Chartered Institute of Taxation

Excellence in Taxation

The Chartered Tax Adviser Examination

November 2020

Taxation of Major Corporates

Suggested Solutions

ANSWER 1

Amarinette Ltd: Tax computation for the year ended 31 March 2020

		£	£
Profit per accounts			7,248,000
Add:			
Depreciation	Note 1	3,500,000	
Entertaining	Note 2	45,000	
Loss on disposal	Workings 1	200,000	
Charitable deduction	Note 3	25,000	
Interest payable	Note 4	400,000	
Write off of loan	Note 5	0	
			4,170,000
Less			
Pension spreading	Note 6	750,000	
			(750,000)
Adjusted profit before capital allowances			10,668,000
Capital allowances	Workings 2		(5,346,554)
Trading profit			5,321,446
NTLR deficit	Note 4		(400,000)
NTLR deficit brought forward	Workings 3		(400,000)
Group Relief	Workings 3		
NTLR 2019		400,000	
Trading 2020		500,000	
NTLR 2020		400,000	
			(1,300,000)
Qualifying Charitable Donation	Note 3		(25,000)
Taxable Total Profits			**3,196,446**

Notes and workings

Note 1. Depreciation is capital in nature and is not deductible for tax purposes.

Note 2. The gifts are less than £50 to each customer. They do contain the name of the business but as they are alcohol, the cost is not permitted as a deduction.

Note 3. The charitable donation to NSPCC was not made for the purposes of the trade and so is added back in the trading profit computation. It is allowed as a deduction against total profits if sufficient profits are available.

Note 4. The loan to purchase the shares in Cranwellion Ltd is not for trading purposes and the interest payable is therefore a non-trading loan relationship (NTLR) debit.

Note 5. Write-off of a loan to an employee is an allowable deduction for Corporation Tax purposes and will form part of the employee's employment income as additional salary

Note 6. For an excess pension contribution of £3 million, the period of spreading is four years. Therefore £750,000 will be allowable in each of the years ending 31 March 2019, 31 March 2020, 31 March 2021 and 31 March 2022.

Workings 1. Calculation of disposal proceeds from the sale of vans

	£
Net book value	800,000
Loss on disposal	(200,000)
Proceeds	£600,000

Workings 2. Capital Allowances

	Note	Main Pool	Special rate pool	Allowances claimed
		£	£	£
Tax written down values at 1 April 2019		15,087,330	1,822,248	
First year allowance				
New cars	a			500,000
Additions				
Workshop	b	4,000,000		
Plant		1,000,000		
Plant installation	c	250,000		
Vans		1,250,000		
Lift	d		750,000	
Car	e		75,000	
Disposal proceeds	f	(600,000)		
Annual investment allowance	g	(250,000)	(750,000)	1,000,000
		20,737,330	1,897,248	
Writing down allowance				
18%		(3,732,719)		3,732,719
6%			(113,835)	113,835
Tax written down value at 31 March 2020		17,004,611	1,783,413	
Allowances claimed				5,346,554

Notes:

Note a: New cars with emissions of no more than 50g/km are eligible for 100% FYA.

Note b: Additions restricted to original cost.

Note c: Alterations to install new plant are main pool additions.

Note d: Lifts are integral features and part of the special rate pool.

Note e: New cars with emissions of more than 130g/km are added to the special rate pool. The private usage of the car does not restrict the allowances that can be claimed.

Note f: See workings 1 for calculation of disposal proceeds.

Note g: AIA allocated to special rate pool first. Cars do not qualify for AIA.

Workings 3. Losses and group relief from Cranwellion Ltd

In the year ended 31 March 2019, the trading profits of £800,000 in Cranwellion Ltd are relieved by £800,000 of the losses made in the year ended 31 March 2017. This is automatic and no claim is required.

The balance of trading losses £200,000 and the NTLR deficit of £500,000 from the year ended 31 March 2017 will be brought forward under the pre 1 April 2017 rules and should be disclosed separately in the tax computation.

The trading loss and NTLR deficit incurred in year ended 31 March 2018 cannot be group relieved in 2020 as they were incurred at a time when the two companies were not in the same group. These losses and deficits are ring fenced for five years.

The NTLR deficit of £400,000 incurred in year ended 31 March 2019 can be carried forward to the year ended 31 March 2020 and surrendered to Amarinette Ltd, as can the losses incurred in the year ended 31 March 2020.

Summary of the trade losses and NTLR position for Cranwellion Ltd:

	Pre April 2017		Post April 2017	
	Trade losses £'000	NTLR deficit £'000	Trade losses £'000	NTLR deficit £'000
B/F April 2017	1,000	500	-	-
B/F April 2018	1,000	500	1,200	400
Claimed APE March 2019	(800)	-	-	-
Incurred APE March 2019	-	-	-	500
B/F 1 April 2019	200	500	1,200	1,000
Incurred APE March 2020	-	-	500	400
Surrendered APE March 2020	-	-	(500)	(800)
C/F March 2020	200	500	1,200	500

MARKING GUIDE

TOPIC	MARKS	
Adjustments to trading profit:		
Depreciation	0.5	
Loss on disposal	0.5	
Entertainment	0.5	
Loan to buy shares in Cranwellion	0.5	
Pension spreading	1.0	
Write off on loan to employee (is allowable)	0.5	
Qualifying Charitable Donation	0.5	
		4
Capital Allowances:		
Fixtures in new workshop. Seller has claimed CA and made election	1.0	
Value in agreement not relevant restrict addition to original cost	1.0	
Add new plant to general pool including cost of installing	1.0	
Add cost of lift to special rate pool	1.0	
Vans are general pool irrespective of emissions	0.5	
Disposal of vans reduce general pool (£600,000)	1.0	
New cars with less 70g/km FYA	0.5	
New car with 160g/km special rate pool. No restriction for private use	1.0	
Allocate AIA against SR Pool first then general pool	1.0	
Except no AIA on cars	0.5	
Calculation of WDA each pool	1.0	
Calculation of total allowances	0.5	
		10
Taxable Total Profits:		
NTLR deficit	0.5	
NTLR deficit b/f	0.5	
Trading loss and NTLR deficit of Cranwellion group relieved (GR)	1.0	
NTLR deficit from 2019 c/f and surrendered	1.0	
		3
Cranwellion losses c/f:		
Pre 2017 losses to be c/f and never available for GR	1.5	
Pre-acquisition losses to be c/f and available for GR after 5 years	1.5	
		3
TOTAL		**20**

ANSWER 2

From	Lesleywalsh@dentonandfarley.co.uk
To	MikeJackson@Girardson.co.uk
Date	X November 2020
Subject	Corporate Interest Restriction

The CIR rules can restrict a group's deductions for interest expense and therefore if the £10 million per annum interest expense is not fully tax deductible, it could make the return on investment unviable.

There are two ways to compute the basic interest allowance of a group: the fixed ratio method, which is the default method, and an alternative group ratio method. The rules are complicated but briefly:

Fixed ratio method

The basic interest allowance is the lower of:

- A fixed percentage (30%) of the worldwide group's aggregate tax-EBITDA; and
- The fixed ratio debt cap for the period.

Thus, the larger the earnings/profits, the larger the amount of interest that can be deductible. If interest to earnings is greater than 30%, the group ratio method should be considered although administratively more burdensome.

Group ratio method

The basic interest allowance is the lower of:

- The group ratio percentage of the aggregate tax-EBITDA; and
- The group ratio debt cap for the period.

If the group outside of the UK has a large amount of external debt, the group ratio method could result in there being no interest restriction in the UK.

There are, however, another set of rules specific to infrastructure projects. Given the nature of the proposed contracts, Girardson Ltd might be able to make an election to enable it to be a qualifying infrastructure company (QIC).

Four conditions need to be met:

1) Public infrastructure income test.

All but an insignificant amount of a company's income for an accounting period must derive from: qualifying infrastructure activities carried on by the company. Significant needs to be considered in both absolute and relative terms.

Qualifying infrastructure activities are: the provision of a public infrastructure asset; or the carrying on of any other activity that is ancillary to, or facilitates, the provision of a public infrastructure asset. Public infrastructure assets are infrastructure of the UK and certain buildings part of a UK property business.

The contracts in question appear to satisfy this test.

2) Public infrastructure asset test.

   All but an insignificant proportion of the company's assets must derive from tangible assets that are related to qualifying infrastructure activities or be certain other assets.

3) The company is fully taxed in the UK.

4) An election is made.

If Girardson Ltd is a QIC, the interest expense is *not* included within 'tax-interest' and therefore cannot be restricted. However, this only applies if the interest is either paid to a creditor that is not a related party of the company, or the related party creditor is also a QIC.

It seems likely that Girardson Ltd will be able to meet the conditions to be a QIC but the precise nature of the funding should be reviewed. It would be possible to seek a non-statutory clearance from HMRC to obtain certainty that the public infrastructure rules can apply; this is advisable if there would be restriction under the fixed ratio and group ratio methods.

Appointment of reporting company

When a worldwide group is subject to an interest restriction for a period of account and wishes to elect for the group ratio method, it must appoint a reporting company and submit an Interest Restriction Return (IRR) because the election for the group ratio method is within the IRR. Otherwise, it is not mandatory for a group to appoint a reporting company and submit IRRs, but many groups choose to do so for administrative simplicity and also to make use of the carry forward provisions that only apply if an IRR is submitted.

The reporting company must be subject to UK Corporation Tax for at least part of the period and not dormant. The appointment is automatically rolled forward unless revoked.

A notice must be given to HMRC within twelve months of end of period of account and must specify first period of account to which it relates. The notice should contain a list of consenting companies and a statement that those companies make up at least 50% of the UK taxable companies in the group.

Submission of IRR

If a reporting company has been appointed, then an IRR must be submitted. The filing date is 12-months from the end of the period of account of the worldwide group (or three months from date of appointment of reporting company if HMRC appoints the reporting company). An IRR must contain details of the ultimate parent, the UK companies, a statement of calculations, how any restriction is allocated, any elections and a declaration.

An abbreviated IRR may be submitted if the group is not subject to a restriction. It does not establish any carry forward amounts, but it can be replaced by a full IRR within five years of the end of the period of account.

We would be happy to advise further.
Regards
Lesley

MARKING GUIDE

TOPIC	MARKS	
Overview of CIR	0.5	
Fixed ratio	1.0	
Group ratio	0.5	
Public infrastructure income test	0.5	
Meaning of insignificant	0.5	
Meaning of qualifying infrastructure activities	0.5	
Meaning of public infrastructure asset	0.5	
Public infrastructure asset test	1.0	
Fully taxed in the UK	0.5	
Elected to be a QIC	0.5	
Certain amounts excluded from being tax interest expense	0.5	
Loans not to be from related parties	0.5	
Non statutory clearance possible	0.5	
		7.5
Requirement to appoint reporting company	0.5	
Voluntary appointment	0.5	
UK company not dormant	1.0	
Rolls forward unless revoked	0.5	
When IRR required	1.0	
Abbreviated returns	1.0	
Contents of full return	1.0	
HMRC powers	1.0	
		6.5
Presentation and higher skills		1.0
TOTAL		**15**

ANSWER 3

Grant of lease

For the accounting period ended 31 March 2020, Rossclair Ltd made a chargeable gain of £345,362 on the grant of the lease (see working 1 below). It is however, be possible to make an election for the gain to be transferred to Greason plc. Greason plc can then use its brought forward capital losses to shelter the gain.

Rossclair Ltd and Greason plc must jointly make an election within two years of the end of the accounting period of the company making the gain, so by 31 March 2022.

For an election to be valid, Rossclair Ltd and Greason plc must be members of the same capital gains group. Greason plc is not a subsidiary so it can be the principal company of a capital gains group. The principal company must hold at least 75% of the ordinary shares in the subsidiary (the other tests are not relevant here). Where there is an indirect holding in a company of more than 50% then that company can be part of the group, however a company can only be part of one group. In this case, the capital gains group comprises of Greason plc, Rossclair Ltd and Varilla Ltd.

Disposal of Sylviarm Ltd shares

If a company makes a disposal to a connected person then the market value (MV) has to be used as the consideration in the chargeable gain calculation.

A company is connected with another company if one company controls the other, or both are controlled by the same person. A company is connected with an individual if that individual either alone, or together with persons connected to him, control the company. Two companies are also connected if a person has control of one company, and persons connected to that person has control over the other company. An individual is connected with his or her spouse or civil partner. Control for this purpose means the power to control 50% of the voting rights.

The Greason group companies, except Walburn Ltd, are connected as they are directly or indirectly controlled by Zoe Willcox either alone or together with Tim Willcox. Greason plc is connected to Tim Willcox as his wife holds 60% of the shares in that company.

Where a company enters into a series of transactions with a connected person that are linked, an appropriate proportion of the aggregated MV should be used in the calculation. The two disposals to Tim Willcox are linked because they took place within six years of each other.

The MV to be used is, therefore, based on the aggregate MV of 6,000 shares rather than the MV of 4,000 shares for the 2016 transaction and 2,000 shares for the 2019 transaction that is:

1 June 2016	£1,500 per share
1 June 2019	£2,000 per share

The chargeable gain for the disposal in June 2019 is £2,138,554 (see working 3 below).

The original calculations for the 2016 transaction will now need to be revised. The original chargeable gain for the disposal in 2016 was £477,911 (see working 4 below). The revised gain is £2,477,911 (see working 5 below).

Although Varilla Ltd has losses brought forward at 1 April 2019, these arose from a transaction with a connected party, Sylviarm Ltd. Such losses can only be set against gains from transactions with the same connected party.

Working 1: Rossclair Ltd lease premium

	£
Lease premium	2,500,000
Less capital element	
2% x 2,500,000 x (20-1)	(950,000)
Income element	1,550,000
Chargeable gain on lease:	
Proceeds	950,000
Less:	
Cost 1,750,000 x (950,000/(2,500,000 +750,000))	(511,538)
Indexation 511,538 x ((278.1-235.2)/235.2)	(93,100)
Chargeable gain	345,362

Working 2: Calculation of cost and indexation allowance

Date	Event	Number	Cost	Indexed Cost
			£	£
June 2010	Acquisition	6,000	4,500,000	4,500,000
June 2016	Indexation (263.1 – 224.1)/224.1			783,133
				5,283,133
	Disposal (4,000/6,000)	(4,000)	(3,000,000)	(3,522,089)
	Carry forward	2,000	1,500,000	1,761,044
June 2019	Indexation (278.1 – 263.1)/263.1			100,402
				1,861,446
	Disposal	(2,000)	(1,500,000)	(1,861,446)
	Carry forward	Nil	Nil	Nil

Working 3: Disposal June 2019

	£
Proceeds 6,000 x £2,000/(2,000/6,000)	4,000,000
Cost (working 2)	(1,500,000)
Indexation (indexed cost £1,861,446 less cost of £1,500,000)	(361,446)
Chargeable gain	2,138,554

Workings 4: Original disposal June 2016

	£
Proceeds 6,000 x £1,000/(4,000/6000)	4,000,000
Cost (working 2)	(3,000,000)
Indexation (Indexed cost of £3,522,089 less cost of £3,000,000)	(522,089)
Chargeable gain	477,911

Workings 5: Revised disposal June 2016

	£
Proceeds 6,000 x £1,500/(4,000/6,000)	6,000,000
Cost (working 2)	(3,000,000)
Indexation (indexed cost of £3,522,089 less cost of £3,000,000)	(522,089)
Chargeable gain	2,477,911

MARKING GUIDE

TOPIC	**MARKS**
Meaning of connected companies	1.0
Meaning of connected individuals	1.0
Meaning of connected between individuals and companies	0.5
Composition of the CG group	1.0
Effect of being in a group	1.0
Lease premium	
Calculation of cost	1.0
Indexation Allowance	0.5
Calculation and deduction of income element	1.0
Transfer gain from Rossclair to Greason to utilise losses brought forward	1.0
Joint election within two years of end of AP	1.0
Losses b/f in Varilla Ltd can only be used against gains with Sylviarm Ltd	1.0
Transactions between connected parties at MV	1.0
Series of transaction between connected parties at aggregate MV	1.0
Comp of 2019 transaction	1.0
Comp of original 2016 transaction	1.0
Comp of revised 2016 transaction	1.0
TOTAL	**15**

ANSWER 4

Cabbot group – Analysis of UK tax issues for the year ended 31 October 2020

1) Adjustments required to taxable profits

(i) Expenses of management

The £1 million of bank fees related to the re-financing should be brought into account as a non-trading debit on a loan relationship and not an expense of management.

The due diligence fees are correctly treated as an expense of management on the basis the related transaction was never approved by the Board.

(ii) Loan relationship debits and credits

The amounts included in the draft tax position are correct subject to:

a) Including £1 million of bank fees; and

b) Excluding the £3,150,000 foreign exchange gain as a loan relationship credit as this arises in respect of net investment hedge. This treatment is mandatory as the loan is a hedge of our AUD$ shareholding in Cabbot South Pty and fair value movements on the shares are disregarded when calculating Cabbot plc's trading profits.

   The gain will potentially be brought into account under the Exchange Gains and Losses (Bringing into Account Gains or Losses) Regulations 2002 (also referred to as the EGLBAGL Regulations), should the shares be disposed of (albeit the Substantial Shareholding Exemption may apply to the disposal to exempt any gain or loss).

(iii) Dividend on fixed rate preference shares

The dividend on the fixed rate redeemable preference shares is not a chargeable gain.

The shares will be a "deemed loan relationship" in accordance with the Disguised Interest rules. As the fixed rate return is economically equivalent to interest, it is likely to meet the definition of a "commercial rate of interest" and this has been clear from the outset. The accounting treatment by the issuer does not have to support this treatment, i.e. the shares do not have to be accounted for as a liability.

This treatment also requires existence of a "tax avoidance purpose" and in this case, it is hard to dispute this unless there is a strong commercial reason for issuing preference share instead of interest bearing debt.

(iv) Utilisation of tax losses

Tax losses should be utilised for the period as set out below:

	Trading profits £	Non-trading profits £	Total profits £
Trading profits	6,700,000		6,700,000
Chargeable gain		7,320,000	
Expenses of management		(750,000)	(750,000)
Non-trade loan relationship debits		(2,250,000)	(2,250,000)
Taxable profits	6,700,000	4,320,000	11,020,000
Less: In-year reliefs: group relief	(1,700,000)	-	(1,700,000)
Profit after in-year reliefs	5,000,000	4,320,000	9,320,000
Allocation of £5 million allowance*	(5,000,000)	-	(5,000,000)
Profits remaining after allowance	-	4,320,000	4,320,000
Additional profits available for shelter (50%)	-	2,160,000	2,160,000
Total profits available for shelter	5,000,000	4,320,000	9,320,000
Offset of pre-April 2017 trading losses (c/f £5,500,000)	(5,000,000)	-	(5,000,000)
Offset of post-April 2017 trading losses (c/f £3,750,000)	-	-	-
Offset of post-April 2017 non-trading losses (c/f £10,730,500)	-	(2,160,000)	(2,160,000)
Utilisation of brought forward losses			(7,160,000)
Taxable profits after loss relief:	-	2,160,000	2,160,000

*The £5m allowance has been offset in full against trading profits to maximise relief available for offset of the WHT credit.

(v) Withholding tax (WHT) on interest

The £425,000 WHT liability may either be credited in full or in part against the Corporation Tax arising on the related foreign source income or expensed as a loan relationship debit.

As illustrated in the above loss relief calculations, it is advisable to optimise the allocation of tax losses to ensure the maximum amount of WHT can be credited against any Corporation Tax liability arising.

2) Application of the Diverted Profits Tax (DPT)

The company has a duty to notify HMRC that it is within the charge to DPT within 3 months of the end of the current accounting period, so by 31 January 2021. The company will need to disclose the royalty and explain that the financial benefit derived from the tax deduction is significant relative to the non-tax benefits of entering into the transaction.

HMRC will then issue a charging notice to the company and the tax is payable within 30 days of the notice being issued to avoid interest and penalties.

The DPT payable next year will not be deductible in computing taxable profits. The royalty payment to Cabbot GmbH should be deductible in the tax computation provided the rate is arm's length.

3) Proposed incorporation of US permanent establishment

If the entire assets and liabilities of the permanent establishment are transferred to the new U.S. company in exchange for the issuance of new shares or securities, it is possible to elect for "incorporation relief" under s.140 TCGA 1992. The election can be made on the tax computation of Cabbot Online Limited.

The chargeable gain or loss ordinarily arising on disposal is postponed indefinitely pending any future disposal of the shares of the U.S. company by Cabbot Online Ltd, or disposal of the assets by the U.S. company within 6 years of the transfer.

It would be preferable, however, for Cabbot Online Ltd to make a permanent establishment exemption election by the end of the accounting period, and defer the transaction briefly until the start of the following accounting period when the election takes effect. The election exempts any chargeable gains or losses on disposal permanently with no risk of future clawback.

MARKING GUIDE

TOPIC	**MARKS**
Expenses of management	
Bank fees deductible as non-trade loan relationship debit	1
Allow due diligence fees [s.1219(2) CTA 2009]	1
Loan relationship debits and credits	
Foreign exchange gain excluded (Disregard Regulation 3)	1
State gain may come into charge under EGLBAGL regulations [SI 2002/1970]	1
Dividend on fixed rate preference shares	
Disguised Interest provisions apply and state relevant conditions [s.486B CTA 2009]	1.5
There is likely a "tax avoidance purpose"	0.5
Utilisation of tax losses	
Group relief applicable and calculate position [s.99 CTA 2010]	1
Note that only 50% of profits may be sheltered with b/f losses	0.5
Allocate £5 million allowance [s.269ZR CTA 2010]	0.5
Offset of pre-April 2017 losses [s.45 CTA 2010]	1
Offset of post-April 2017 losses [s.45A CTA 2010 & s.463H CTA 2009]	1
Withholding tax on interest	
WHT may be credited against CT liability related to foreign source income [s.18 TIOPA 2010]	1
Diverted Profits Tax	
Identifying potential "tax mismatch outcome" & "insufficient economic substance"	2
Duty to notify HMRC within 3 months post year end [s.92 FA 2015]	1
HMRC obligation to issue charging notice and timeline to pay tax [s.98 FA 2015]	1
DPT is a separate tax chargeable at 25% rate	1
Incorporation relief	
Explain that transaction results in disposal of assets at fair market value	0.5
Conditions for relief under s.140 TCGA 1992	2
State risk of potential claw back of gain [s.140(4)&(5) TCGA 1992]	1
Brief deferral of transaction with election under s.18A CTA 2009 is preferable	0.5
TOTAL	**20**

<u>ANSWER 5</u>

Notes: Explanation of UK tax risks

There are risks in the following areas:

- Application of the Controlled Foreign Companies (CFC) legislation;
- Inadequate transfer pricing documentation;
- Potential migration of UK tax residency of ANCL Water; and
- Non-compliance with International Movement of Capital (IMOC) regulations.

<u>CFC analysis</u>

ANCL Finance and ANCL Electrics are CFCs of ANCL Utilities Ltd, as the company controls both subsidiaries.

Income of ANCL Electrics is exempt under the Tax Exemption as profits are subject to tax at a rate of 20% in Jersey.

Interest income on the loan from ANCL Finance to ANCL Water has incorrectly been subject to a reduced CFC apportionment through applying the Finance Company Partial Exemption (FCPE). This is because the borrower, ANCL Water, is a UK tax resident company.

It is not permitted to offset tax losses in ANCL Utilities Ltd against any CFC apportionment.
Corporation Tax has been underpaid in years to 31/12/2019:

£400,000,000 x 5% x 20% x 1¼ = £5,000,000
£400,000,000 x 5% x 19% x 1¾ = £6,650,000

Total tax underpaid = £11,650,000

<u>Transfer pricing</u>

The group must prepare transfer pricing documentation in support of the pricing of inter-company transactions and may be subject to penalties for non-compliance. A transfer pricing policy should outline a methodology for determining an arm's length rate of interest and quantum for intra-group loans.

This requires periodic benchmarking against similar debt for the utilities sector and loans by the Private Equity house plus other intra-group loans. It is important to ensure cash flow projections support companies being able to repay intra-group loans and related interest expense.

Where a company is deemed to have excess debt above what it can borrow externally from an unrelated party (for example, a bank), it will be considered "thinly capitalised". Often debt cover ratios such as Earnings Before Interest, Tax, Depreciation and Amortisation (EBITDA) to interest expense, and debt to EBITDA, will be considered in determining an arm's length level of debt.

Where a company is thinly capitalised, a proportion of any interest expense will be disallowed to the extent it relates to "excess debt". Interest will also be disallowed to the extent the interest rate is deemed excessive.

Conclusion:

It is not possible to quantify the tax exposure without undertaking a detailed transfer pricing study of the loans.

Potential migration

ANCL Water Ltd may have migrated tax residency from the UK to the Netherlands effective 1 January 2019 in view of Mr and Mrs Dunn emigrating to the Netherlands and discharging their duties as directors from there.

As the company is incorporated in the UK, it is deemed to be tax resident here. The company is also deemed tax resident in the Netherlands if managed and controlled there and so may be a dual resident company.

The UK / Netherlands double taxation agreement (DTA) should be consulted. Assuming that residency is determined by the "place of effective management", this is the place where key management and commercial decisions that are necessary for the conduct of the entity's business are undertaken. Subject to the DTA, this could be decided by a Mutual Agreement Procedure (MAP). Where the company is considered to be resident outside of the UK under the relevant double taxation treaty, this then also applies for purposes of domestic law.

If the company has ceased to be UK tax resident, it is deemed to dispose of and immediately thereafter reacquired all its assets for chargeable gains purposes.

The impact of these provisions is limited to the waterworks situated in the Isle of Man. The London waterworks and other assets related to the business, such as the patents, that would be carried on via a UK permanent establishment are excluded.

Tax exposure:

A chargeable gain of £5 million arises on deemed disposal of the investment property (£10 million deemed proceeds less £5 million base cost).

The tax exposure for ANCL Water is £5,000,000 million x 19% = **£950,000**

As the potential migration is to territory in the European Economic Area, the company may to either:

- Pay the tax in six equal instalments, starting 1 October 2020 (9 months and 1 day after accounting period of migration); or
- Pay the tax at the earlier of the disposal of the investment property or 31 December 2029.

Under either approach, the full amount of tax is due if the company goes into liquidation or administration.

As the migration has occurred prior to 1 January 2020 and the waterworks in the Isle of Man is used for the purposes of a trade, ANCL Water Ltd and ANCL Utilities Ltd can jointly elect to postpone the chargeable gain.

The deferred exit charge will be levied upon ANCL Utilities Ltd in the event that:

- The waterworks is sold by ANCL Water Ltd before 1 January 2025; or
- ANCL Utilities Ltd disposes of a 25% shareholding or more in ANCL Water Ltd.

The tax charge is pro-rated subject to part disposal of the asset or the shareholding. ANCL Utilities Ltd may shelter some the gain with any available tax.

Conclusion:

If a migration has occurred, an election (under s187(1)(b) TCGA 1992) should be made jointly by ANCL Utilities Ltd and ANCL Water Ltd by 1 January 2021 to defer the chargeable gain on the investment property.

If this cannot be determined in this timeframe, it is possible to defer payment of the tax up to 31 December 2029.

<u>Tax filings</u>

The International Movement Of Capital (IMOC) Regulations require a “reporting body”, in this case ANCL Utilities Ltd, to have reported the £100 million share subscription in ANCL Finance as an issue of shares by a foreign subsidiary as the transaction value exceeds £100 million.

The report should state the relevant transactions undertaken and explain the UK tax consequences. A failure to report a transaction will give rise to a penalty of £300 plus £60 per day of default.

Conclusion:

An IMOC report should be submitted to HMRC immediately to mitigate a potential penalty of £300 plus £60 per day of default.

MARKING GUIDE

TOPIC	MARKS
CFC analysis	
Overview of CFC regime and state relevant conditions	**1**
Tax Exemption applicable to profits of ANCL Electrics [s.371NB TIOPA 2010]	1
FCPE not applicable as ANCL Water UK tax resident [s371H(2) TIOPA 2010]	1
CFC apportionment incorrectly offset by losses [s.371UD TIOPA 2010]	1
Transfer pricing	
Risk of penalty if not transfer pricing documentation in place	0.5
Transfer pricing policy should extend to related party loans [s.152 – 153 TIOPA 2010]	0.5
Interest rate and volume to be benchmarked	1
Projected cash flows should also support intra-group loans	1
Thin capitalisation risk and considerations in determining arm's length level of debt	1
Tax residency of ANCL Water Limited	
ANCL Water may have migrated tax residency to Netherlands	0.5
Explain ANCL Water dual resident company	1
Note need to consult treaty and possible MAP	1
Explain concept of place of effective management	1
Tax consequence of migration per s.185 / 186 TCGA 1992	2
Calculate the exit charge related to the IoM property	1
Impact of the EEA instalment provisions	1
Recommend a joint election under s.187(1)(b) TCGA 1992	2
Non-compliance with IMOC regulations:	
Transaction should have been reported [Para 4 SI 2009 No 2192]	0.5
Outline content of IMOC Report [Para 3 SI 2009 No 2192]	1
Applicable penalty for non-compliance [s.98 TMA 1970]	1
TOTAL	**20**

ANSWER 6

Briefing note for Audit Partner

I have set out below some guidance as requested.

Compliance Checks

The Compliance Check is formal notification that HMRC has opened an enquiry into a Company Tax Return. It should be issued within a statutory time limit of 12 months after the due date of the Company Tax Return, note the enquiry window is extended where a Company Tax Return is filed late. This may be a “full” enquiry covering the full contents of the tax return or an “aspect” enquiry dealing with specific issues.

During the enquiry, both the company and HMRC are entitled to make amendments to the tax return although in practice, HMRC rarely make amendments until completion of the enquiry. If HMRC and the company are unable to agree on a specific technical issue, this can be jointly referred to the Tax Tribunal for independent determination.

An enquiry is complete when HMRC issue a notice of completion and detailing its conclusions. The tax return is amended directly by the closure notice and any outstanding tax settled.

Discovery Assessments

This type of assessment may be raised for periods where the window for enquiring into a tax return has passed. A Discovery Assessment is issued where HMRC discover that income or gains have not been taxed, or insufficient tax has been charged or excessive reliefs given.

The time limits and circumstances in which HMRC can raise an assessment are as follows:

Time limit (years)	**Fault**	**Cause**
4	Incomplete disclosure	• Not due to careless or deliberate conduct
6	A loss of tax	• Due to careless conduct
20	A loss of tax	• Due to a deliberate action, or • A failure to notify liability, or • Attributable to a notifiable tax avoidance scheme (DOTAS), a hallmarked scheme or listed scheme, and

If there has been a loss of tax in the earlier periods, then the returns and any other information sent to HMRC should be reviewed to ensure that HMRC are able to make such assessments.

A Discovery Assessment may be appealed within 30 days of its issue. Grounds for appeal may be objecting to the technical analysis or often the circumstances in which the error arose.

Penalties

HMRC are permitted to charge penalties where a return or other document that contains an inaccuracy that:

- Results in tax being unpaid, understated or over-claimed, and
- Was careless, deliberate or deliberate and concealed.

The penalty will be a percentage of the tax underpaid governed by the following criteria:

Type of behaviour	**Unprompted disclosure**	**Prompted disclosure**
Reasonable care	No penalty	No penalty
Careless	0% to 30%	15% to 30%
Deliberate	20% to 70%	35% to 70%
Deliberate and concealed	30% to 100%	50% to 100%

Further reductions are available for the quality of disclosure including making all information available and assisting HMRC.

MARKING GUIDE

TOPIC	MARKS
HMRC Compliance checks	
Time limit for raising enquiry [Para 24 Sch 18 FA 1998]	1
Enquiry may cover any aspect of tax return [Para 25 Sch 18 FA 1998]	1
Right of referral to Tax Tribunal [Paras 31A-31D Sch 18 FA 1998]	1
Requirement for HMRC to issue closure notice [Para 32 Sch 18 FA 1998]	1
Discovery assessments:	
Circumstances in which Discovery Assessment may be issued [Para 41(1) Sch 18 FA 1998]	2
Time limits for Discovery Assessment [Para 46 Sch 18 FA 1998]	1
Penalties:	
Circumstances where HMRC may apply penalty (per HMRC guidance)	1
Explain how penalties calculated and range of penalty (per HMRC guidance)	2
TOTAL	**10**