The Chartered Tax Adviser Examination

May 2019

Application and Professional Skills

Taxation of Larger Companies and Groups

TIME ALLOWED – 3 ¼ HOURS

- The first 15 minutes is designated as reading time. During this time you may read your question paper and legislation, annotate your question paper and use your calculator. You are not permitted to start writing your answer. The Presiding Officer will inform you when you can start writing.

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

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

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

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

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

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

- Candidates who answer any law elements in this paper in accordance with Scots law or Northern Ireland law should tick the appropriate box on the cover sheet.

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

- Unless otherwise indicated by the provision of additional table information, you may assume that 2018/19 rates and allowances continue to apply for 2019/20 and future years. Candidates referring to actual or pending rates and allowances for 2019/20 and future years will not be penalised.

You are James Johns, a tax senior at Little & Smith LLP, a firm of Chartered Accountants. Ormport Group plc is a long-standing tax compliance and advisory client of the firm.

Earlier this year, an opportunity arose for the Ormport Group to acquire a part-completed factory development in Stockerton in the north of England from North & West Estates Ltd, an unrelated local developer. Factory 19 Ltd, a wholly owned subsidiary of North & West Estates Ltd, is undertaking the development.

Ormport Group plc decided to investigate further the possible acquisition and accordingly, in April 2019, your firm undertook commercial and financial due diligence in respect of the development. Having considered the due diligence report, the Board has decided that the Ormport Group will acquire the development if commercial terms can be agreed with the vendor.

Your tax partner, Eleanor Street, has received a letter from Andy Brown, the Chief Financial Officer of Ormport Group plc, asking for tax advice on how best to undertake the acquisition and what to do with the development to optimise the after-tax position.

The following exhibits are provided to assist you:

EXHIBIT A: Letter from Andy Brown to Eleanor Street

EXHIBIT B: Extracts from the financial due diligence report on Factory 19 Ltd

EXHIBIT C: Extracts from the statutory accounts of Factory 19 Ltd for the period ended 31 December 2018

EXHIBIT D: Pre-seen information

Requirement:

Prepare a draft report to the Board, for review by Eleanor Street, advising on the acquisition of the factory development and what to do with it after its acquisition in order to optimise the after-tax position.

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Continuation

EXHIBIT A

Letter from Andy Brown to Eleanor Street

Ms E Street
Little & Smith LLP
Old Road
London

Ormport Group plc
New Street
Newtown

29 April 2019

Dear Eleanor

Development at Stockerton

At a meeting last week, the Board decided to proceed with the acquisition of the part-completed factory development, or the company that owns it (Factory 19 Ltd), if commercial terms can be agreed.

The purchase price will be met out of existing cash resources of Ormport Group plc, invested by way of share subscription into an Ormport company, that will then use the cash subscribed to:

1) buy the development itself, or

2) buy the shares in Factory 19 Ltd and repay the inter-company loan between Factory 19 Ltd and North & West Estates Ltd. The development would then be transferred to another group company since we would not wish to retain the development in Factory 19 Ltd.

We have received a report from external surveyors and valuers in which they advise that the open market value of the part-completed development is £9.3 million. We estimate that a further £4.7 million will need to be spent to bring the development to completion, of which £1 million would qualify for capital allowances as building fixtures.

There are three options available to the Ormport Group as to the future development of the part-completed factory development once purchased.

Option 1: Complete the development of the factory and then sell it on the open market. Once completed, the open market value of the freehold factory and land is estimated at £18 million.

Option 2: Dispose of the part-completed factory development for around £12.5 million in 12 months' time without undertaking any further work thereon. We believe there will be increased demand for industrial units in the area as a large automotive factory is due to open nearby next year, which should allow us to make a profit simply by holding the development.

Option 3: Complete the development of the factory as per Option 1 but instead of selling it, rent it out to tenants. Net rental income is estimated at £900,000 per annum.

Our overall objective is to maximise the post-tax profit from exploiting the factory development at Stockerton.

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Ignoring any profits that might be generated from the factory development, the group is forecasting a break-even result for the years ended 31 December 2019 and 31 December 2020.

Please produce a report, supported by calculations, that I can share with the Board, which advises:

1) whether to acquire the part-completed factory development or the shares of Factory 19 Ltd;

2) which of Options 1, 2 or 3 (set out above) we should pursue; and

3) which company should acquire the development.

I look forward to hearing from you.

Yours sincerely

Andy Brown
Chief Financial Officer

EXHIBIT B

Extracts from the financial due diligence report on Factory 19 Ltd

Background

North & West Estates Ltd and its subsidiaries carry on the business of developing properties, which are then retained for rental. One subsidiary, Factory 19 Ltd, is undertaking the development of a factory at Stockerton on land that it owns.

The Board of North & West Estates Ltd has recently decided to dispose of the part-completed factory development so that the group can concentrate on retail property development. It would consider either an asset sale of the factory development or a share sale of Factory 19 Ltd.

The purpose of this report is to review the financial position of Factory 19 Ltd to enable an informed decision to be made as to whether the shares in the company should be acquired or whether the factory development should be acquired.

In order to undertake our review, we were given full access to the accounting records of Factory 19 Ltd and held meetings with the directors of Factory 19 Ltd and of North & West Estates Ltd for the purposes of obtaining further information.

Financial Information

Statutory accounts have been prepared for the nine months ended 31 December 2018 (**EXHIBIT C**), which show that the company has negative net assets of £1,925 and that the value of the freehold property at cost was £5 million. Management accounts to 31 March 2019 were also provided to us.

In the course of our enquiries, we have established that:

1) Factory 19 Ltd has been financed by way of an inter-company loan from its parent company on arm's length terms;

2) the construction expenditure incurred to date does not include any expenditure on items, such as building fixtures, which would qualify for capital allowances;

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3) the company has no employees with all work being undertaken by third party subcontractors; and

4) the company is VAT registered but no VAT option to tax has been made on the land.

The key changes in the balance sheet to 31 March 2019 as reported in the management accounts are:

1) £1 million has been spent on construction costs since 31 December 2018;

2) the loan from North & West Estates Ltd has increased by £800,000; and

3) the amount due to subcontractors has increased by £200,000.

Subcontractors

We were unable to verify that the company has maintained adequate records to support its classification of workers as subcontractors and whether tax should be withheld from payments to subcontractors. The possibility therefore exists that insufficient tax has been withheld under PAYE or the Construction Industry Scheme, but quantification of the tax risk was outside the scope of our work.

Conclusion

Apart from our concern in relation to subcontractors, we are satisfied that the balance sheet of Factory 19 Ltd at 31 December 2018 fairly states the company's assets and liabilities at that date, that the management accounts at 31 March 2019 fully reflect transactions undertaken since 31 December 2018, and that there are no material liabilities of Factory 19 Ltd other than those included in the management accounts at 31 March 2019.

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EXHIBIT C

Extracts from the statutory accounts of Factory 19 Ltd for the period ended 31 December 2018

Directors' report

The company was incorporated in 1 April 2018 and began to develop land at Stockerton on 10 April 2018.

Income Statement for period ended 31 December 2018

	£	Note
Turnover	–	
Cost of sales	–	
Gross profit	–	
Administrative expenses	(500)	
Interest paid	(4,000)	1
Interest received	2,000	
	(2,500)	2
Loss before taxation		
Tax on loss	475	
Loss after taxation	(2,025)	

Balance sheet at 31 December 2018

	£	Note
Fixed assets	5,000,000	3
Current assets	147,600	4
Corporation Tax	475	5
Creditors falling due within one year	(5,150,000)	6
Total net liabilities	(1,925)	
Share capital	100	
Reserves	(2,025)	
	(1,925)	

Notes to the accounts

1) Interest payable on inter-company loan.

2) Bank interest received.

3) Cost of the freehold land plus development costs incurred to date.

4) Cash at bank.

5) Amount receivable for losses surrendered as group relief.

6)

	£
Loan from parent company	4,550,000
Amounts owed to subcontractors	600,000
Total creditors falling due within one year	5,150,000

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Continuation

EXHIBIT D

Pre-seen information

Client Name: Ormport Group plc

Background

The Ormport Group is a property development and property investment group, founded in 1975 and listed on the London Stock Exchange in 1990. All group companies make up statutory accounts to 31 December each year.

In the past two years, it has been recovering from a number of commercial setbacks that it suffered in 2016. It has reported a negligible overall profit/loss for 2017 and 2018.

Ormport Group plc is the parent company of a group, comprising five wholly owned subsidiaries, to which it provides administrative support services. All companies in the group are UK resident.

Ormport Developments (No 1) Ltd

This company has carried on a trade of the development and maintenance of commercial office blocks. It incurred significant cost overruns on the construction of an office block for an insurance company, which resulted in a large trading loss in the accounting period to 31 December 2016. Since then, its only activity has been property maintenance. It has been owned by Ormport Group plc since 1975.

Ormport Developments (No 2) Ltd

This company carries on a trade of property development in the retail, office and industrial sectors. It incurred a trading loss in 2016 but has traded profitably as a property developer since then. It was renamed after it was acquired by Ormport Group plc on 30 June 2018.

Ormport (Land Holdings) Ltd

This company holds the group's land bank earmarked for future property development. In 2016, it suffered a loss on the value of a parcel of land in London, because of development restrictions imposed by the local council. It has been owned by Ormport Group plc since its incorporation in 1975.

Ormport Investments (North) Ltd

This company owns a large industrial estate on which industrial units have been let to tenants. The whole estate was vacated in 2016 when asbestos was discovered in the buildings and it is still unoccupied. Losses arose in 2016 and 2017 as a result of the reduction in revenues and the remedial and compensation costs. In late 2017, the company acquired a business park on which office accommodation is let to tenants. The company was acquired on 31 December 2018 by Ormport Group plc and renamed.

Ormport Investments (South) Ltd

This company owns a large out-of-town retail park on which retail units are let to retail company tenants. Its revenues and property values have reduced as retail companies have moved to the recently redeveloped city centre nearby, resulting in a loss in 2017. It has been owned by Ormport Group plc since its incorporation in 1975.

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VAT

There is a group registration in place covering all group companies.

Both Ormport Investments (North) Ltd and Ormport Investments (South) Ltd have opted to tax all of their properties.

Corporation Tax losses

The group companies have the following unutilised losses carried forward at 31 December 2018:

	Accounting period in which loss arose	Trading	UK Property trade
		£'000	£'000
Ormport Developments (No 1) Ltd	2016	(16,000)	
Ormport Developments (No 2) Ltd	2016	(1,000)	
Ormport (Land Holdings) Ltd	2016	(3,000)	
Ormport Investments (North) Ltd	2016		(6,000)
	2017		(2,000)
			Total (8,000)
Ormport Investments (South) Ltd	2017		(2,000)