THE CHARTERED INSTITUTE OF TAXATION

APPLICATION AND PROFESSIONAL SKILLS

Taxation of Larger Companies and Groups

TIME ALLOWED
3 HOURS 30 MINUTES

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

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

  You will be assessed for competence in a number of broad topics for the following skills:
  - Identification and Application
  - Relevant Advice and Substantiated Conclusions

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

- All workings should be shown and made to the nearest month and pound unless the question specifies otherwise.

- Candidates who answer any law elements in this paper in accordance with Scots law or Northern Ireland law should indicate this where relevant.

- Scots Law candidates may provide answers referring to Land and Buildings Transaction Tax rather than Stamp Duty Land Tax.

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

- You must type your answer in the space on the screen as indicated by the Exam4 guidance.

You are a tax manager at TaxBrand LLP, a firm of Chartered Tax Advisers. One of your long-standing clients is Burrey plc, the parent company of a large multinational group that operates in the power generation sector.

Your tax partner, Lorna Paddocks, has received an email (**EXHIBIT A**) from Trevor Shellings, the Head of Tax at Burrey plc, concerning the potential acquisition of Stormback Ltd, a company that has been doing research into fuel-efficient power generators.

Lorna has asked you to prepare a draft report for Trevor advising on the acquisition of Stormback Ltd.

The following exhibits are provided to assist you:

EXHIBIT A: Email from Trevor Shellings to Lorna Paddocks

EXHIBIT B: Notes of a meeting between Burrey plc and Stormback Ltd

EXHIBIT C: Pre-seen information

Requirement:

Prepare a draft report to Trevor Shellings, for review by Lorna Paddocks, which advises on the UK tax consequences of the acquisition of Stormback Ltd.

Continued

EXHIBIT A

Email from Trevor Shellings to Lorna Paddocks

To:	Lorna Paddocks
From:	Trevor Shellings
Date:	1 November 2020
Sensitivity:	Confidential
Subject:	Project Green: Acquisition of Stormback Ltd

Lorna

As part of an on-going review into reducing the environmental impact of our products, we have identified a company called Stormback Ltd that has been undertaking research into a highly fuel-efficient diesel power generator. The company completed a fully functioning prototype in March 2020. They have started receiving orders and have commenced production.

We believe that this generator could provide a great opportunity for us to expand into more environmentally-friendly power generators, and we are therefore considering acquiring the company. We have made contact with the directors to see whether there is interest in this as they are likely to require further funding soon, which may prove difficult to obtain. I have attached notes of a meeting held last week between our Head of Mergers and Acquisitions and Leslie Dry, one of the directors of Stormback Ltd (**EXHIBIT B**).

Due to the amount of tax losses in Stormback Ltd, which we anticipate being able to start utilising once the company becomes profitable, we are only considering a share acquisition of the company. We therefore do not require advice in respect of an acquisition of the trade and assets.

We would like your advice on whether the consideration for the acquisition should be in the form of cash, an issue of shares, or any sensible alternative. For negotiation purposes, it would be helpful for us to understand the potential tax consequences on the directors of Stormback Ltd of each form of consideration.

We are aware that the HMRC enquiry brings the accuracy of the previous tax returns into question, especially with regard to the R&D claim. We would like your advice on the likely impact of the enquiry and the acquisition on both the submitted tax returns and the forecast tax position for the year ended 31 March 2021.

As we do not have a R&D department, we would like to retain Alicia Addams and Ben Brittany, the two members of Stormback Ltd's R&D team whom we feel are key to the on-going development of the new generator. We would like advice on how to deal with their existing share options because although we would like to continue incentivising them, we do not want our holding of Stormback Ltd to dilute when the vesting period comes to an end.

Please let me know if you need any further details.

Regards

Trevor Shellings

Head of Tax
Burrey plc

Continued

Continuation

EXHIBIT B

Notes of a meeting between Burrey plc and Stormback Ltd

Attendees

Burrey plc: Kate Blackhurst, Head of M&A; Bob Ritchie, M&A Manager
Stormback Ltd: Leslie Dry, Director

Background

Stormback Ltd was incorporated in the UK in October 2016 and is UK-resident for tax purposes. All activities have been carried out in the UK. FRS 102 accounts are prepared annually to 31 March.

Stormback Ltd has an issued share capital of 15,000 ordinary shares of £1 each. The three directors (Leslie Dry, Kareena Smith and Alex Wheedon) each own 5,000 shares and have done so since incorporation.

The company was dormant until January 2017 when a £7 million bank loan was obtained, enabling it to commence R&D activities. The bank loan has an interest rate of 7% and remains outstanding.

Further finance was required and on 1 April 2019, Leslie made an interest-free loan of £800,000 to the company. The loan is repayable on 31 March 2022 and in accordance with FRS 102 was recorded on the balance sheet at a discounted value of £650,000.

The first full working prototype was completed on 1 March 2020, and orders for 200 generators have been received to date. No turnover was recognised in the accounts to 31 March 2020.

R&D expenditure charged to the income statement from incorporation up to 31 March 2020 comprised:

	£'000
Consumables	1,600
Wages and salaries	2,000
Externally provided workers	900
Work subcontracted to Buildz Ltd (an unconnected company)	1,500
Total	6,000

Employees

Employee numbers have gradually increased each year and there are now 18 full-time employees excluding the directors.

On 1 January 2018, unapproved share options were granted to Alicia Addams and Ben Brittany, two key employees in the R&D team. The options vest on the earlier of five years from grant and the date of the company listing on a UK stock exchange.

Corporation Tax

Company Tax returns for the years ended 31 March 2017, 31 March 2018 and 31 March 2019 and for the period ended 29 February 2020 showed a non-trading loan relationship deficit in respect of the interest payable on the bank loan.

Continued

The Company Tax return from commencement of trade on 1 March 2020 to 31 March 2020 showed a trading loss (before the R&D enhanced deduction but after other adjustments) of £7.5 million and was submitted on 30 June 2020 (together with the return for the period to 29 February 2020). In advance of submission of these returns, HMRC confirmed that the projects being undertaken by Stormback Ltd constituted R&D for tax purposes. Qualifying R&D expenditure of £6 million was shown (analysed out above), resulting in a R&D enhanced deduction of £7.8 million and a total trading loss of £15.3 million. No claim was made to receive a R&D tax credit.

The trading loss for the period to 31 March 2020 included a deduction for the interest payable on the bank loan and for the unwinding of the discount on the loan from Leslie, which have been treated as trading loan relationship debits since commencement of trade. The return also showed a brought forward non-trading loan relationship deficit of £1,597,500, being the cumulative interest payable on the bank loan and unwinding of the discount up to 29 February 2020.

On 15 October 2020, HMRC opened an enquiry into two aspects of the 31 March 2020 Company Tax return:

1) R&D expenditure: HMRC noted that there was no breakdown of R&D expenditure by type included in the return or in the accounts. They would therefore like to see this information covering all periods up to 31 March 2020.

2) Loans: HMRC have requested further details of the loans made to Stormback Ltd. They would like to check that the deductions being claimed are not caught by any anti-avoidance legislation.

Leslie stated that the accounts manager responsible for submitting the Company Tax returns left Stormback Ltd on 30 September 2020 and they have not hired a replacement yet.

Forecasts

Stormback Ltd expects to break even in the year ended 31 March 2021 and to have a turnover of £3 million.

Forecast R&D expenditure for the year ended 31 March 2021 is:

	£'000
Consumables	500
Wages and salaries	600
Externally provided workers	300
Work subcontracted to Buildz Ltd	500
Total	1,900

After taking account of the above R&D expenditure, the company is forecast to have a Corporation Tax loss of £2.5 million.

Consideration

It was agreed that the value of Stormback Ltd is around £20 million.

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Continuation

EXHIBIT C

Pre-seen information

Client Name: Burrey plc and subsidiaries

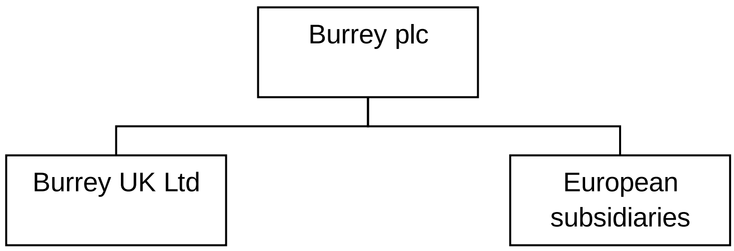
Background

The principal activity of the Burrey group is the manufacture and sale of power generators. It has activities in the UK and several other European countries.

Burrey plc was incorporated in 2006. It was the main trading entity in the UK until 2011 when the trade and assets were hived down into a new company, now called Burrey UK Ltd. The Burrey group has grown via the acquisition of smaller power generator manufacturing companies across Europe.

The shares of Burrey plc are listed on the London Stock Exchange. Its only source of income is dividend income from subsidiaries.

Summarised group structure:



All subsidiaries are wholly owned. Burrey plc and Burrey UK Ltd are incorporated and tax resident in the UK. All other companies in the group are incorporated and tax resident outside the UK.

UK VAT matters

Burrey UK Ltd is the representative member of a VAT group comprising itself and Burrey plc.

No options to tax have been made.

UK Corporation Tax matters

Accounts are made up to 31 March each year and all returns for periods up to 31 March 2020 have been submitted.

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

There was no interest restriction for the year ended 31 March 2020, although a relatively high level of borrowing means that there is currently very little capacity for further borrowing before some level of interest restriction would apply. The cash balance shown below is required for trading purposes.

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Continuation

Summarised financial information for Burrey plc

Consolidated income statement for the year ended 31 March:

	2020	2019
	£million	£million
Revenue	1,240	1,120
Cost of sales	(950)	(900)
Gross profit	290	220
Administrative expenses	(200)	(180)
Operating profit	90	40
Net financing costs	(20)	(15)
Profit before tax	70	25
Tax charge	(15)	(5)
Profit after tax	£55	£20

Consolidated statement of changes in equity:

	Retained earnings
	£million
Balance at 1 April 2018	540
Profit for the year	20
Re-measurement losses on pension assets and liabilities, net of tax	(30)
Share based payments, net of tax	10
Balance at 1 April 2019	540
Profit for the year	55
Re-measurement gains on pension assets and liabilities, net of tax	5
Share based payments, net of tax	(10)
Balance at 31 March 2020	£590

Consolidated balance sheet at 31 March:

	2020		2019	
	£million	£million	£million	£million
Property, plant and equipment	590		510	
Intangible assets	20		20	
Deferred tax asset	60		70	
Total non-current assets		670		600
Inventories	380		360	
Trade and other receivables	400		370	
Cash and cash equivalents	30		30	
Total current assets		810		760
Total assets		1,480		1,360
Financial liabilities	(350)		(280)	
Trade and other payables	(280)		(270)	
Provisions	(10)		(10)	
Total current liabilities		(640)		(560)
Pension scheme deficit		(250)		(260)
Total liabilities		(890)		(820)
Net assets		590		540
Called-up share capital		100		100
Share premium account		60		60
Retained earnings		430		380
Total equity		590		540