	Total (100)

Continued

3. Continuation

EXHIBIT A

Letter from the partners to Edgar Eagle

Edgar Eagle
Bowham on Sea Tax Consultancy
21 Front Street
Bowham on Sea

The Partners
Masies
12 Front Street
Bowham on Sea

22 April 2017

Dear Edgar

As you know we are planning to relocate to larger premises later this year. Aaron, who is approaching state retirement age, did not want to be involved in the disruption that this will entail and so decided to retire from the partnership on 31 March 2017. The following day our (unrelated) friend Davina Davies, who was employed as a chef by a competing business, became a partner. We did not require her to make any capital contribution upon her admission to the partnership.

Aaron, whose income has dropped significantly as he is no longer a partner, is particularly interested in knowing his closing tax position including a note of when any tax liabilities will be payable. The rest of us can wait at this stage for this information although we would be grateful if you could explain how our profits will be allocated for taxation purposes for the two accounting years ended 31 October 2016 and 2017.

We have prepared profit and loss accounts for the year ended 31 October 2016 and forecast accounts for the year ended 31 October 2017 (**EXHIBIT B**) that may help you with this and they are enclosed.

Following his departure Aaron became entitled to a repayment of his capital account and his current account balances. The former will be adjusted for the revaluation of the partnership goodwill and our current premises at 12 Front Street as at 31 March 2017. He is also entitled to keep his car. We would be grateful if you could please explain the tax consequences, if there are any, arising from these events.

In view of the recent food poisoning case (**EXHIBIT B**) we would also appreciate any comments on the impact of the partnership changes upon our personal liability for any partnership debts.

We have found new larger premises just around the corner at 34 Sea View and are planning to relocate at the end of October 2017. At that time we will sell our existing property for £260,000 to a third party developer. Please explain any tax consequences arising from this sale.

The property at 34 Sea View was previously used as a restaurant but they went out of business a couple of years ago and it has been empty ever since. The property will require quite a lot of work to bring it up to scratch although we could open pretty much straightaway. However, we would need to close again at some point to undertake some fairly significant repairs to the roof and chimney which our surveyor has identified will be required. We are in the process of negotiating a price reduction to reflect this and our best estimate at this stage is that the property will cost us £250,000. No VAT is chargeable on this property. Ideally we also would wish to redesign the layout of the interior of the building. We feel therefore that it may be better to temporarily close our business whilst the building works are completed. We envisage a break in the business of around two months before reopening as soon as possible after completing the building work. I have enclosed extracts (**EXHIBIT D**) from a quote provided from a local builder that gives further information regarding the work to be undertaken which you may find useful.

Continued

3. Continuation

In addition to this we will move as much equipment as possible from our current restaurant, bought at the beginning of the business, to the new restaurant. We will however also need to spend a further £55,000 to buy new kitchen equipment costing £35,000; new furniture for the restaurant costing £15,000 and £5,000 to be spent on artworks to create a pleasant atmosphere for our customers.

We expect that all of these costs will be incurred in the year ended 31 October 2018 and funded from the sale proceeds of 12 Front Street with any shortfall being made up with a bank loan to be made to the partnership.

We would be grateful if you could also explain any tax implications arising from the purchase of 34 Sea View and the additional costs identified above that we are likely to incur. It may help you to know that the vendor's solicitors have informed us that 'the pooling requirement for fixtures has not been satisfied in relation to this property'.

As you are aware we like the simplicity of trading as a partnership and the ability to draw funds as and when we require, so we do not need any information on a possible incorporation of the business.

We look forward to hearing from you in the near future.

Yours sincerely

Partners, Masies

EXHIBIT B

Profit and loss accounts of Masies for the year ended 31 October 2016 and forecast for the year ended 31 October 2017

	<u>Note</u>	<u>Year ended</u> <u>31/10/2016</u>		<u>Year ended</u> <u>31/10/2017</u>	
		£	£	£	£
Sales			276,250		300,000
Opening stock		12,400		15,750	
Purchases		83,300		100,000	
Less: closing stock		<u>(15,750)</u>		<u>(16,000)</u>	
Cost of sales			<u>(79,950)</u>		<u>(99,750)</u>
Gross profit			196,300		200,250
Expenditure:					
Wages	1	50,900		60,650	
Utilities		8,450		9,000	
Legal expenses	2	-		12,000	
Advertising		2,100		2,500	
Office costs		1,800		2,000	
Repairs		750		1,000	
(all allowable)					
Entertaining	3	1,450		-	
Insurance		2,500		2,600	
Motor expenses	4	12,450		12,000	
Loan interest		4,350		4,350	
Depreciation		<u>6,500</u>		<u>5,500</u>	
			<u>(91,250)</u>		<u>(111,600)</u>
Net profit			<u>£105,050</u>		<u>£88,650</u>

Continued

3. Continuation

Notes

- 1) Partners' salaries are included in wages.
- 2) In March 2017 a customer contracted mild food poisoning after eating at Masies. The amount of £12,000 shown for legal expenses includes legal fees of £2,000 and a provision for an estimated compensation payment of £10,000 to the customer. The lawyers involved have indicated, based on previous similar cases, that the eventual compensation payable is likely to be around £2,500. The legal fees comprise £1,500 to be incurred in the year ended 31 October 2017 and an estimated further £500 to complete proceedings after this.
- 3) Entertaining includes £600 relating to a Christmas party for staff held every other year, of which half related to the attendance of the partners. The remainder of the entertaining costs related to entertaining suppliers.
- 4) Motor expenses, which accrue evenly, comprise the following:

<u>Year ended</u>	<u>31/10/2016</u>	<u>31/10/2017</u>
	£	£
Aaron Amies	2,100	900
Bill Bowles	2,650	2,800
Chloe Cowen	1,900	2,200
Davina Davies (from 1 April 2017)	nil	1,517
Van	<u>5,800</u>	<u>4,583</u>
	<u>£12,450</u>	<u>£12,000</u>

Aaron Amies, Bill Bowles and Chloe Cowen have always used their cars 20% for business purposes. Davina Davies uses her car entirely privately whilst the van is entirely used by an employee of Masies for business purposes.

EXHIBIT C

Extracts from client files/partnership agreement

Information relating to Masies

Historical information

The partnership began trading on 1 January 2012. The business trades from a property located at 12 Front Street, which was acquired for £90,000 on 1 January 2012 with each partner contributing £30,000 which has been held on capital account within the partnership accounts.

A bank loan was taken out to fully equip the restaurant at the beginning of the business. The equipment purchased at that time qualified for 100% annual investment allowances.

On 31 March 2017 Masies goodwill and property were valued by a reputable firm of professional valuers at £45,000 and £240,000 respectively. These revalued amounts were included within the partnership accounts on 31 March 2017 by making credits to the capital accounts of Aaron Amies, Bill Bowles and Chloe Cowen on that date (i.e. before the admission of Davina Davies on 1 April 2017). The goodwill and property are the partnership's only chargeable assets.

Continued

3. Continuation

Previous tax adjusted profits

Masies tax adjusted profits to date are as follows:

<u>Period/year ended</u>	£
31 October 2012	23,400
31 October 2013	35,700
31 October 2014	58,800
31 October 2015	82,500

Capital allowances

Masies' tax written down values brought forward as at 1 November 2015 were as follows:

	£
Main pool	nil
Aaron Amies' car	4,000
Bill Bowles' car	4,000
Chloe Cowen's car	4,000

Upon becoming a partner, Davina Davies introduced her car to the partnership at its market value of £4,000. All the other cars are the same make and model and were acquired at the same time. All cars qualify for writing down allowances at 18%. Aaron kept his car upon retirement at which time it was valued at £3,000.

Except as identified above, no fixed asset purchases or disposals have occurred or are planned for the two years ending 31 October 2017.

Forecast profits for year ending 31 October 2018

It is expected that tax adjusted profits (before capital allowances) for the year ending 31 October 2018 will be £80,000.

Profit allocations

Revenue profits

Until 1 February 2016 each partner had an equal entitlement to profits.

From 1 February 2016 Aaron Amies became entitled to a salary of £1,000 per calendar month with residual profits shared equally.

From 1 April 2017 Davina Davies is entitled to 20% of any profits. The remaining profits are to be shared equally by Bill Bowles and Chloe Cowen.

Capital profits

Until 31 March 2017 each partner had an equal entitlement to capital profits.

From 1 April 2017 capital profits will be shared 40% to Bill Bowles and Chloe Cowen and 20% to Davina Davies.

Continued

3. Continuation

Personal Information

With the exception of Aaron Amies (who will receive pension income of £20,000 per year from 6 April 2017) none of the partners (including Davina Davies) has any taxable income in any year apart from their income from Masies.

Aaron Amies' tax and Class 4 National Insurance liability for the 2015/16 tax year was £5,276.

Pending the completion of the partnership accounts for the year ended 31 October 2017 Aaron Amies' current account balance within the partnership as at 31 March 2017 is estimated to amount to £15,000.

EXHIBIT D

Extract from the builder's quote for the refurbishment works

We are able to quote for the proposed works to be undertaken at 34 Sea View, Bowham on Sea as follows:

	£
Roof and chimney repairs	35,000
Internal alterations to redesign room layout as required (includes £3,000 for wooden panelling to restaurant area)	15,000
Building alterations to install equipment	2,500
Re-wiring property (includes £3,000 of specialist cabling required for kitchen equipment)	15,000
Supply and install new heating system	15,000
Plumbing, supply and installation of sanitary ware	15,000
Internal decorating	5,000
External decorating	<u>2,500</u>
Total (excluding VAT)	<u>£105,000</u>

4. You are Marcus White, a manager in the Human Capital team of a large international firm of accountants. You have been engaged by a new client, Devari Ltd, which is the UK wholly owned subsidiary of a US company, Devari Inc. Devari Inc is a software company listed on the New York Stock Exchange and has wholly owned subsidiaries around the world, which sell the software in those local territories.

As well as selling software in the UK, Devari Ltd is the head office for the European and Middle East area (EMEA) which includes Devari Inc subsidiaries in France, Germany, Italy and the United Arab Emirates (UAE).

Brenda Long is the new payroll manager at Devari Ltd and she has emailed you (**EXHIBIT A**) as she has concerns over a letter she has received from HM Revenue & Customs (**EXHIBIT B**) regarding a forthcoming review of the Devari Ltd payroll that they will be undertaking. She would like your support in preparing for the initial meeting with HM Revenue & Customs.

The following exhibits have been provided to assist you:

EXHIBIT A: Email from Brenda Long

EXHIBIT B: Letter from HM Revenue & Customs

EXHIBIT C: Extract from the Long-Term Incentive Plan rules

EXHIBIT D: Notes on Assignees

EXHIBIT E: Excerpts from the UK-US Double Taxation Agreement

You are required to:

- 1) **Draft a letter to Brenda Long, for review by your Tax Partner, advising on the issues raised in her email.**
- 2) **Draft a covering note to your Tax Partner setting out any non-tax matters which you feel he should consider.**

Marks will be allocated as follows:

Requirement 1	Derek Pratt property	(14)
	Other matters	(57)
Requirement 2		(7)
Presentation and higher skills		(22)
		Total (100)

Continued

4. Continuation

EXHIBIT A

Email from Brenda Long

From: Brenda Long
To: Marcus White
Date: 1 May 2017
Subject: HM Revenue & Customs payroll review

Dear Marcus

As you know, I have only recently joined Devari Ltd and feel a little out of my depth with the review that HM Revenue & Customs have commenced into the company's payroll matters. They had an initial visit last week and have now written to us (**EXHIBIT B**) asking for more information on the long-term incentive plan (**EXHIBIT C**).

I have established that the scheme commenced on 1 January 2010 and is administered by our reward team in the US. Payments under the scheme are made in the currency of the participant's home country, converted from USD using the exchange rate on the date of payment.

I have also established that except for two participants, all Devari Ltd staff who have participated in the scheme have been UK resident employees working in the UK for Devari Ltd. There are however two individuals, Alex Marsh and Derek Pratt, whose situation is different and I don't know if this will have any bearing on the position. Alex is a Devari Ltd employee who is on assignment to one of the other companies in the EMEA region and Derek is a Devari Inc employee who is on an assignment here in the UK. I have attached some relevant information on these employees and their remuneration package (**EXHIBIT D**) in case there are any other issues.

Our finance department have said that they would like to ignore any issues which may relate to historic scheme transactions as they have already closed off the accounts for those periods. I am inclined to agree with the finance department and concentrate on getting things right going forward.

The Devari Group do not operate a tax equalisation policy but we have on occasion paid out "tax settlements" with individuals who believe they have been disadvantaged financially as a result of overseas assignments.

In addition to the above matters, Derek Pratt has raised some concerns over his personal tax situation in the UK. Given his seniority, the company would like to assist him as best we can and will cover the costs for all advice provided in relation to Derek.

Firstly, he has recently had to pay a significant amount of tax following the filing of his UK 2015/16 tax return and it has left him somewhat short of disposable income. We would appreciate your suggestions on what could be done about this.

Secondly, he would like advice on the UK tax implications of his plans for UK properties that he owns. He has provided me with the following information:

- 1) He intends to return to the UK when he retires. He has continued to own his family home in London, which he occupied throughout the period from purchase up to the date that he moved to the US. Since then he has rented out the property.
- 2) He also owns a property in Reading, which he has been renting out to his daughter at half of the normal market rent since September 2015 whilst she completes her university course. As a result Derek makes a loss on this property and offsets it against any profit made on letting his main home.
- 3) He intends to transfer the Reading property, worth £375,000, into a new UK resident discretionary trust with his daughter as the only beneficiary. He has made no other gifts in the last seven years.

Continued

4. Continuation

4) He reports his UK rental and other investment income via his UK self-assessment returns, which he has always filed on time.

Please provide me with your thoughts.

Many thanks in advance for your comments.

Brenda

EXHIBIT B

Letter from HM Revenue & Customs

Finance Director
Devari Ltd
Victory House
Parkhead Place
Newtown
NT15 7RP

25 March 2017

Dear Sir

Devari Ltd Payroll Review

Thank you for your time during our 'Know Your Customer' visit last week. At the meeting you indicated that the company has a long-term incentive plan. We have reviewed our records and note that we have no record of any share scheme and that the company has made no returns in relation to employment related securities.

Can you please provide me with information in relation to the incentive plan including a copy of any scheme rules, details of individuals who have participated in the scheme and any amounts which have been included in the Devari Ltd payroll reporting in relation to the scheme?

Although our review will initially concentrate on processes and reporting in relation to the incentive plan, the scope of the review may be expanded based on our findings.

Yours faithfully

HM Revenue & Customs

Continued

4. Continuation

EXHIBIT C

Extract from the Long-Term Incentive Plan rules

Definitions

Devvari Inc Group	Devvari Inc plus its wholly owned subsidiaries.
Eligible Employee	An employee at grade B or C who has been continuously employed within the Devvari Inc Group for the whole or part of the Plan Year.
Option	An option to acquire shares in Devvari Inc.
Plan	The Devvari Inc long-term incentive plan.
Plan Year	The calendar year commencing on 1 January in respect of which awards under this Plan are made.

Rules of Plan

- 1) The Plan is a long-term incentive plan designed to reward the commitment of long-term employees of the company and operates on an annual basis by reference to a Plan Year.
- 2) The Plan is open to all Eligible Employees.
- 3) Eligible Employees will receive an award based on company and individual performance in the Plan Year.
- 4) Senior employees at level B1 or B2 will receive an award in the form of a grant of an Option to purchase a number of Devvari Inc shares.
 - (a) The Option will be granted within 90 days of the end of the Plan Year.
 - (b) The Option will vest on the fourth anniversary of the grant date.
 - (c) Any Options not exercised within seven years of the end of the Plan Year will lapse.
 - (d) The exercise price will be determined by the market value of the shares on the date of the grant and will be confirmed upon notification of the grant.
- 5) All other employees will receive a cash award based on the movement in the share price over the period of the award.
 - (a) The award will be granted within 90 days of the end of the Plan Year.
 - (b) On the fifth anniversary of the grant date, the employee will receive a cash payment.
 - (c) The cash payment will be calculated as the difference between the share price on the fifth anniversary and the share price on grant multiplied by the notional number of shares over which the grant was originally made.
 - (d) Employees no longer employed by the Devvari Inc Group on the fifth anniversary of the grant date will forfeit any unvested awards.

Continued

4. Continuation

Notes on Scheme

For UK tax purposes, it has been confirmed previously that the earnings period for the plan, runs from the grant date to the relevant vest/payment date.

No steps have been taken by the company to obtain qualifying status for the plan in the UK.

EXHIBIT D

Notes on Assignees

Assignment Details

<u>Individual</u>	<u>Grade</u>	<u>Home location/ Contractual employer</u>	<u>Host location</u>	<u>Assignment duration</u>	<u>Start date</u>	<u>Expected end date</u>
Alex Marsh	C2	UK	UAE	3 years	1 June 2014	31 May 2017
Derek Pratt	B2	US	UK	4 years	1 July 2015	30 June 2019

Assignee Remuneration

Alex Marsh has a gross annual salary of £92,000 and in addition the company matches the £9,000 that he pays into the Devari Ltd pension scheme.

Derek Pratt has a gross annual salary of £200,000 and in addition the company matches the £14,500 that he pays into his pension scheme. Derek's pension scheme is a US 401k scheme and Devari Ltd has received approval from HM Revenue & Customs that the US scheme corresponds to a UK tax relieved pension scheme.

Remuneration figures have been/will be unchanged throughout the assignment.

LTIP Awards

<u>Assignee</u>	<u>Grant/Award date</u>	<u>Option exercise date/date of cash payment</u>	<u>Cash award</u>	<u>MV of shares received less amount paid on exercise</u>
Alex Marsh	20 March 2010	20 March 2015	£25,000	
Alex Marsh	20 March 2011	20 March 2016	£17,000	
Derek Pratt	15 March 2012	15 November 2016		£70,000

Assignee background information

Alex Marsh

Alex is an outbound assignee to the United Arab Emirates (UAE) working under a UK contract of employment. His family has accompanied him to the UAE and he only returns to the UK for a three day annual conference in February and for two visits per year, of four weeks each, in May and August. On each of the longer UK visits, he carries out his UAE duties remotely for two weeks whilst his wife and children visit family and friends. He is a British national.

The company applied for an NT PAYE code for Alex when he left the UK in 2014. The company assumed that this would be accepted and decided to cease deducting PAYE at the assignment start date. The NT code still has not been received. The company has continued to deduct UK National Insurance Contributions from all payments made to Alex as they know there is no social security agreement between the UK and the UAE.

4. Continuation

Derek Pratt

Derek is a senior employee of Devari Inc, who is in the UK to restructure the European accounting function and troubleshoot areas of excessive budget spend.

Derek is a British national born and raised in the UK who moved to the US in 1995. Devari Inc's US tax adviser has confirmed that because Derek is a Green Card holder (with the right to live permanently in the US), the US tax authorities will continue to tax him as tax resident in the US. He has therefore remained on the US payroll and Devari Inc have continued to operate US withholding taxes. As a result, he has not been included on the Devari Ltd UK payroll and an application for a certificate of coverage for Derek under the UK-US Social Security Agreement has not been made.

Derek's wife and teenage son, who is still in school, have remained in the US so he returns for one week each month to visit them and works approximately 20% of his time in the US. He also spends an additional 5% of his time working around Europe as part of the accounting restructure. While in the UK Derek either stays in a hotel or with family members.

EXHIBIT E

Excerpts from the UK-US Double Taxation Agreement

Article 4 - Residence

- 1) Except as provided in paragraphs 2 and 3 of this Article, the term "resident of a Contracting State" means, for the purposes of this Convention, any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, citizenship, place of management, place of incorporation, or any other criterion of a similar nature. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or of profits attributable to a permanent establishment in that State.
- 2) An individual who is a United States citizen or an alien admitted to the United States for permanent residence (a "green card" holder) is a resident of the United States only if the individual has a substantial presence, permanent home or habitual abode in the United States and if that individual is not a resident of a State other than the United Kingdom for the purposes of a double taxation convention between that State and the United Kingdom.
- 3) The term "resident of a Contracting State" includes:
 - (a) a pension scheme;
 - (b) a plan, scheme, fund, trust, company or other arrangement established in a Contracting State that is operated exclusively to administer or provide employee benefits and that, by reason of its nature as such, is generally exempt from income taxation in that State;
 - (c) an organization that is established exclusively for religious, charitable, scientific, artistic, cultural, or educational purposes and that is a resident of a Contracting State according to its laws, notwithstanding that all or part of its income or gains may be exempt from tax under the domestic law of that State; and
 - (d) a qualified governmental entity that is, is a part of, or is established in, that State.

Continued

4. Continuation

- 4) Where by reason of the provisions of paragraph 1 of this Article, an individual is a resident of both Contracting States, then his status shall be determined as follows:
- (a) he shall be deemed to be a resident only of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident only of the State with which his personal and economic relations are closer (centre of vital interests);
 - (b) if the State in which he has his centre of vital interests cannot be determined, or if he does not have a permanent home available to him in either State, he shall be deemed to be a resident only of the State in which he has an habitual abode;
 - (c) if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident only of the State of which he is a national;
 - (d) if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall endeavour to settle the question by mutual agreement.

Article 18 – Pension schemes

- 1) Where an individual who is a resident of a Contracting State is a member or beneficiary of, or participant in, a pension scheme established in the other Contracting State, income earned by the pension scheme may be taxed as income of that individual only when, and, subject to paragraphs 1 and 2 of Article 17 (pensions, social security, annuities, alimony, and child support) of this Convention, to the extent that, it is paid to, or for the benefit of, that individual from the pension scheme (and not transferred to another pension scheme).
- 2) Where an individual who is a member or beneficiary of, or participant in, a pension scheme established in a Contracting State exercises an employment or self employment in the other Contracting State:
- (a) contributions paid by or on behalf of that individual to the pension scheme during the period that he exercises an employment or self-employment in the other State shall be deductible (or excludable) in computing his taxable income in that other State; and
 - (b) any benefits accrued under the pension scheme, or contributions made to the pension scheme by or on behalf of the individual's employer, during that period shall not be treated as part of the employee's taxable income and any such contributions shall be allowed as a deduction in computing the business profits of his employer in that other State.

The reliefs available under this paragraph shall not exceed the reliefs that would be allowed by the other State to residents of that State for contributions to, or benefits accrued under, a pension scheme established in that State.

- 3) The provisions of paragraph 2 of this Article shall not apply unless:
- (a) contributions by or on behalf of the individual, or by or on behalf of the individual's employer, to the pension scheme (or to another similar pension scheme for which the first-mentioned pension scheme was substituted) were made before the individual began to exercise an employment or self-employment in the other State; and
 - (b) the competent authority of the other State has agreed that the pension scheme generally corresponds to a pension scheme established in that other State.

4. Continuation

- 4) Where, under sub-paragraph (a) of paragraph 2 of this Article, contributions to a pension scheme are deductible (or excludable) in computing an individual's taxable income in a Contracting State and, under the laws in force in that State, the individual is subject to tax in that State, in respect of income, profits or gains, by reference to the amount thereof which is remitted to or received in that State and not by reference to the full amount thereof, then the relief that would otherwise be available to that individual under that sub-paragraph in respect of such contributions shall be reduced to an amount that bears the same proportion to that relief as the amount of the income, profits or gains in respect of which the individual is subject to tax in that State bears to the amount of the income, profits or gains in respect of which he would be subject to tax if he were so subject in respect of the full amount thereof and not only in respect of the amount remitted to or received in that State.

Exchange of Notes with reference to Article 14 (Income from employment)

It is understood that any benefits, income or gains enjoyed by employees under share/stock option plans are regarded as "other similar remuneration" for the purposes of Article 14.

It is further understood that where an employee:

- (a) has been granted a share/stock option in the course of an employment in one of the Contracting States;
- (b) has exercised that employment in both States during the period between grant and exercise of the option;
- (c) remains in that employment at the date of the exercise; and
- (d) under the domestic law of the Contracting States, would be taxable by both Contracting States in respect of the option gain.

then, in order to avoid double taxation, a Contracting State of which, at the time of the exercise of the option, the employee is not a resident will tax only that proportion of the option gain which relates to the period or periods between the grant and the exercise of the option during which the individual has exercised the employment in that Contracting State.

With the aim of ensuring that no unrelieved double taxation arises the competent authorities of the Contracting States will endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of Article 14 and Article 24 (Relief from double taxation) in relation to employee share/stock option plans.

5. You are Ashley Bell, a Tax Manager in a provincial firm of accountants and tax advisers, Beacon & Co. The firm's senior partner, Jennifer Daley, has received a letter (**EXHIBIT A**) concerning an existing client, Hays Head Farm, which she has forwarded to you for your attention.

Hays Head Farm is a partnership between Rory and Linda Morris, who are dairy farmers in Somerset. The farm has been struggling for a few years and the letter suggests changes to the business structure to ensure the farm's survival. Your partner has also forwarded you a letter the client has received from HM Revenue & Customs (**EXHIBIT B**).

The following exhibits are provided to assist you:

EXHIBIT A: Letter from Linda Morris to Jennifer Daley

EXHIBIT B: Letter from HM Revenue & Customs

EXHIBIT C: Information extracted from the client file of Hays Head Farm

You are required to write a draft report to the partnership, for review by Jennifer Daley, addressing the issues raised in EXHIBITS A and B, including any necessary calculations.

Marks will be allocated as follows:

VAT	(51)
Other indirect taxes	(11)
Direct taxes	(9)
Law	(7)
Presentation and higher skills	(22)
	Total (100)

Continued

5. Continuation

EXHIBIT A

Letter from Linda Morris to Jennifer Daley

Jennifer Daley
Beacon & Co
Any Town
Somerset
AT1 0JS

Linda Morris
Hays Head Farm
Fulverton
Somerset
FN11 4QP

26 April 2017

Dear Jennifer

Hays Head Farm

As you know, our dairy farming business has been struggling for a number of years due to the falling milk price. Consequently, we have tried to diversify in various ways in the last year.

Firstly, we opened a farm shop to sell locally produced meat and vegetables both from our farm and other neighbouring farms. We also sell fruit juices and colas.

Secondly, we now provide both grazing for horse owners in the locality and also stabling, having recently built new stables. We refer to this as the "livery", but in reality, we do not provide any additional services such as care and grooming.

The work to set up the farm shop and the stables was performed in house. The costs were trivial and were not recorded in the books, and no VAT was recovered.

Our quarterly VAT returns are simple: we don't charge VAT on anything because we only sell food etc., but we claim back all the VAT we incur. This includes VAT on heating, lighting etc. on the use of an office in the farmhouse for farm correspondence. This has always been the case. However, we have just received a worrying letter from the VAT office, which I shall forward to you. They have been to the farm shop and have also looked at the stables. We will need your assistance in replying.

We recently received a devastating blow when we found that we have tuberculosis in the dairy herd. This means that a number of cows will have to go for slaughter. This is now the final straw; we cannot face rebuilding the herd, given the low milk price. We are therefore going to cease milk production, sell the remainder of the herd, and look to trade in new areas. We will receive an insurance claim of £20,000 as compensation under a loss of profits policy.

Our daughter, Becky, is an employee and will become an integral part of the business. Thus, we would like to gift her a stake in the farm. We will do this by transferring for no payment the partnership land and buildings (except for the land on which the milking parlour is situated and an adjoining field – see below) into a new partnership owned in the ratio of 2/5 each for Rory and me and 1/5 for Becky. We would do this before the conversion work referred to below is started, and we would wish to minimise any stamp taxes arising.

As well as the livery stables, the farm buildings currently comprise a milking parlour, a farm shop and other general farm buildings (apart from the milking parlour) in use within the dairy – for convenience I refer to these as the 'dairy buildings' in this letter. Whilst retaining the farm shop, we will also seek to carry out new activities as follows:

Continued

5. Continuation

1) Riding school

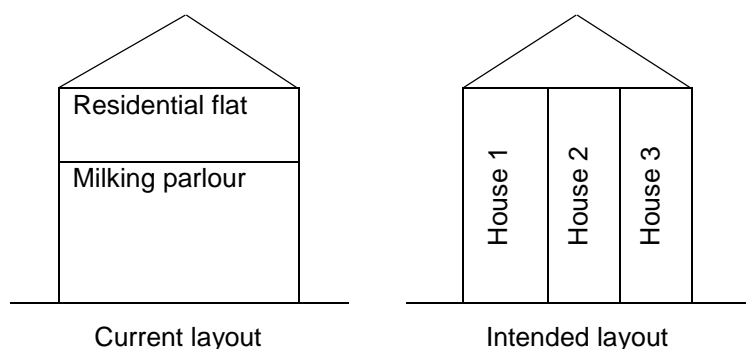
We propose to convert the dairy buildings into a riding school. Becky and I are both accomplished riders and would take the classes. I have been talking to a friend of mine in the village about this. Competition between riding schools is high and she says we can attract significantly more customers if we don't charge VAT. Whilst a licence to run a riding school requires mandatory insurance to cover any injuries incurred by riders, we are still concerned about our liability as owners in the event of accidents. Thus, we need advice here on whether we should trade through a traditional partnership or a limited liability partnership (LLP).

2) Milking parlour conversion

Currently we have a milking parlour at the perimeter of our land. The parlour has a residential flat on its upper floor for use when we take on a relief milker, for example, when we are fully stretched on the farm or when we go on holiday.

We intend to carry out a residential conversion on the parlour, which will be funded by the proceeds from the sale of the herd and the insurance claim.

We have already obtained outline planning permission to insert an extra floor and to convert the parlour into a terrace of three, three storey houses (see the side view plans below).



The intention is for the existing partnership to sell the completed properties to third parties. Do we need to charge VAT on the sale?

[Note for candidates – you are not required to discuss direct tax matters in relation to the conversion and sale of the milking parlour]

As part of our plans, we will also dispose of most of a field, which will not be needed for grazing horses, to a neighbouring farm for £80,000, whilst retaining a strip of this land to create a new entrance road to the farm. The market value of the land to be retained is £10,000. We bought this field in 1998 for £36,000, and immediately let it for a period of four years, charging VAT on the lease. However, we are unsure whether we ever notified the VAT office of an option to tax over this field (we have certainly never made an option to tax over the farm as a whole). We assume that we need to charge VAT again on the sale. Could you advise here please?

3) Anaerobic digester unit

We are hopeful of obtaining grant funding to set up an anaerobic digester unit. Anaerobic digestion involves harnessing gas released from rotting waste in a controlled environment without oxygen. The gas released (known as biogas) can be used as a fuel source for heating and/or electricity production. Anaerobic digester plants can also use energy crops or wood waste. The opportunity is therefore to power and heat the farm buildings and to sell surplus electricity to the National Grid.

Continued

5. Continuation

We may put a small area of land over to pasture for growing energy crops such as maize for use in the digester unit, whilst arranging to receive slurry and other waste products from local farms. We could start as soon as we receive approval from the local planning office. However, it has been suggested that we understand the implications of a tax called Climate Change Levy. Can you advise?

[Note for candidates – in relation to the anaerobic digester unit, you are ONLY required to consider Climate Change Levy]

To summarise the changes being proposed:

<u>Existing partnership activities</u>	<u>New partnership activities</u>
Farm shop	Farm shop
Grazing / Stabling <i>(Both activities to be transferred)</i>	Grazing / Stabling
Dairy farming – <i>to cease</i>	Riding school
Milking parlour: convert to houses and sell surplus land <i>(Activity to be carried out by existing partnership until VAT deregistration)</i>	Anaerobic digester unit

I look forward to hearing from you.

Kind regards

Linda

EXHIBIT B

Letter from HM Revenue & Customs

Rory and Linda Morris, trading as
Hays Head Farm
Fulverton
Somerset
FN11 4QP

HM Revenue & Customs

21 April 2017

Dear Sirs

Hays Head Farm – VAT visit
VAT Number: 123 4546 78

We have been reviewing the latest partnership VAT returns in conjunction with recent anonymous visits to the Hays Head Farm Shop by officers of HM Revenue & Customs.

Whilst attending the farm shop we were not aware that any VAT invoices were available for customers, notwithstanding that certain items on sale were clearly liable to VAT. Further, we noticed that the farm provides grazing and stabling for horses, and during the visit we observed that calls were made to the vet to attend to a sick horse.

Continued

5. Continuation

We need to ensure that VAT is correctly charged on all items where appropriate. We would like to hear your comments within 21 days, in advance of a possible formal VAT visit.

Finally, we note that you do not make use of the farmers' flat rate scheme, and we wonder whether this is something you may wish to consider in conjunction with your advisers?

Yours faithfully

EXHIBIT C

Information extracted from the client file of Hays Head Farm

The partners are Rory and Linda Morris who trade as Hays Head Farm. Trading and capital profits and losses are shared equally and they have an equal interest in assets. All farm land is within the partnership.

The partnership draws up accounts to 5 April each year. It currently expects to make a small profit for the year ended 5 April 2017, but not enough to be sustainable. At 6 April 2017, each partner has capital losses brought forward from previous years of £10,000, but has no trading losses brought forward.

The partnership land and buildings (excluding the milking parlour and adjoining field) were acquired in 1992 for £500,000 and revalued in April 2017 at £1,200,000. Goodwill is not recorded in the partnership accounts. The farm house is for residential use only (except for the office used for farm correspondence) and has always been excluded from the assets of the partnership.

Rory and Linda have no other significant sources of income and partnership profits are such that they are basic rate taxpayers.

The partnership VAT returns have stagger dates in line with calendar quarters. The files have no record of an option to tax over any area of the farm. The dairy buildings were replaced in April 2009 at a cost of £350,000 excluding VAT at 15%.