Chartered Institute of Taxation
Excellence in Taxation

The Chartered Tax Adviser Examination

May 2018

Taxation of Major Corporates

Suggested Solutions

1. GOSLING LTD

Capital allowance calculation for the year ended 31 December 2017

	General pool	Special rate pool	Short life assets	Energy-saving assets	Explanation
	£	£	£	£	
TWDV at 1 January 2017	73,295,000	12,512,000	221,000	-	
Additions:					
Ceiling improvements	-	-	-	-	Non-qualifying as classed as a “building”
Thermal insulation	-	600,000	-	-	Special rate expenditure per s.104A CAA 2001
Air conditioning equipment	-	-	-	732,000	Energy-saving P&M per s.45A CAA 2001
Distillation equipment	1,834,000	-	-	-	Note 1
Computers and accessories	1,135,000	-	-	-	Note 2
Disposal proceeds (restricted to original cost)	(650,000)	-	-	-	
AIA	-	(166,667)	-	-	Notes 3 and 4
	75,614,000	12,945,333	221,000	732,000	
Balancing allowance	-	-	(165,750)	-	Note 5
WDA at 18%	(13,610,520)	-	(9,945)	-	Note 6
WDA at 8%	-	(1,035,627)	-	-	
FYA at 100%	-	-	-	(732,000)	
TWDV at 31 December 2017	62,003,480	11,909,706	45,305	-	

Capital allowance calculation for the period ended 30 April 2018

	General pool	Special rate pool	Short life assets	Explanation
	£	£	£	
TWDV at 1 January 2018	62,003,480	11,909,706	45,305	
Additions:				
Lifts	-	175,000	-	Integral feature per s.33A CAA 2001
	62,003,480	12,084,706	45,305	
WDA at 18%	(3,720,209)	-	(2,718)	Prorated WDA of 18% x 4/12 = 6%
WDA at 8%	-	(322,259)	-	Prorated WDA of 8% x 4/12 = 2.67%
TWDV at 30 April 2018	58,283,271	11,762,447	42,587	

Notes: Explanations and workings

1. Even though payment was not made until after the period end, there was an unconditional obligation to pay on delivery and so the capital expenditure can be included in the period that the unconditional obligation to pay arose.
2. Note that short life asset elections could have been made in respect of the new computers. However, the elections would not have affected the closing deferred tax balance.
3. The annual investment allowance (AIA) is only available for the period from 1 January 2017 to 31 October 2017. The maximum allowance is therefore £200,000 x 10/12 = £166,667.
4. The AIA has been allocated against the special rate expenditure to maximise the capital allowance claim.
5. A balancing allowance will be available on the computers that were scrapped. The total balancing allowance is £221,000 x 150/200 = £165,750.
6. The computers that were not scrapped receive a normal writing down allowance. This allowance is (£221,000 - £165,750) x 18% = £9,945.

Deferred tax calculation

Tax base – the tax written down value of the qualifying assets:

	At 31 December 2016	At 30 April 2018
	£	£
General pool	73,295,000	58,283,271
Special rate pool	12,512,000	11,762,447
Short life assets	221,000	42,587
	£86,028,000	£70,088,305

Carrying value – the value that the qualifying assets are held at in the accounts:

	At 31 December 2016	At 30 April 2018
	£	£
Plant and machinery	66,780,000	54,521,000
IT equipment	9,025,000	8,330,000
Thermal insulation (£600,000 less depreciation charge of £600,000 x 10%)	-	540,000
	£75,805,000	£63,391,000

Deferred tax asset at 30 April 2018:

	At 31 December 2016	At 30 April 2018
	£	£
Tax written down value	86,028,000	70,088,305
(Qualifying net book value)	(75,805,000)	(63,391,000)
Deductible temporary difference	10,223,000	6,697,305
Deferred tax asset at 19%	1,942,370	1,272,488
Less deferred tax asset at 31 December 2016		(1,942,370)
Decrease in deferred tax asset		(669,882)

MARKING GUIDE

TOPIC	MARKS
Year ended 31 December 2017	
- Roof is non-qualifying as classed as a “building” per s.21 CAA 2001	0.5
- Thermal insulation is special rate expenditure per s.104A CAA 2001	0.5
- Air conditioning equipment is eligible for 100% first year allowance as an item of energy-saving plant or machinery per s.45A CAA 2001	0.5
- Distillation equipment qualifies for the general pool. Allowances available in y/e 31 December 2017 because the unconditional obligation to pay arose during the period.	1
- Computers and accessories go into general pool	0.5
- Disposal proceeds restricted to original cost and allocated against general pool	1
- Annual investment allowance pro-rated for 10 months	1
- Annual investment allowance allocated against special rate pool to maximise allowances	0.5
- Calculation of short life asset balancing allowance and WDA at appropriate rate	1
- Calculation of other WDAs at appropriate rates (18%, 8%, 100%)	1.5
Period ended 30 April 2018	
- Lifts are integral features per s.33A CAA 2001	0.5
- WDAs prorated for 4 months	1
Deferred tax calculation	
- Calculation of opening and closing carrying value of qualifying assets (including calculation of closing carrying value of thermal features)	2
- Calculation of opening and closing tax base of qualifying assets	2
- Calculation of opening and closing deferred tax asset at 19%	1
- Calculation of movement in deferred tax in the period	0.5
TOTAL	**15**

2. THE BARLEY GROUP

Preparation for the disposal of shareholding in Sweetcorn Ltd

The group, excluding Wheat Ltd, forms a chargeable gains group with Barley plc as the principal company.

The effect of the chargeable gains group is that both the transfer of business premises from Granola Ltd to Sweetcorn Ltd and the transfer of shares in Soya Ltd from Sweetcorn Ltd to Barley plc will be treated as occurring on a “nil gain nil loss” basis for tax purposes. Therefore, no chargeable gains or losses will arise on the transfers.

However, as Sweetcorn Ltd will be sold, and hence leave the capital gains group, within six years of the transfer of business premises, a degrouping charge will arise in Sweetcorn Ltd. The degrouping charge will be equal to the chargeable gain that would have arisen on the intergroup transfer, i.e. £3.5 million.

Stamp duty land tax (SDLT) will be chargeable on the transfer of the building. Group relief is not available because, at the time of the transfer, arrangements are in place to dispose of Sweetcorn Ltd, the recipient of the transfer. The SDLT payable will be as follows:

	£
£125,000 x 0%	0
(£250,000 - £125,000) x 2%	2,0
(£11,000,000 - £250,000) x 5%	537,500
SDLT payable	539,500

This will be payable by Sweetcorn Ltd.

No stamp duty will be chargeable on the transfer of the shares in Soya Ltd as beneficial interest is being transferred to an associated company and at the time of the transfer there are no arrangements for a non-associated person to acquire control of either Barley plc or Soya Ltd.

Substantial shareholdings exemption (SSE)

The conditions to be met for SSE to apply to the disposals are as follows:

a) the investing company must have held at least 10% of the ordinary share capital of the investee company for a continuous period of at least 12 months in the preceding two years;
b) the investing company must be a sole trading company or a member of a trading group for the same period and immediately after the sale; and
c) the investee company must be a qualifying trading company or a qualifying holding company of a trading group for the same period and immediately after the sale.

If the conditions are met, then any chargeable gain is exempt from Corporation Tax and any capital loss is not allowable.

As the non-trading activities of Barley plc and Muesli GmbH do not constitute a substantial amount of non-trading activity for the group as a whole, Barley plc meets condition b) in respect of all disposals.

Disposal of shareholding in Sweetcorn Ltd

This disposal should qualify for SSE, as:

a) Barley plc has held at least 10% of Sweetcorn Ltd for more than a year;
b) Sweetcorn Ltd is a trading company.

This not only means that no chargeable gain will arise on disposal of the shareholding, but also that the degrouping charge arising from the transfer of business premises will be exempt from tax.

<u>Disposal of shareholding in Rye Ltd</u>

This disposal will not qualify for SSE as Barley plc has not held the shares for a continuous period of at least 12 months. However, as Barley plc is exchanging shares in Rye Ltd for shares in Clementine Ltd, and Clementine Ltd would be acquiring more than 25% of the ordinary share capital of Rye Ltd, "share for share" relief is available. Barley plc will be treated as having made neither a disposal nor an acquisition and so no chargeable gain will arise. Instead, for chargeable gains purposes, the new shares (i.e. the shares in Clementine Ltd) will "stand in the shoes" of the old shares (i.e. the shares in Rye Ltd). This means the gain that would have arisen on disposal of the old shares is effectively rolled into the base cost of the new shares.

The acquisition of shares in Clementine Ltd will be liable to a Stamp Duty charge of £7 million x 0.5% = £35,000, payable by Barley plc.

<u>Disposal of shareholding in Muesli GmbH</u>

This disposal will not qualify for SSE as Muesli GmbH is not a qualifying trading company or qualifying holding company of a trading group.

The sales proceeds include an element of contingent but ascertainable consideration. As a result, Barley plc will be taxed upfront on the full £8 million proceeds, resulting in a chargeable gain of £7.5 million.

If Muesli GmbH does not commence trading by the end of the five-year period, Barley plc will be able to make a claim to have the gain recalculated using actual proceeds received of £6 million.

<u>Disposal of shareholding in Wheat Ltd</u>

This disposal will not qualify for SSE as Barley plc does not hold at least 10% of the ordinary share capital of Wheat Ltd.

The sales proceeds include an element of contingent and unascertainable consideration. The value of this right to receive future contingent consideration must be estimated and will be taxed upfront with the £9 million proceeds. There will therefore be a chargeable gain equal to £3 million plus the value of the right.

The onus will be on Barley plc to provide a valuation of the right. However, the valuation may be agreed with HM Revenue & Customs after the disposal has taken place in order to obtain certainty over the transaction.

When the contingent consideration is received, this is treated as a disposal of the right. There will therefore be a further chargeable gain calculation in the period in which the contingent consideration is received, based on the difference between the original value of the contingent element and the actual amount that is eventually received.

MARKING GUIDE

TOPIC	MARKS
Preparation for disposal of Sweetcorn Ltd	
- The group, excluding Wheat Ltd, forms a chargeable gains group.	0.5
- Transfers of business premises and shares done on “nil gain nil loss” basis	1
- Degrouping charge arises on business premises as Sweetcorn Ltd leaves group within six years of transfer	1
- Calculation of degrouping charge	0.5
- SDLT due on transfer as group relief not available, with explanation	1
- Calculation of SDLT	1
- No Stamp Duty payable on transfer of shares, with explanation	1
Substantial shareholdings exemption (*)	
- Conditions required for SSE to apply	2
- Investing company trading requirement met by the group for all disposals	0.5
- Effect of SSE if conditions are met	0.5
Disposal of shareholding in Sweetcorn Ltd	
- Disposal of Sweetcorn Ltd covered by SSE, with explanation	1
- Degrouping charge exempt from tax as SSE applies to the disposal	0.5
Disposal of shareholding in Rye Ltd	
- Disposal will not qualify for SSE	0.5
- “Share for share” relief available, with explanation	1
- No chargeable gain and new shares “stand in the shoes” of old shares	1
- Calculation of Stamp Duty charge on acquisition of Clementine Ltd shares	1
Disposal of shareholding in Muesli GmbH	
- Disposal will not qualify for SSE	0.5
- Contingent but ascertainable consideration must be included in upfront gain calculation	0.5
- Calculation of chargeable gain	0.5
- Future claim available if Muesli GmbH does not commence trading	1
Disposal of shareholding in Wheat Ltd	
- Disposal will not qualify for SSE	0.5
- Value of right to receive contingent and unascertainable consideration must be estimated and taxed upfront	1
- Valuation may be agreed with HMRC after disposal has taken place	0.5
- Calculation of chargeable gain	0.5
- Second chargeable gain calculation will arise in period in which contingent consideration is received	1
TOTAL	**20**

(*) The model answer is in line with the scope of the syllabus. However, credit will be given for answers in accordance with the new rules that are effective at the time of the exam.

3. CRAWL LTD

Our address

Your address

X May 2018

Dear Emma

I set out below the Corporation Tax consequences of the proposed cessation of trade and liquidation of Crawl Ltd.

Cessation of trade

Cessation of trade causes an accounting period to end on the last day of trading, and a new period to commence the following day. A caveat to this is that if Crawl Ltd is already in liquidation when it ceases to trade, the cessation of trade will not cause an accounting period to end.

All plant and machinery and inventory owned by Crawl Ltd is deemed to be sold at market value on the last day of trading, regardless of the actual date of transfer. The deemed disposal of plant and machinery will result in capital allowance balancing adjustments.

Post-cessation expenses are allowable if they would have been deductible as a trading expense had Crawl Ltd continued to trade. However, such expenses cannot be group relieved and can only be offset against post-cessation receipts, which are rare. It may therefore be difficult to obtain relief for these expenses. Expenses relating to the cessation are disallowed, except for statutory redundancy payments plus any non-statutory redundancy payments up to three times the gross statutory redundancy payment.

Liquidation

The appointment of a liquidator will cause an accounting period to end on the day before the appointment, and a new period to commence on the day of appointment. As the liquidation is only expected to last nine months, this new period would therefore be the final accounting period of the company.

The liquidator will become responsible for fulfilling Crawl Ltd's Corporation Tax obligations, such as the filing of returns and payment of tax.

The appointment of the liquidator will cause Crawl Ltd to lose beneficial ownership of its assets. One effect of this is to break the group relief group between Crawl Ltd and Butterfly Ltd. This would mean the losses generated by Butterfly Ltd would not be able to be surrendered to other Paddle group companies. Once the shares have been transferred to Splashing Ltd, however, group relief can operate as before.

The liquidator's fees will be allowable, either as a trading expenses or a post-cessation expense, but any other costs associated with winding up the company are unlikely to be tax-deductible.

Other points arising from the step plan

The disposal of the land and buildings will crystallise a chargeable gain of £10 million less indexation allowance. This gain can be offset by current period trading losses but not by post-cessation expenses.

The transfer of the shareholding to Splashing Ltd will be done on a "nil gain nil loss" basis as the two companies are in the same capital gains group, even during liquidation.

Any expense arising from the write-off of trade receivables will be allowable as a trading expense or a post-cessation expense, as appropriate.

There should be no Corporation Tax consequences on Crawl Ltd of settling trade payables or paying up a distribution.

Recommendations

If it is legal and practicable, Crawl Ltd should continue to trade until after liquidation has commenced. This would prevent the subsequent cessation of trade from ending an accounting period. The main benefits of this are that the trading losses arising in the post-liquidation period can be used to reduce or eliminate the chargeable gain on sale of land and buildings, and any excess trading losses in the post-liquidation period can be group relieved to the Paddle group.

If for whatever reason it is not possible for Crawl Ltd to continue trading until after liquidation has commenced, I would recommend ensuring now that provisions are made (in accordance with relevant accounting standards) for any expenses that are expected to arise during liquidation, e.g. the liquidator's fees and any trade receivable impairments. This will reduce the amount of post-cessation expenses arising.

I would also recommend that the transfer of the shares in Butterfly Ltd is done as soon as possible after liquidation has commenced, to reduce the group relief restriction caused by the liquidation. You may wish to transfer the shares before the appointment of the liquidator to avoid the restriction completely.

I trust the above helps. Please contact me if you have any further queries.

Yours sincerely
Tax Adviser

MARKING GUIDE

TOPIC	MARKS
Cessation of trade	
- Cessation causes an accounting period to end	0.5
- Rule doesn’t apply if company is already in liquidation	0.5
- Plant and machinery and inventory deemed to be sold at market value on last day of trading, CA balancing adjustments arise	1.5
- Relevant comments relating to post-cessation expenses and receipts (0.5 for each)	1.5
Liquidation	
- Appointment causes accounting period to end, and final accounting period will end at end of liquidation	1
- Crawl Ltd loses beneficial ownership of assets	0.5
- Group relief group broken – Butterfly Ltd losses cannot be surrendered	1
- Liquidator’s fees allowable, but costs associated with winding up not allowable	1
Other step plan points	
- Disposal of land and buildings crystallises £10m chargeable gain, offset by trading losses but not post-cessation expenses	1
- Capital gains group not broken, so transfer of shareholding done at “nil gain nil loss”	1
- Treatment of bad debt expenses	0.5
- No Corporation Tax consequences on Crawl of other steps	0.5
Recommendations	
- Continue to trade until after liquidator appointed, with explanation of benefits	1.5
- If can’t continue to trade, ensure provisions are made for potential post-cessation expenses, with explanation of benefit	1
- Transfer Butterfly Ltd shares as soon as possible to reduce/avoid group relief restriction	1
Presentation and higher skills	1
TOTAL	**15**

4. THETA PLC GROUP

Briefing note

Co-op financing structure

1) Alpha 1 Ltd / Alpha 2 Ltd

- These are UK resident companies, subject to Corporation Tax on their worldwide profits.

- For UK tax purposes, Alpha Co-op is treated as a partnership. Where a company is a partner, the partnership profits should be calculated as if the corporate partner had undertaken the activities of the partnership itself. As a result, Alpha 1 Ltd and Alpha 2 Ltd will be taxed on their respective share of the profits of Alpha Co-op.

- The bank loan represents a loan relationship for the corporate partner, as it is a money debt that has arisen from a transaction for the lending of money.

- Each of Alpha 1 Ltd and Alpha 2 Ltd will therefore obtain relief for their respective share of the interest payable and any other losses or expenses in respect of the loan in line with the amounts recognised to the partnership's income statement. These will be a non-trading loan relationship debits and can be deducted against any taxable profits arising in the same period, carried back against non-trade loan relationship profits of the previous year, carried forward against future non-trading profits or surrendered as group relief to other UK group companies.

- Any dividends received by Alpha Co-op from Alpha BV will be exempt income given that it is in respect of ordinary shares.

2) Controlled Foreign Companies (CFC) rules

Alpha Co-op

- For UK tax purposes, Alpha Co-op is not considered to be a company and so it cannot be a CFC.

Alpha BV

- Alpha BV is a foreign company that is controlled by UK persons (Alpha 1 Ltd and Alpha 2 Ltd acting together in partnership) and so it will be considered to be a CFC.

- It is necessary to consider whether Alpha BV is covered by an exemption.

- The Excluded Territories Exemption may apply as Netherlands is on the list of excluded territories. However, this exemption is not available where the company is involved in an arrangement, the main purpose of which is to obtain a tax advantage. On this basis, it is possible that the exemption would not apply.

- The other exemptions will not be relevant:

    - Exempt period exemption – not relevant as not a newly acquired company.
    - Low profits exemption – not available as profits are more than £50,000.
    - Low profit margin exemption – not available assuming profits are more than 10% of relevant operating expenditure.
    - Tax exemption – not available as local tax paid is less than 75% of the corresponding UK tax.

- On the basis that none of the exemptions apply, the gateway tests need to be considered.

- The interest income on the loan receivable will fall under the non-trading financial profits gateway given the funds originated from the UK and were contributed to Alpha BV (the funds originated from Alpha 1 Ltd and Alpha 2 Ltd acting together in partnership).

- Alpha BV may claim the ‘Finance Company Partial Exemption’ so to exempt 75% of the profits from qualifying loan relationships.

- A ‘qualifying loan relationship’ is a loan relationship where the CFC is the creditor and the ultimate debtor is another group company that is not UK resident. As such, the profits on the loan, which ultimately goes to the group’s French subsidiaries, should be able to be reduced in this way. In addition, the CFC must have businesses premises in the territory in which it is resident.

- It can therefore be expected that 25% of the interest on the loan made by Alpha BV may be subject to a CFC apportionment, 12.5% to each of Alpha 1 Ltd and Alpha 2 Ltd.

- The CFC apportionment cannot be offset by the non-trading loan relationship debits arising on the interest payments made by Alpha 1 Ltd and Alpha 2 Ltd. However, relief will be available against the CFC tax for any corporate tax paid by Alpha BV on its interest income.

<u>3) Potential challenges</u>

Unallowable purpose (s.441 CTA 2009)

- An unallowable purpose is where the loan has no business or other commercial purpose. This includes where one of the main purposes of entering into a loan is tax avoidance. HM Revenue & Customs (HMRC) may argue that one of the main purposes of Alpha 1 Ltd and Alpha 2 Ltd borrowing from the bank through Alpha Co-op is to obtain a UK tax advantage. Any debits attributable to the unallowable purpose would be restricted.

- It would be important to establish the commercial purposes for why the companies borrowed the funds and invested in Alpha BV. Where the tax advantage is mere ‘icing on the cake’ – an incidental benefit to the commercial purpose – then the rule would not be invoked. We should review the documentation to provide support for the reasons for the structure.

Hybrid mismatch rules (Part 6A TIOPA 2010)

- HMRC may argue that the hybrid mismatch rules should apply. These rules came into effect on 1 January 2017 and, amongst other cases, would restrict deduction in the UK on a financial instrument where relief is also obtained in another jurisdiction.

- These rules apply to counter the effect of a ‘double deduction’ or a ‘deduction / non-inclusion’ mismatch. The rules are limited to specific circumstances, but in this case the structure would fall into the hybrid entity category. This is because Alpha Co-op is treated as a taxable person in the Netherlands and tax-transparent in the UK.

- The hybrid mismatch rules apply regardless of the purpose of the arrangement and therefore it is difficult to see why this would not restrict the whole of the relief claimed in the UK.

Residence

- HMRC may look to examine the residency of Alpha BV. For example, if the management of the company is in the UK then it will be subject to UK Corporation Tax on the whole of the interest income. This would be reduced by any double tax relief for tax suffered in the Netherlands, although this is anticipated to be minimal.

- Determining the residency depends on a close examination of the facts. It would be important to show the directors of Alpha BV were undertaking control of the company in the Netherlands, and key decisions were not being made in the UK. It would be necessary to consider ‘central management and control’ for determining UK residence. However, if it is resident in both the UK and Netherlands, the tax treaty uses ‘effective management and control’ as the tie-breaker test.

MARKING GUIDE

TOPIC	MARKS	
Alpha 1 Ltd / Alpha 2 Ltd		
- UK companies taxable on their worldwide profits.	1	
- Each company has a share of the gross debits and credits	2	
- Loan relationship definition	1	
- Non-trading loan relationship debits (*)	1	
- Dividends exempt	1	
		6
CFC		
- CFC Definition	1	
- Alpha Co-op not a CFC / Alpha BV is a CFC	1	
- No charge if exemption applies	0.5	
- Exemptions	2	
- Need to consider if profits fall into one of the gateways	0.5	
- Non-trading financial profits gateway	1	
- Finance Company Partial Exemption	1	
- Chargeable profits to companies with 25%+ holdings	1	
		8
Potential challenges (**)		
- Unallowable purpose	2	
- Anti-hybrid rules	2	
- Residency	2	
		6
TOTAL		**20**

(*) The model answer is in line with the scope of the syllabus. However, credit will be given for answers in accordance with the new rules that are effective at the time of the exam.

(**) Credit will be given for other potential challenges that could apply, for example outlining the potential transfer pricing issues with the structure.

5. FARADAY PLC

Faraday plc

		£
Taxable profits		
UK property income		2,000,000
Chargeable gain	(2)	4,238,800
Non-trading profits on IFAs	(3)	4,000,000
Management expenses		(90,000)
Taxable profits before group relief		10,148,800
Group relief		(10,148,800)
Taxable total profits		-

Notes

1) This is an investment company. It can obtain relief for ongoing costs related to its investment business as management expenses.

2) The gain on disposal of property is taxed as a chargeable gain. This is calculated as:

	£
Gross proceeds	12,000,000
Less disposal costs	(220,000)
Net proceeds	11,780,000
Cost	(3,400,000)
Indexation (1.218 x £3,400,000)	(4,141,200)
Chargeable gain	4,238,800

Indexation factor = (269.3 – 121.4)/121.4 = 1.218

3) The patent income does not qualify for the patent box. Faraday plc does not appear to undertake any active ownership of the IP and therefore the company does not satisfy the active ownership condition. The income is taxed as arising from a non-trading intangible fixed asset.

Faraday Consulting Ltd

	Notes	UK £	Ireland £	Total £
Profit before tax		8,460,000	930,000	9,390,000
Adjustments				
Bonuses – 2017	(2)	2,500,000	1,000,000	3,500,000
Bonuses – 2016	(2)	(1,200,000)	(800,000)	(2,000,000)
Lease premium adjustment	(3)	36,000		36,000
Restrict car rental	(5)	750		750
Disallow fine	(8)	20,000		20,000
Disallow client entertainment	(9)	450,000	280,000	730,000
Add back charitable donation	(10)	100,000		100,000
Reapportion interest	(11)	154,930	(154,930)	-
Trading profits		10,521,680	1,255,070	11,776,750
Qualifying charitable donation	(10)	(100,000)		
Group relief	(14)	(10,421,680)	(571,310)	(11,092,989)
Taxable total profits		-	683,761	683,761
Corporation Tax at 19.5%		-	133,333	133,333
Double tax relief	(13)		(133,333)	(133,333)
Corporation Tax liability		-	-	-

Notes

1) The company is a trading company with a foreign permanent establishment in Ireland.

2) Bonuses are paid more than nine months after period end, and are therefore deductible when paid.

3) Capital element of lease premium is £2,000,000 x 2% x (10-1) = £360,000
Revenue element of the lease premium is £2,000,000 - £360,000 = £1,640,000.
Deduction for the year is therefore limited to £1,640,000 / 10 = £164,000.

4) The computer equipment finance lease is not a long funding lease because it is for less than five years. Therefore, no adjustment is required because tax relief is given by way of allowing the depreciation and finance costs that are expensed through the income statement. No capital allowances are available.

5) Car leasing rentals should be restricted to 85% of the rental cost where CO_2 exceeds 130g/km for leases entered into on or after 1 April 2013. Therefore a restriction of £750 (£5,000 x 15%) applies.

6) Tax relief for bad debts is available in line with the impairment loss recognised under generally accepted accounting practice (GAAP).

7) All employee-related costs should be deductible as being wholly and exclusively for the purposes of the trade. This will include travel costs for the employee's family.

8) The fine for the breach of health and safety rules is non-deductible.

9) Client entertainment must be disallowed but not staff entertainment costs.

10) Relief is available as a qualifying charitable donation. The qualifying charitable donation can be allocated in the most preferential way. Therefore none of this is allocated to the Irish office.

11) Bank interest is deductible as a trading expense as the loan relationship is taken out for the purposes of the bank's trade.

In determining this amount, expenses of the trade should be attributed to the permanent establishment on a just and reasonable basis. In particular, some of the bank interest should be deducted in calculating the profits of the branch. This has been done on the basis of staff costs (being the costs that the working capital is funding).

	UK	**Ireland**	**Total**
osts	),000,000	,500,000	5,500,000
tage	84.5%	15.5%	100%
nterest	845,070	154,930	,000,000

12) The exchange gain arising on the retranslation of part of the company's business recognised in other comprehensive income is not taxable.

13) Double tax relief is available for foreign tax suffered on profits of a permanent establishment. Relief is based on the actual tax suffered, and this should be translated into sterling at the transaction date. Therefore foreign tax suffered is £133,333 (€140,000/1.05).

Double tax relief is limited to the amount of UK Corporation Tax that arises on the corresponding profits in respect of which foreign tax has been suffered.

14) Group relief should be limited so as to leave £683,761 of taxable profits, so that the credit relief for the foreign tax is not wasted. (£683,761 = £133,333 / 19.5%)

MARKING GUIDE

TOPIC	MARKS	
Faraday plc:		
- Investment co / management expense	1	
- Property business	1	
- Intangible fixed asset	1	
- Patent box	1	
- Gain on disposal of property lease	1	
		5
Faraday Consulting Ltd:		
- Bonuses	1	
- Lease premium	1	
- Equipment - finance lease	1	
- Leased car restriction	1	
- Bad debts	1	
- Family travel costs – no restriction in relief	1	
- Health and safety fine (*HMRC v McLaren Racing Ltd* [2014] UKUT 0269)	1	
- Client entertainment	1	
- QCD	1	
- Bank interest – trading deduction	1	
- Forex gain in OCI	1	
		11
Calculation of CT Liability / CT Rate	1	1
DTR / Group relief		
- Credit relief	1	
- Restricted to UK tax (lower of test)	1	
- Calculation of group relief	1	
		3
TOTAL		**20**

6. BIKES PLC

To: **K.Muray@bikesplc.com**
From: **C.Green@taxadvisers**
Date: **X May 2018**
Subject: **Employee share plans**

Thank you for your email asking for advice on the Corporate Tax treatment of the proposed share plans.

(1) Share options

There are special rules governing the tax relief for share options. It does not matter whether the share options are under a tax-advantaged scheme, such as the Company Share Option Plan (CSOP), as long as the necessary conditions are satisfied.

The effects of these rules are as follows:

- The expense recognised in the accounts for the share option is added back in the tax computations.
- Instead, tax relief is available at the time an option is exercised. The amount of relief is the market value of the shares at the time the option is exercised less the exercise price (and any other consideration given by the employee).
- No relief is available where the share options lapse without being exercised.

To qualify for relief each of the following conditions must be met in relation to the shares acquired:

1) The shares must be ordinary shares that are fully paid-up and not redeemable.

2) The shares must be:
    a) shares of a class listed on a recognised stock exchange,
    b) shares in a company that is not under the control of another company, or
    c) shares in a company that is under the control of a listed company.

3) The shares are shares:
    a) in the employing company,
    b) the parent of the employing company, or
    c) in a member of a consortium that owns or is in consortium with the employing company.

As things currently stand these conditions should be met as the group is not under the control of another company and the shares are in the parent company of the group.

Should the group become listed, the conditions will continue to be met assuming nothing else changes and no company obtains control of Bikes plc.

Should the group be taken over, there may be tax consequences if the conditions are no longer met, but note that the second condition is relaxed in the case of a takeover. Relief will still available where the second condition is satisfied immediately before the takeover, the share options are exercised within 90 days of the takeover, and the arrangement was not part of a tax avoidance scheme.

(2) **Share Incentive Plan (SIP)**

Separate rules apply in respect of an approved Share Incentive Plan. These state that:

- Tax relief is available for the cost of providing the free or matching shares, based on the market value of the shares available. The deduction is given in the period in which the shares are awarded to the employee.

- A deduction is also available where the shares purchased by employees ('partnership shares') based on the amount of any discount to market value given to the employees.

The company can also obtain tax relief for the costs of setting up and running the share plans.

I trust that helps with your understanding of the Corporation Tax treatment for the company.

Kind regards

Charlie

MARKING GUIDE

TOPIC	MARKS	
Share options:		
-	1	
- Disallow accounting charge	1	
- Relief on exercise / amount	1	
- No relief if not exercised	2	
- Criteria	1	
- Relaxation of criteria for takeover of the group	1	
- Application to Bikes plc		7
SIP:		
- Deduction for the free or matching shares	1	
- Deduction for partnership shares purchased at a discount	1	
		2
Deduction for the costs setting up and running the plan	1	1
TOTAL		**10**