The Chartered Tax Adviser Examination

May 2017

Suggested solutions

Advanced Corporation Tax

Advisory Paper

ANSWER 1

To: Tax Partner

From: Manager

Taxable result

To calculate the loss arising for tax purposes, an adjustment is required in connection with the lease assignment.

The relevant profit is excluded from the taxable result and replaced with the chargeable gain/ loss.

On acquisition, the lease was for 75 years, so runs to 31 March 2050. Therefore, on disposal the lease has 33 years and 4 months to run, so is a wasting asset requiring a part disposal calculation using the lease depreciation tables.

		Cost	March 1982 MV
		£	£
Proceed Proceeds		2,000,000	2,000,000
Deductible cost	S/P x cost (2m)	(1,811,440)	
	S/P x MV 1982(2.5m)		(2,264,300)
Unindexed gain/(loss)		188,560	(264,300)
Indexation	March 1982 to November 2016 (restricted)	(188,560)	-
Indexed gain		£Nil	£(264,300)

S is the percentage for the period remaining at the sale of the lease (90.572 being 90.280 + (4 x 0.073)).

P is the percentage for the period on purchase of the lease, 100% as the original acquisition was for a long lease in excess of 50 years.

As the asset was held at 31 March 1982, two calculations must be prepared with the lower gain or loss being taken. At March 1982, the lease still had 67 years to run, so P is still 100% as the lease still exceeded 50 years.

As a loss arises under the March 1982 calculation, and no gain or loss under the cost calculation, no chargeable gain or loss arises.

Therefore the taxable trading loss for the year ended 31 November 2016 is £2.3 million (£1.5 million plus £0.8 million), with taxable interest income of £200,000 and taxable rental income of £1.5 million.

The estimated trading loss for the six months ended 31 May 2017 is £7 million with taxable rental income of £750,000.

Loss relief options

It is important to consider the tax rate for each period to maximise the benefit.

- Carry forward against future trading profits – although there may be rental income or chargeable gains, there will be no future trading income, so there is no benefit to the automatic carry forward of the loss.
- Offset against the profits of the same accounting period – the loss arising in the six months ended 31 May 2017 can be offset against the rental income, saving tax of

£150,000 (750,000 x 20%) and the loss arising in the year ended 31 November 2016 against the interest and rental income (total £1.7 million) saving tax of £340,000 (1.7m x 20%). In addition, if a gain on the Liverpool property were crystallised in the year, the loss could be offset against this – see below.

	Effective Corporation Tax rate	Year ended 30 November 2016 £	Six months ending 31 May 2017 £	Tax saved £
Loss arising		(2,300,000)	(7,000,000)	
Offset in p/e 30/11/2016	20.00%	1,700,000		340,000
Offset in p/e 31/05/2017	19.33%		750,000	144,975
Remaining		£(600,000)	£(6,250,000)	

- Carry the loss back against the total profits of the previous year, following a current year claim

		£	£	£
Available		(600,000)	(6,250,000)	
Carry back to y/e 30/11/2015	20.33%	600,000		121,980
Carry back to y/e 30/11/2016			Not available	n/a
Remaining		Nil	£(6,250,000)	

- Make a claim for terminal loss relief – loss in the 12 months before trade ceases can be carried back against total profits for the preceding 36 months. Losses of earlier accounting periods must be used before losses of later accounting periods.
- The loss arising in the six months ended 30 November 2016 can be carried back on a Last In First Out (LIFO) basis for three years from the start of the accounting period i.e. against profits arising in the period 1 December 2012 to 30 November 2013 and subsequent. However as it is on a LIFO basis, all losses are utilised against the income for the year ended 31 November 2015 so the effect would be the same as the prior year carry back.
- Losses for the period ended 31 May 2017 can be carried back to the year ended 30 November 2014 and subsequent.

			£	£
Available		Nil	(6,250,000)	
Offset in p/e 31/11/2015	20.33%		1,900,000	386,270
Offset in p/e 30/11/2014	21.67%		4,100,000	888,333
Offset in p/e 30/11/2013	23.33%		begins more than three years from beginning of period	n/a
Remaining			£(250,000)	

- Surrender the losses to other group companies if profits are available.
  Whilst group relief could be claimed in preference to the claims explained above, offset would be in the years ended 30 November 2016 and 30 November 2017 with effective tax rates of 20% and 19.33% respectively, hence less beneficial than the carry back and terminal losses relief claims which should therefore be made in preference.

Freehold Property

An immediate sale of the property could significantly reduce the sale proceeds received. When considering delaying the sale, the anticipated after tax proceeds must be considered.

A new accounting period will commence on the cessation of the trade and appointment of a liquidator. Hence if the property is retained in Stevens Books Ltd and sold after the appointment of the liquidator, any gain will arise in the new accounting period and the brought forward trading losses will not be available to offset against the gain. A sale prior to the appointment of the liquidator would allow losses to be offset against the gain. Whilst saving tax within the company, it would reduce the loss available for group relief. So the potential tax benefit depends whether there are sufficient profits in the group to fully utilise the trading loss.

An alternative would therefore be to transfer the property to another group company and wait until an appropriate sale price can be agreed. As Roberts Publishing plc owns in excess of 75% of the share capital, the companies should be in a chargeable gains group so a transfer could still be made between the companies at nil gain/nil loss for tax purposes as the company remains part of the chargeable gains group until the final distribution of the assets whilst the actual transfer should be at the current market value to protect the interests of the minority.

MARKING GUIDE FOR Q1

TOPIC	**MARKS**	**TOTAL**
Taxable result		
Exclude profit on assignment and replace with gain	0.5	
Long lease on acquisition, short lease (33yrs 4 months on	1	
disposal)		
Wasting asset so use lease depreciation tables (values)	1.5	
Calc for cost and March 1982 value	1	
Nil result	0.5	
Final taxable results	0.5	5
Loss relief		
Consider tax rate	0.5	
Carry forward option s.45 CTA 2010	0.5	
No future trading profits so lost	0.5	
Current year offset and impact for each period(s.37(3)(a)		
CTA 2010)	1.5	
Prior year offset – after CY – November 16 only (s.37(3)(b)	1.5	
CTA 2010)		
Terminal loss relief (s.37 CTA 2010) – identify final 12	1	
months	0.5	
36 months	0.5	
LIFO basis	0.5	
6 m/e 30/11/16 to APE 30/11/13 onwards	0.5	
LIFO so all used in 31/11/15	0.5	
6 m/e 31/5/17 to APE 30/11/14 onwards	0.5	
Effect and tax saving	0.5	
Group relief if capacity	1	
Current year rates lower so TLR best with GR for balance		
		10
Property sale		
Consider net after tax proceeds	0.5	
Appointing liquidator / cessation of trade means new AP	0.5	
So no use of trading losses	0.5	
Could offset if sold now, before appointment	1	
But only tax benefit if losses can't be otherwise relieved	1	
Consider transferring within group as gains group remains	1	
(>75%)	0.5	
Protect minority		5
TOTAL		**20**

ANSWER 2

Diverted Profits Tax

The Diverted Profits Tax (DPT), announced in 2014, is designed to counter the use of aggressive tax planning techniques used by multinational enterprises to artificially divert profits from the UK.

The legislation was included in FA 2015, applicable to diverted profits from 1 April 2015.

The Tax

DPT is a new tax, separate from Corporation Tax. The normal rate of DPT is 25% of the diverted profit plus any ‘true-up interest’, with a higher rate of 55% for certain ring-fence profits.

The process

DPT has its own rules for notification, assessment and payment. Whilst not self-assessed, companies must notify HMRC within three months of the end of an accounting period in which they are potentially within the scope of the tax and do not meet certain conditions for exemption. There is a tax-geared penalty for failure to do so.

When it applies

DPT applies if:

1) A UK company uses transactions or entities that lack economic substance resulting in a tax mismatch outcome.

2) A foreign company with a permanent establishment (i.e. a taxable presence) in the UK uses transactions or entities that lack economic substance resulting in a tax mismatch outcome.

3) A person carries on activity in the UK which is in connection with the supply of goods, services or other property by a foreign company and it is reasonable to assume this activity is designed to ensure that the foreign company does not create a permanent establishment in the UK and it results in a tax mismatch outcome (or is undertaken with a main purpose of avoiding tax).

A tax mismatch outcome arises where the transaction gives a reduction in tax for one company (C), and any additional tax for the other person (P) is less than 80% of the reduction.

There are exemptions for small and medium sized companies and the rules do not apply in respect of loan relationships.

Calculation of the diverted profits

The rules are complex but are designed to identify the ‘diverted’ profit under transfer pricing principles and charge this to tax.

Where DPT is imposed due to the avoidance of a UK permanent establishment, the taxable diverted profit is the amount that it is just and reasonable to assume would be the chargeable profit of the UK PE, had the avoided PE been a UK PE through which the foreign company carried on the relevant trade. Where the actual transaction is to be recharacterised, the diverted profits are calculated by determining the appropriate level of profits that would have arisen on the transaction that would have been entered into ignoring tax considerations.

The taxable diverted profit will be reduced by any transfer pricing adjustment reflected in the UK company's self-assessment return in connection with the material provision.

Conclusion

DPT is unlikely to arise where offshore companies have sufficient substance, where there is appropriate and well documented transfer pricing through the international value chain or where companies with UK activities maintain a taxable presence in the country.

MARKING GUIDE FOR Q2

TOPIC	**MARKS**	**TOTAL**
Background and timing Rate Separate administration Notification required (three months) Penalties for failure to notify	1 0.5 0.5 0.5 0.5	 3
Application Avoided PE Lack of substance Exploiting tax mismatches Tax mismatch outcome SME exemption Not applicable to LRs	 1 0.5 0.5 0.5 0.5 0.5	 3.5
Charge to tax on avoided PE – on just and reasonable profits Otherwise just and reasonable profits on recharacterised transaction. Adjust for TP adjustment in CT return	1 1 1	 3
Conclusion - limited application	0.5	0.5
TOTAL		**10**

ANSWER 3

Fixed assets

The depreciation charge (£1,600,000) is disallowed in calculating taxable trading profit.

Liverpool property disposal

The accounting profit of £1,700,000 (proceeds of £2,500,000 less net book value (1,000,000 - 200,000)) is excluded from taxable profits. As the fully depreciated plant was scrapped, no profit or loss arises so no adjustment is required in this respect and no proceeds arise for capital allowances purposes.

The pub may have included fixtures on which capital allowances had previously been claimed. The appropriate disposal value should be included in the capital allowances workings based on the sale agreement and any election made under s.198 CAA 2001 determining the consideration to be allocated to qualifying plant and machinery, which will be restricted to the original qualifying expenditure.

A chargeable gain will arise on the disposal. Immediately prior to the original transfer, David Ltd would have been deemed to appropriate the property from trading stock to fixed assets at market value, regardless of the actual consideration. David Ltd would therefore have paid tax on the trading profit of £0.1 million. The transfer to Stuart plc would then have been at no gain no loss between group companies meaning that base cost is £1.1 million, resulting in a gain in the current period as shown below:

		£
Proceeds		2,500,000
Deemed cost June 2012		(1,100,000)
Unindexed gain		1,400,000
Indexation (260.0-241.8)/241.8=0.075 June 2012 to Feb 2016	0.075x1,100,000	(82,500)
Indexed gain		£1,317,500

This gain will be included in the total taxable profits of the company for the year ended 31 December 2016. However, to reduce the tax payable, the company could consider a rollover relief claim. This would defer the tax payable on the gain to the extent that the proceeds have been reinvested into appropriate assets, such as the new Colchester pub. An appropriate reinvestment would be into a new property acquired in the period 12 months before the disposal to three years after which is to be used for purpose of company's trade.

Based on the information relating to the current year, the proceeds have not been fully reinvested to date so the options are to:

1. Review expenditure in the period from 26 February 2015 to 31 December 2015 to identify any additional expenditure in qualifying assets. If sufficient, this will permit a full claim resulting in a reduced base cost for the assets against which the gain has been deferred.
2. Consider if there is any eligible spend in other group companies, as rollover relief operates on a group basis.
3. Submit a provisional claim if further qualifying expenditure is anticipated and monitor future spend within the three year timescale.
4. Submit a partial claim whereby the gain cannot be deferred to the extent that the proceeds have not been reinvested. As the proceeds were £2.5 million and only £2.3

million was reinvested a gain is taxable in the year equal to the lower of the total gain (£1,317,500) and the amount not reinvested (£0.2 million) i.e. £0.2 million.

A claim detailing the ‘old’ and ‘new’ assets must be submitted within four years of end of accounting period, but a provisional claim can be included within the Company Tax return.

The plant and machinery scrapped are likely to be exempt assets with a cost below £6,000. However, even if this is not the case, no allowable loss will arise on the scrapping of the assets to the extent that full capital allowances have been received.

Colchester property acquisition

The property may include items of plant and machinery eligible for capital allowances. As a pub, items such as air conditioning are likely to be included (eligible for inclusion in the special rate pool) and the terms of the acquisition may also include items such as furniture (eligible as general pool items). Therefore, as with the disposal of the Liverpool property, if not already done, discussions should be conducted with the vendor to:

- Ascertain the extent of expenditure on the property which was eligible for capital allowances;
- Agree through the use of a s198 election the amounts to be recognised as disposal value in the vendors’ pools and qualifying additions in the pools of Stuart plc.

When finalising the tax computations, it is important to consider the claims on a group wide basis to ensure the most efficient use of Annual Investment Allowance, which gives immediate relief for the first £200,000 of qualifying expenditure. As this can be used for expenditure in the main or special rate pool and is spread across the group, the earliest relief for expenditure will be by allocating this to expenditure eligible for the slower relief of 8% per annum in the special rate pool.

Grant of leases

As the Exeter lease being granted is for 20 years, it is a short lease and the premium is taxable in the year of receipt. Part of the premium is taxable as income and part as a chargeable gain.

The amount taxed as income in total taxable profits, is

Premium x (50-Y)/50

where Y is the duration of the lease in complete years ignoring the first year i.e.

£25,000 x (50-19)/50 = £15,500

The amount taxed as capital is the balance of £9,500. To ascertain the value of the chargeable gain we need to ascertain the deductible cost. This is similar to the part disposal calculation:

a/(A+B) x cost (£300,000) where

a is the part of the premium treated as capital £9,500

A is the gross premium £25,000

B is the value of the reversionary interest.

Therefore we need to ascertain the value of the reversionary interest to ascertain the chargeable gain arising on the grant of the lease and this should be requested from the client, together with details of the acquisition date of the property to calculate the indexation allowance.

As the Stevenage lease is for 60 years this represents the grant of a long lease and the premium received is taxed in full as a capital receipt. As the grant of a lease again represents a part disposal, the gain will be calculated on a similar basis but using the standard A/(A+B) x cost formula.

MARKING GUIDE FOR Q3

TOPIC	**MARKS**	**TOTAL**
Disallow depreciation	0.5	0.5
Liverpool disposal		
Gain excluded from taxable profit	0.5	
No profit on plant as nil NBV and scrapped	0.5	
Discuss disposal value to pool	1	
Chargeable gain arises	0.5	
Base cost 1.1m	0.5	
Explanation	1	
Indexed gain 317.5k	0.5	
Potential rollover	0.5	
Conditions timing/trade	1	
Insufficient reinvestment in year	0.5	
Look at prior year	0.5	
Explanation of deferral	0.5	
Consider group claim	0.5	
Provisional claim	0.5	
Partial claim – 0.2million taxable	0.5	
Claim details	0.5	
No allowable loss on plant as full CAs	0.5	10
Colchester acquisition		
Capital allowances – both pools	1	
S198 election and fixed value requirement	1.5	
Group allocation of AIA, £200k	1	
Use for special rate pool	0.5	4
Leases		
Exeter short lease so part income, part gain	1	
Income £15,500	0.5	
Gain a/(A+B)	0.5	
a=9,500	0.5	
A=25,000	0.5	
B=value of reversionary interest – to be determined	0.5	
Acquisition date required for indexation	0.5	
Stevenage long lease so all CG	0.5	
A/(A+B)	0.5	
Explanation of calculation	0.5	5.5
TOTAL		**20**

ANSWER 4

To: APatel@Travelagents.com
From: SCooper@Travelagents.com
Date: X May 2016
Subject: Bank loan and interest rate swap

Hi Arun

You asked about the Corporation Tax treatment of the bank loan and proposed interest rate swap.

Loan

The loan is a 'loan relationship' because it is a money debt arising from a transaction for the lending of money.

The company will obtain relief for the interest paid in line with the accounting treatment. These will be non-trading loan relationship debits given that the company is a holding company, and does not carry on a trade.

Any net debits can be used as non-trade loan relationship deficits as follows:

a) Set against the taxable profits of the company for the accounting period;
b) Carried back against the non-trading loan relationship profits of the company in the previous 12 months;
c) Carried forward and set against any future non-trading profits of the company; or
d) Group relieved to another group company.

Derivative contract

The interest rate swap will be a derivative contract for tax purposes as:

a) It is a relevant contract (a contract for difference);
b) It satisfies the accounting conditions (accounted as a derivative financial instrument); and
c) It is not an excluded contract (eg. certain derivatives over shares are excluded from meeting the definition of a derivative for tax purposes).

The derivative will be a non-trading instrument. As such, the profits and losses will be brought into account as non-trading loan relationship debits and credits.

The amounts brought into account for tax purposes will be the amounts recognised accounts the income statement. Amounts recognised as items of other comprehensive income (OCI) will only be brought into account when they are transferred to the income statement.

As a result, the company would not be taxable on the fair value movements recognised in OCI. However, it will be taxed on amounts recognised in the income statement, including any volatility relating to ineffectiveness in the hedge.

Disregard Regulations

The Disregard Regulations apply to 'disregard' certain fair value movements, such as those that can arise under International Accounting Standards, and restore the old UK GAAP treatment for tax purposes.

With the swap, the company has the option of applying regulation 9 of the Disregard Regulations. This applies where an interest contract is taken out to hedge a risk where the risk is not taxed on a fair value basis.

Regulation 9 has the effect of disregarding the fair value movements on the derivative contract for tax purposes, and instead taxing the company on the basis of an 'appropriate accruals basis'. This will spread the profits and losses on the derivative over the period of the hedged risk.

This therefore removes the tax volatility for the company, making it easier to forecast the company's tax payments. Depending on the particular movements, this could result in higher or lower tax in the short term.

Given that the company has not previously held any derivatives and it is not within the Senior Accounting Officer regime, it will need to make an election before 12 months from the end of the accounting period.

Kind regards

Sam

MARKING GUIDE FOR Q4

TOPIC	**MARKS**
Loan	
Loan relationship definition	1
Interest expense as a non-trading debit	1
Use of NTLR deficits	1
Derivative	
Derivative contract definition	1
Profit and losses taxed and relived as non-trading LR debits and credits	1
Follows amounts in P&L, amount in OCI not taxed until recycled	1
Disregard regulations:	
Background	1
Conditions for reg 9	1
Application of reg 9 (disregard FV movements, apply accruals basis)	1
Election required within 12 months of year end	1
TOTAL	**10**

ANSWER 5

Joanne Driver
Finance Director
Fast Cars plc
[Address]

Tax Adviser
[Address]

X May 2017

Dear Joanne

Proposed acquisition of White Trucks plc: Controlled Foreign Company (CFC) Issues

Further to your due diligence work on the White Trucks group, I set out the potential CFC issues from the information provided.

1) CFC rules

The UK CFC rules are designed to prevent UK companies diverting income away from the UK to low taxed companies in other countries. These rules apportion certain profits of a CFC considered to be artificially diverted to UK corporate investors in the CFC that hold more than 25% relevant interests in the CFC, and subject them to 'CFC tax'. This is charged at the same rate as UK Corporation Tax (CT) and the amount of these 'chargeable profits' is calculated on CT principles.

A CFC is any company that is resident outside of the UK and is controlled by UK persons.

No apportionment is necessary where one of the following exemptions apply:

a) Exempt period exemption
b) Excluded territories exemption
c) The low profits exemption
d) Low profit margin exemption
e) The tax exemption
f) Partial or full exemption on qualifying loan relationships

In addition, only profits that pass through one of the following 'gateways' can potentially be apportioned to CFC tax:

a) Profits attributable to UK activities
b) Non-trading financial profits
c) Trading financial profits
d) Captive insurance business
e) Solo consolidation profits

White Trucks plc have suggested that no CFC issues should arise due to the Cadbury Schweppes decision at the Courts of Justice of the Europe Union (CJEU). The case involved the previous CFC rules and concerned the freedom of establishment within the Europe Union (EU) and the European Economic Area (EEA). The CJEU found that the UK CFC rules did constitute a restriction on a UK company's freedom to establish in another member state and was only justified in the context of 'wholly artificial' arrangements.

The new CFC rules were designed in light of the Cadbury Schweppes decision, and HMRC are likely to strongly contest any argument these rules are contrary to EU law. In addition, the judgement will have no application to non-EEA jurisdictions, such as Utopia.

2) Application to White Trucks Group

There are a number of potential CFC issues that may arise from an acquisition of the White Trucks plc group.

<u>a) White Trucks plc</u>

Currently this company does not appear to be controlled by UK persons. Assuming this is the case, there should be no historic CFC liabilities.

However, if the company is acquired by Fast Cars plc, it will become a CFC and potentially be subject to a CFC apportionment.

Because the company is not currently a CFC, you could look to benefit from the ‘exempt period exemption’. This provides a period of 12 months following the acquisition where there would be no CFC apportionment. However, it only applies if the activities of the company are reorganised within that period such that no CFC tax arises in the subsequent period. HMRC may in certain circumstances extend the exempt period.

Any dividend income that White Trucks plc receives from a controlled subsidiary would be exempt for CT purposes and therefore this is not subject to a CFC apportionment.

The interest income on the loan will fall under the non-trading financial profits gateway on the assumption that the funds originated from the UK meaning that a charge will potentially arise for Fast Cars plc.

However, the company may be able to benefit from the ‘Finance Company Partial Exemption’. Where this applies, 75% of the profits from qualifying loan relationships will be exempt.

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 attributable profits on the £400 million loan, which ultimately goes to WT Sweden AB should be reduced in this way.

The £300 million loan to WT Trading Ltd will not qualify as the ultimate debtor is UK resident. The full amount of interest on this loan will therefore be subject to a CFC apportionment in the future. You may therefore wish to give consideration to restructuring activities following the acquisition.

<u>b) WT Insurance Ltd</u>

It would appear that as a subsidiary of WT Holdings Ltd, this company is currently a CFC.

The company’s profits will fall within the captive insurance business gateway to extent they derive from insurance contract entered into with a connected UK company (or UK branch) or with a UK resident person which is linked with the provision of goods or services to that person. It is these profits that are potentially subject to a CFC apportionment going forwards.

However, because WT Insurance Ltd is resident in the EEA, the profits will only pass through the gateway to the extent that the person insured does not have a significant non-UK tax reason for the insurance. We therefore need to ask White Trucks plc to provide details of the motivation for the structure to assess whether it genuinely has a significant commercial purpose. In the absence of such support you should consider requesting specific indemnities in connection with any historic liabilities arising from this issue.

Note that this company would not be able to benefit from the tax exemption (which applies where the local tax is at least 75% of the corresponding amount of UK tax) as the tax paid by the company is refunded when the profits are distributed to its non-resident shareholder.

c) WT Sweden AB

This is currently a CFC.   Profits could be attributable to the UK where the activities are attributable to 'significant people functions' in the UK.

Given that the tax rate in Sweden is 22%, it would seem likely that the company will benefit from the tax exemption. This applies where the local tax amount is at least 75% of the corresponding amount of UK tax.

Please contact me if you have further questions.

Yours sincerely

Tax Adviser

MARKING GUIDE FOR Q5

TOPIC	**MARKS**
Presentation	1
General explanation of CFC rules:	
Chargeable profits and apportionment	1
Definition	1
Gateways	1
Exclusions	1
Cadbury Schweppes decision	
Old CFC constituted a restriction on freedom of establishment within EEA	1
Only justified where wholly artificial arrangements	1
New rules unlikely to be considered contrary to EU law	1
White Trucks plc:	
No historic CFC issues as not controlled by UK	1
Exempt period exemption	1
Dividend exemption	1
Non-trading financing profits gateway	1
Finance Company Partial Exemption	1
Meaning of qualifying loan relationship	1
No Finance Company Partial Exemption for loan to UK	1
WT Insurance Ltd	
Historic and future CFC issues as controlled by UK	0.5
Insurance gateway – insurance contracts with UK	1
Tax exemption not available as tax refunded	1
WT Sweden AB	
Historic and future CFC issues as controlled by UK	0.5
Profits potentially attributable to UK gateway	1
Tax exemption, so should not be subject to CFC apportionment	1
TOTAL	**20**

ANSWER 6

Taxable profit / loss summary

		Bidco Ltd (Pre-acq)	Bidco Ltd (post-acq)	Robin Gyms plc	RGUK Ltd
		1 Jan to 30 June	1 July to 31 Dec	1 April to 31 Dec	1 April to 31 Dec
		£	£	£	£
Trading profit	W1				5,791,100
Non-trade loan relationship profits	W3			1,000	
Non-trade intangible fixed asset profits	11			60,000	
Total profits		-	-	61,000	5,791,100
Management expenses	W2	(158,750)	(50,000)	(957,000)	
Non-trade loan relationship deficits	W3	-	(6,152,615)		
Excess charitable donation	12			(10,000)	
		(158,750)	(6,202,615)	(906,000)	5,791,100
Group relief surrenders					
Bidco Ltd to RGUK Ltd	13		3,860,733		(3,860,733)
Robin Gyms plc to RGUK Ltd				906,000	(906,000)
		£(158,750)	£(2,341,882)	Nil	£1,024,367
Corporation Tax liability at 20%					£204,873

W1 Trading profits / (losses)

		RGUK Ltd
		£
Profit before tax		4,361,000
Depreciation - owned assets		3,900,000
Depreciation - leased assets	10	1,500,000
Capital allowances	W4	(3,969,900)
		£5,791,100

W2 Management (expenses)

		Bidco Ltd (Pre-acq)	Bidco Ltd (post-acq)	Robin Gyms plc
		£	£	£
Pre-decision bid costs	2	(108,750)		
Post-decision legal costs – capital	3	-		
Cost of incorporation – capital	4	-		
Staff costs		(50,000)	(50,000)	(770,000)
Other business costs				(187,000)
		£(158,750)	£(50,000)	£(957,000)

W3 Non-trade loan relationships credits / (debits)

		Bidco Ltd	Robin Gyms plc
		£	£
Interest income		10	1,000
Interest expense – senior debt		(6,000,000)	
Arrangement fees	5	(120,000)	
Due diligence fees	1	(32,625)	
		£(6,152,615)	£1,000

W4 Capital allowances workings – RGUK Ltd

		Main pool	Allowances claimed
		£	£
TWDV b/f		27,200,000	
Additions			
Computer software	8	-	
Building work - non-qualifying		-	
Air conditioning			75,000
Swimming pool construction		300,000	
Heating system for pool	9	25,000	
Fitness equipment	10	365,000	
Less Annual Investment Allowance	6	(150,000)	150,000
		27,740,000	
WDA @18% (reduction for short AP)	7	(3,744,900)	3,744,900
TWDV c/f		£23,995,100	£3,969,900

Explanations

Deal and financing costs

Companies with investment businesses can claim relief for 'management expenses'. To qualify, the expenses have to be revenue in nature. This would include expenses such as preliminary reports to appraise potential investments.

However, these should be distinguished from costs of a capital nature for which relief is specifically precluded. Once the decision to acquire is made then the expenditure will be capital in nature and therefore disallowed, and will form part of the acquisition cost of the investment.

Where companies take out loan finance, costs that are directly attributable to taking out of the loan will obtain relief under the loan relationship rules. These take precedent over the management expense rules, and contain no revenue / capital distinction.

(1) 75% of the due diligence costs are considered to be directly attributable to taking out of a loan relationship. Therefore £326,250 will be deductible in line with the accounting treatment. It is expected that this amount will be spread over the five-year term of the loan. So accrual for six-month period is £32,625 (£326,250 x 6 / 60).

(2) The remaining 25% of the due diligence costs (£108,750) should be deductible as management expenses as they are considered to be pre-decision costs of assessing the potential investment.

(3) Transaction costs (post-decision) are capital in nature and hence the legal fees on the sale agreement are non-deductible.

(4) Costs of forming company are also capital in nature and hence non-deductible.

(5) Arrangements fees paid by Bidco Ltd are directly attributable to entering into a loan relationship and hence are deductible in line with the accounting treatment. It is expected that these will need to be spread over the five-year term of the loan. So accrual for six-month period is £120,000 (£1,200,000 x 6 / 60).

Fixed assets/capital allowances

(6) Maximum amount of Annual Investment Allowances for the nine-month period is £150,000 (£200,000 x 9 /12).

(7) Writing down allowances reduced to nine twelfths for the short accounting period.

(8) Relief for accounts amortisation of software costs of £16,000 taken as more beneficial than capital allowances (18% of £80,000 x 9/12 = £10,800).

(9) Payments for qualifying expenditure falling due more than four months after obligation to pay has become unconditional are treated as being incurred when the payment becomes due. Therefore only £25,000 (50% of £50,000) is qualifying expenditure in the current period.

(10) RGUK Ltd leases the fitness equipment under a finance lease, which qualifies as a long funding lease. As lessee, it is therefore treated as incurring qualifying expenditure in respect of long funding leases. The amount of the qualifying expenditure is the present value of the minimum lease payments.

Lessee under a long funding finance lease obtains relief for the finance cost element of the lease payments. No relief is available for the amounts recognised as depreciation in the company's accounts, given that capital allowances are available for the present value of the minimum lease payments.

Other points

(11) Royalties received by Robin Gyms plc are in respect of a non-trading intangible fixed asset.

Group relief

(12) Charitable donation is deductible as a qualifying charitable donation. This can be surrendered as group relief under s.99(1)(d) CTA 2010.

(13) Group relief claimed from Bidco Ltd is limited to profits/losses attributable to the overlapping period:

- o Time apportionment appears reasonable basis for attribution of the profits of RGUK Ltd. Profit attributable for the overlapping period is therefore £3,865,923 (£5,798,885 x 6/9).

- o Costs of Bidco Ltd need to be attributable to the pre-acquisition and post-acquisition periods on a just and reasonable basis. All the finance costs relate to the overlapping period, so the whole of the non-trade loan relationship deficit can be surrendered. Bid costs within management expenses arose before the acquisition and are therefore not attributable to the overlapping period. Staff costs apportioned on a time basis, so £50,000 of management expenses can be surrendered.

(14) Group relief claimed from Bidco Ltd in priority to the claim from Robin Gyms plc to maximise amount of group relief.

MARKING GUIDE FOR Q6

TOPIC	**MARKS**	**TOTAL**
Bidco – deal costs: DD costs (25%) - Pre-decision allowable, post-decision capital. DD costs (75%) - NTLRDs, will need to spread over life of the loan. Cost of forming company is capital in nature and non-deductible as are SPA costs. Arrangement fees as a NTLRD	 1 1 1 1	 4
RG plc: Royalties taxed as NTIFAs Charitable donation	 1 1	 2
RGUK: Long funding finance lease – depreciation ND / finance cost D Computer software costs – relief for amortisation more beneficial	 2 1	 3
RGUK capital allowances: No relief for buildings FYA for air conditioning (no reduction for short AP) Heating system – 4m rule Swimming pool Leased equipment – PV of future obligations AIA (reduced for short AP) Main pool (reduction for short AP)	 1 1 1 1 1 1 1	 7
Group relief: Claim from Bidco: Need to identify overlap period Claim from Bidco: Pro-rata profits of RGUK Claim from Bidco: J&R losses of Bidco	 1 1 1	 3
CT calculation	1	1
TOTAL		**20**