Application and Professional Skills

Chartered Institute of Taxation
Excellence in Taxation

Taxation of Larger Companies and Groups

(Ensure this number matches your candidate number on your desk label and on your candidate attendance form)

BEL	Centre Code
0 9 0 5 2 0 1 9	Date of Examination

☐ Tick box if you have answered in accordance with Scots Law

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Instructions

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Please do all of the above before the end of the examination.

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Report

To: Board of Omport Group
From: James Johns, Little & Smith LLP
Subject: Factory 19
Date: 9 May 2019.

This report has been prepared for the Board of Omport Group plc to advise on the acquisition of Factory 19 from North & West Estates Ltd.

This report is intended solely for the use of the Board of Omport Group Plc and no responsibility will be accepted for any reliance placed on this report by third parties.

Background

Omport Group wish to acquire the Factory 19 property from North & West Estates Ltd either via direct purchase of the property itself or a purchase of the shares in Factory 19 Ltd. This report will provide a discussion on the implications of both methods of acquisition, a recommendation as to which group company should acquire the property and a recommendation of which option to pursue with the property.

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Executive Summary

I would recommend that Ornport Developments (No1) Ltd acquire Factory 19 itself and carry out the necessary expenditure to complete the development of the property. Then Ornport Developments (No1) Ltd should sell the property for £18 million. This is on the basis that the above transactions are commercially viable from the vendor perspective.

This will allow the Ornport Group to maximise the post-tax profit on the Factory 19 development and will also allow Ornport Developments (No1) Ltd to utilise brought forward trading losses.

I would not recommend acquiring the shares of Factory 19 Ltd, as I understand the Ornport Group is specifically interested in the factory alone. Acquiring the shares means acquiring the factory along with the 'baggage' of intercompany debt to be settled and possible issues with subcontractor payments. In addition, the post 1 April 2017 losses arising in Factory 19 Ltd will not be available to ~~surrender~~ surrender via group relief to the Ornport Group for a period of 5 years, as these will be deemed pre-entry losses. ~~[illegible]~~ Furthermore, there are losses available in the current Ornport Group

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Acquisition of the development Factory 19

Stamp Duty Land Tax (SDLT) is payable by the purchaser (Omport) on acquisition of property. SDLT is based on the actual consideration paid, which is assumed to be £9.3 million being the open market value of Factory 19. Please see Appendix 1 for the calculation of the SDLT payable which amounts to £454,500. This will be payable under all three options in regards to future plans of the Factory.

Factory 19 does not have an option to tax on it. This means that no VAT will be included in the purchase price for Factory 19.

The initial outlay payable (purchase price + SDLT) by Omport is £9,754,500.

Acquisition of shares in Factory 19 Ltd

I have analysed the most recent financial information available for February 19 Ltd. It would appear the company is in a poor liquidity position and therefore the value of the shares could be reasonably negotiated to be equal to the balance sheet value of the building - being £6 million. For the purposes of this report I have assumed this to be the purchase value.

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Stamp Duty is payable (0.5%) on the purchase consideration for shares, meaning Ompot would suffer £30,000 stamp duty tax on purchase of shares in Faebery Ltd.

I understand Ompot will repay the loan owed to North & West Estates Ltd should they purchase the shares. The loan amount at the date of purchase (based on most recent financial results to 31 March 2019) is likely to be £5,350,000. The initial outlay for purchasing the shares in Faebery 19 Ltd is (£6m + £5.35m + £30k) £11,380,000. Please note that a different value being placed on the shares of Faebery Ltd could increase or decrease this amount.

I understand that upon completion of the purchase of shares in Faebery 19 Ltd, Faebery 19 development will be transferred to another group company in the Ompot Group. This transfer will occur on a 'no gain no loss' basis, however, if Faebery 19 then leaves the Ompot Group (under option 1 and 2) this could results in what is known as a degrouping charge. This is discussed in further detail below. Depending on the group company Faebery 19 is transferred to, there may also be an appropriation to stock which would result in a tax charge in the absence of certain elections.

There is interest payable in Faebery 19 Ltd - acquiring it could have potential CIR implications

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Recommendation

It is not possible to recommend either purchasing Factory 19 itself or purchasing the shares in Factory 19 Ltd, without considering the options available going forward and the different implications they have. Please therefore refer to the 'overall recommendation' section. I felt it was important to provide a discussion of these standalone transactions as they integrate differently with each of the below options.

Options going forward

I understand there are three different options available going forward regarding what to do with Factory 19. I have provided advice on each option, how it integrates with purchase of property and the purchase of shares and ~~our~~ recommendation of the most appropriate option.

Option 1 - complete the development and sell on the open market.

This option requires expenditure of £4.7 million to complete the development. £1m of this expenditure qualifies for capital allowances which results in a tax saving of £180,000 (£1m x 18%). Please note I have not carried out a capital allowances review to back up

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this figure. The proceeds received under this option would be £18 million. I have outlined below what the net proceeds before tax would be.

	£
Proceeds received	18m
Original cost	(9,754,500)
Additional expenditure	(4,700,000)
Net proceeds.	3,545,500

The above is based on Faebury 19 being purchased directly.

if the shares in Faebury Ltd were purchased, under this option when the property is sold outside of the group, a degrouping charge arises. A degrouping charge is the difference between market value and cost at the time of the intercompany 'no gain no loss' transfer. A degrouping charge arises where the asset leaves the group within six years of the intercompany transfer. The degrouping charge is as follows:

	£
Proceeds (market value)	9,300,000
Cost	(6,000,000)
Degrouping gain	3,300,000

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The net proceeds are therefore as follows:

	£
Proceeds received	18m
Cost (initial outlay for shares)	(11,380,000)
Additional expenditure	(4,700,000)
~~Degrouping charge~~	~~(3,300,000~~
Net proceeds before tax and degrouping charge.	1,920,000

If option 1 were to be considered, buying the property itself would result in the more profit after tax. You will note I have not, at this point, displayed any 'post tax' results. This is because there may be the possibility of utilising losses in the Ompert Group so that no tax is payable and the net proceeds before tax will therefore be the resulting cash inflow. The overall recommendation section discusses this in further detail.

Option 2 - hold the Raebury for 12 months, then sell it.

Under this option, no additional expenditure is required and therefore the initial outlay, from acquiring the Raebury 19 development or acquiring the shares in Raebury 19 Ltd, will be the cost for

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the purposes of calculating the net profit/proceeds under this option. £12.5million will be received for the development in its current state.

	Acquired property	Acquired shares
Proceeds received	£12.5m	£12.5m
Cost (initial outlay)	(£9,754,500)	(£11,380,000)
Net proceeds	£2,745,500	£1,120,000

It is worth noting that the same degrouping gain (£3.3m) calculated under option 1 applies if the shares were acquired and the development was sold under this option. The issue with this is discussed further in the overall recommendation section.

If option 2 were chosen, it would be best to acquire the Fuebury 19 development rather than the shares.

Option 3 - complete the Fuebury and rent it out

As in option 1, this option will require additional expenditure of £4.7m to complete the development. It is worth noting that if the Fuebury 19 is let out under a 'long funding lease', the £180,000 capital allowances would not be available to claim, as the relief will be benefitted by the lessee. We can discuss this further should option 3 be undertaken.

The total expenditure under option 3 is as follows:

	Acquire property	Acquire shares
Initial outlay	9,754,500	11,380,000
Additional expenditure	4,700,000	4,700,000
	14,454,500	16,080,000
£900k received per annum	900,000	900,000
Years before costs recouped (estimate)	16	18

This option does not result in an immediate post tax profit as the income streams will be yearly rather than one lump sum. If this option is exercised, ~~option~~ acquiring property directly is more preferable to acquiring shares as the costs are recouped in a shorter amount of time by the rent payments.

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Overall recommendation

I would recommend:

A) acquiring the Factory 19 development itself;

B) complete the development of the factory and sell at open market value (option 1); AND

C) Ompart Developments (No 1) Ltd acquires the property.

As you will have seen from the calculations throughout this report, the net proceeds received (before tax) under option 1 is £3,545,500.

Ompart Developments (No 1) Ltd has trading losses brought forward from 2016 which were incurred in its property development trade. As these losses are pre 1 April 2017, they are only available to be offset against future profits of the same trade. Developing Factory 19 and selling it on for a profit of £3,545,500 results in a property development trade profit. Therefore, £3,545,500 is the net proceeds received and as this profit can be offset against the £16,000,000 available losses in Ompart Developments (No 1) Ltd, no tax is payable on this amount and the £3,545,500 is effectively cash inflow, which is the best outcome for the Ompart Group from a post-tax perspective.

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Please note than there is a restriction (50% of taxable profits) on the amount of brought forward losses which can be used when the amount used exceeds £5 million (deductions allowance)

It is also worth noting that the degrouping charge which arises in option 1 and option 2 cannot be offset against these losses, which is why I would not recommend acquiring shares of Faeborg 19 Ltd.

An alternative option, should the above recommendation not be commercially viable, would be to acquire the property itself and rent out the property (option 3). If this is done through Ormport Investments (North) Ltd, ~~the~~ the rental income could be offset against the ~~prope~~ losses arising in Ormport Investments (North) Ltd from UK property trade (rental income would be UK property trade income).

If you have any queries regarding any of the content in this report, please do not hesitate to contact me.

Kind regards,

James Johns

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Appendix 1 - SDLT calculation

0% £0 - £150,000
2% £150,001 - £250,000
5% £250,001 +

Purchase consideration = £9,300,000

£150,000 × 0% = 0
£100,000 × 2% = £2,000
£9,050,000 × 5% = £452,500

Total SDLT payable = £454,500

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Plan. CT | CGT | VAT | SDLT | SD | * Consider of best option for us will be commercially viable for vendor.

* RECOMMENDATIONS

① Acquire Peebury or acquire shares?

Acquire Peebury

> Cost = £9.3m (MV)

> SDLT payable by purchaser

> No option to tax on the land which means no VAT charged therefore none recoverable.

Under option 1. - OD No 1

- Extra £4.7m (£1m of CA's)
- Sell for £18m, depending on what company it will be trading profit or capital gain.
- Could utilise trading losses in OD (No 1) £16m.

Under option 2 - OD No 1

- Sell for £12.5m
- Same as above re. trade + capital, but less profit made here and less loss therefore is utilised.

Under option 3 - OIN.

- Extra £4.7m (£1m CA's)
- Property business trade, we get losses in OIN.

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Acquiring shares

> SD on purchase price
- What is value of shares?
- Would have to repay loan.
- Negative reserves - [illegible]
- Only really want the factory - why buy the shares and take on liabilities?
- Cannot GR the losses in Factory 19 Ltd for 5 years.
- Uncertainty around subcontractors WHT.
- As development will be stock in some companies + fixed assets in other, it may have to be appropriated when being transferred ∴ tax charge

Exec Summary

Option 1
- Property will have been transferred S171 and then leaving the group potential degrouping charge. If appropriated before transfer - no degrouping.
- £4.7m (£1m CA's)

Option 2
- Definitely degrouping charge.

Ø

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Option 3

£4.7m (£1m CA's)

Calculations

Buying development:

£93m purchase price.

0% - £150k.

2% - 150k - 250k = 2% × £100k = £2,000

5% - 250k + =(£93 - £250k) × 5% = £452,500

£454,500

Buying developments - £93m + £454,500

= £9,754,500

(1) £4.7m extra.

= £14,454,500

Sell for £18m. Profit/gain = £3,545,500 → Net proceeds.

CA's of £1m × 18% = (180,000)

£3,365,500

If OD (No1) - can use 2016 losses because these relate to the construction of the block: ~~prop~~ development trade - same trade.

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② £9,754,500

£12.5m - ↑ = £2,745,500 → Net proceeds.

Could we lease again but this would mean less net proceeds than option 1.

③. Cost less CA's = 14,454,500

(180,000)

14,274,500

No proceeds realised, just annual rental income of £900k p.a.

16 years before it returns a profit.

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[redacted]

Acquiring shares.
- Reasonable to assume a low purchase price? ~~[illegible]~~.
- 5,350 to pay back on loan.
+ SD on shares. ~~[illegible]~~ will be low.

① Degrouping charge. - or ELSG gc S171 then appropriated to stock = Trade profit of £3.3m.

MV - £9.3m
Cost - (£6m)
£3.3m.

£4.7m extra spent.

			+3.3
Proceeds	£18m		21.3m
Cost.	(£~~10~~7m)		(£~~10~~7m)
Actual spend.	£~~4~~7.3m		10.6m

~~[illegible]~~ (£4.7m) spent.
18m received
(10.6 tax)
=

↓
+3.3
£~~10~~6

② Degrouping of £3.3m.

Proceeds =	12.5m	15.8m
Cost	(10.7)	(10.7)
	1.8m	5.1m
	+3.3m	
	5.1m.	

Receive 12.5m
(5.35)
(5.17)