

THE CHARTERED INSTITUTE OF TAXATION

APPLICATION AND PROFESSIONAL SKILLS

Taxation of Larger Companies and Groups

May 2022

TIME ALLOWED

3 HOURS 30 MINUTES

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

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

You will be assessed for competence in a number of broad topics for the following skills:

- Identification and Application
- Relevant Advice and Substantiated Conclusions

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

- All workings should be shown and made to the nearest month and pound unless the question specifies otherwise.
- Candidates who answer any law elements in this paper in accordance with Scots law or Northern Ireland law should indicate this where relevant.
- Scots law candidates may provide answers referring to Land and Buildings Transaction Tax rather than Stamp Duty Land Tax.
- Unless otherwise indicated by the provision of additional information in the question, you may assume that 2021/22 legislation (including rates and allowances) continues to apply for 2022/23 and future years. Candidates answering by reference to more recently enacted legislation or tax cases will not be penalised.
- You must type your answer in the space on the screen as indicated by the Exam4 guidance.

You are a tax manager at NGH LLP, tax advisers to Novic Ltd.

Novic Ltd is a UK incorporated and tax resident company. It is owned by a consortium of three UK tax resident companies, Alpha plc, Beta plc and Gamma Ltd. The consortium members own, in equal amounts, all of the share capital of Novic Ltd.

Your tax partner, Delia Bistung, recently attended a meeting with the Chief Financial Officer of Novic Ltd, Bill Jones, and has just received a follow-up letter requesting tax advice. Delia has asked you to draft a report as requested in Bill's letter.

The following exhibits are provided to assist you:

EXHIBIT A: Note of meeting between Delia Bistung and Bill Jones

EXHIBIT B: Letter from Biopharma Inc to Novic Ltd

EXHIBIT C: Letter from Bill Jones to Delia Bistung

EXHIBIT D: Pre-seen information

Requirement

Prepare a draft report to Novic Ltd on the implications of the options to resolve the dispute, as set out in Bill Jones' letter, and recommend how to proceed.

Continued

EXHIBIT A

Note of meeting between Delia Bistung and Bill Jones

Date: 26 April 2022
Present: Bill Jones (CFO, Novic Ltd)
Delia Bistung (Tax partner, NGH LLP)

Subject: Dispute with CHB Ltd

Bill explained that since the end of last year, Novic Ltd has been in dispute with a competitor company, CHB Ltd.

CHB Ltd alleges that Novic Ltd has used (and continues to use), without permission, their intellectual property to develop a new drug (Drug B). This drug, although not yet approved for sale, has the potential for significant global sales and profits. CHB Ltd is seeking damages of £150 million as compensation for sales which they could have otherwise generated by creating the drug themselves or licensing their intellectual property. Novic Ltd has not accepted that compensation is due so CHB Ltd has started legal action. A court hearing is scheduled for late July 2022, with judgement expected shortly thereafter. Legal advice suggests that CHB Ltd has a more than 50 percent chance of success if the matter proceeds to court.

Bill explained that an offer to settle had recently been received from CHB Ltd's parent company, Biopharma Inc, and he provided a copy of the letter setting this out (**EXHIBIT B**). Whilst CHB Ltd claim significant compensation, they also recognise that Novic Ltd's own research and work on its drugs has significant value and so they are interested in acquiring Novic Ltd.

Bill has undertaken some research on CHB Ltd. CHB Ltd is tax resident and registered in Utopia, a Caribbean tax haven country. It is a wholly-owned subsidiary company of Biopharma Inc, which is tax resident in the USA. Biopharma Inc is the parent company of a multinational group. The group undertakes pharmaceutical research, and produces and sells drugs used to treat a variety of medical conditions. The intellectual property created by the research activities is protected by patents filed in numerous countries, with most of that intellectual property owned by CHB Ltd.

Biopharma Inc has a single wholly-owned UK tax resident subsidiary company, Biop (UK) Ltd. That company distributes drugs and has consistently reported annual profits of £5 million for the past five years.

Bill would like us to advise on how to proceed and he said that he would write to us in a few days with some further information once the Board had discussed potential options (**EXHIBIT C**).

Continued

EXHIBIT B

Letter from Biopharma Inc to Novic Ltd

The Board of Directors
Novic Ltd
Camford Science Park
Camford
CB99 9ZZ

Biopharma Inc
Los Angeles
USA

April 19, 2022

Dear Sirs

Dispute with CHB Ltd – without prejudice and subject to contract

Further to earlier correspondence in this matter, Biopharma Inc and CHB Ltd would be willing to settle the current dispute on one of the following terms:

- 1) An immediate payment of £100 million in cash to CHB Ltd with Novic Ltd entering into an arms' length royalty agreement for future use of the intellectual property; or
- 2) Biopharma Inc will buy, subject to due diligence, all of the share capital of Novic Ltd for £300 million, and the intellectual property dispute would be dropped; or
- 3) Biopharma Inc will buy, subject to due diligence, all of the share capital of Novic Ltd for £400 million, but with a prior cash payment to CHB Ltd by Novic Ltd of £100 million to settle the intellectual property dispute.

The consideration payable by Biopharma Inc under options 2 and 3 above would be increased by the tax value of losses brought forward and any deductions obtained for an intellectual property settlement figure, once agreed by HMRC.

Biopharma Inc is not willing to buy less than 100% of the share capital of Novic Ltd.

Yours faithfully

Chief Financial Officer
Biopharma Inc

Continued

EXHIBIT C

Letter from Bill Jones to Delia Bistung

Ms D Bistung
Tax Partner
NGH LLP
1 Middle Street
London
WC1Z 9ZZ

Novic Ltd
Camford Science Park
Camford
CB99 9ZZ

2 May 2022

Dear Delia

Dispute with CHB Ltd

Thank you for coming to see us last week.

The Board has had an initial discussion on this matter and has also discussed it with the consortium members. We have decided that before we make up our minds on how to proceed, we would like you to provide us with a report setting out the tax implications for us of each of the options and your recommendations as to how to proceed.

The options we have are to allow the dispute to proceed to court, or to settle on one of the terms set out in the letter from Biopharma Inc (**EXHIBIT B**).

Please note that we will share your report with each of the consortium members who may use your report as the basis of deciding how to proceed.

At our meeting, I said I would provide you with further relevant information. This is set out below.

The latest financial position (unaudited) of Novic Ltd at 31 March 2022 is as follows:

	£ million
Fixed assets	5
Cash at bank and debtors	<u>35</u>
Net assets	<u>40</u>
Share capital	60
Share premium	30
Reserves	<u>(50)</u>
Total equity	<u>40</u>

We have estimated that for the year ended 31 December 2022, the Corporation Tax losses of Novic Ltd will be £50 million. This figure excludes any settlement of the dispute with CHB Ltd. As HMRC has still not accepted that our activities qualify for Research & Development tax reliefs, we have not taken any such reliefs into account.

Novic Ltd has sufficient cash to conclude its current research project and obtain the necessary regulatory approvals. If that project is successful, the company will make significant profits from 2025 onwards. But if the project is not successful, the company will no longer be commercially viable.

Novic Ltd does not currently have sufficient cash to fund any settlement in respect of the dispute with CHB Ltd. However, each consortium member has agreed to provide one-third of any required funding if that route is pursued.

Continued

Continuation

The Corporation Tax position of each consortium member is as set out below:

<u>Consortium member</u>	<u>Alpha plc</u> £million	<u>Beta plc</u> £million	<u>Gamma Ltd</u> £million
Corporation Tax profits/(losses) for year ended 31 December 2021	100	150	(2)
Estimated future Corporation Tax profits per annum	100	150	1
Trading losses carried forward at 31 December 2021	nil	nil	(2)
Capital losses carried forward at 31 December 2021	(10)	nil	nil

Please contact me if you require further information.

Yours sincerely

Bill Jones
Chief Financial officer

Continued

EXHIBIT DPre-seen informationCompany name

Novic Ltd

Date of incorporation

2 January 2018

Country of incorporation

UK

Ownership

Novic Ltd is owned one third each by Alpha plc, Beta plc and Gamma Ltd.

Alpha plc and Beta plc are both UK incorporated and UK tax resident companies whose shares are listed on the London Stock Exchange.

Gamma Ltd is a UK incorporated and UK tax resident private company.

Chief Financial Officer

Bill Jones

Number of employees

200

Background

Alpha plc incorporated Novic Ltd in January 2018 and subscribed £20 million for all of its share capital. The original business plan of Novic Ltd was that it would undertake research into the creation of new anti-inflammatory drugs and commercially exploit the results of that research, either by licensing, or manufacture and sale of those drugs.

Novic Ltd has patented one new drug (Drug A) which has been authorised by UK regulators. Since 1 October 2021, Novic Ltd has been generating sales of Drug A of around £100,000 per month, all in the UK.

Further funds were required to continue and accelerate research into a second drug (Drug B) of potentially much wider application. External sources of investment were sought and as a result, Beta plc and Gamma Ltd each subscribed £35 million in January 2022 for one-third of the share capital of Novic Ltd.

None of Alpha plc, Beta plc and Gamma Ltd have any subsidiary companies.

Financial information for Novic LtdIncome statement for the year ended 31 December

	<u>2021</u>	<u>2020</u>
	£million	£million
Revenue	0.3	nil
Cost of sales	<u>(9.8)</u>	<u>(2.3)</u>
Gross profit/(loss)	(9.5)	(2.3)
Administrative expenses	<u>(2.0)</u>	<u>(1.0)</u>
Profit before tax	(11.5)	(3.3)
Tax	<u>nil</u>	<u>nil</u>
Profit after tax	<u>(11.5)</u>	<u>(3.3)</u>

Continued

Continuation

Balance Sheet as at 31 December

	<u>2021</u>	<u>2020</u>
	£million	£million
Fixed assets	1.0	1.2
Cash at bank and debtors	<u>3.0</u>	<u>14.3</u>
Net assets	<u>4.0</u>	<u>15.5</u>
Equity:		
Share capital	20.0	20.0
Reserves	<u>(16.0)</u>	<u>(4.5)</u>
Total equity	<u>4.0</u>	<u>15.5</u>

Corporation Tax

All company tax returns have been submitted on time and there are no open enquiries.

<u>Year end 31 December</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>
	£'000	£'000	£'000	£'000
Loss per accounts	(500)	(700)	(3,300)	(11,500)
Add back depreciation	500	400	300	200
Deduct capital allowances	(400)	(300)	(200)	(150)
Corporation Tax loss	(400)	(600)	(3,200)	(11,450)

All losses up to 31 December 2021 have been surrendered as group relief to Alpha plc.

HMRC have not yet accepted that any Research & Development reliefs are available.

VAT

Novic Ltd is registered for VAT in the UK.