



The Chartered Tax Adviser Examination

November 2019

Application and Professional Skills

Taxation of Larger Companies and Groups

TIME ALLOWED – 3 ¼ HOURS

- The first 15 minutes is designated as reading time. During this time you may read your question paper and legislation, annotate your question paper and use your calculator. You are not permitted to start writing your answer. The Presiding Officer will inform you when you can start writing.
- In order to secure a pass in this paper, you will be required to demonstrate competence in each of three skills.

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

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

- Identification and Application
- Relevant Advice and Substantiated Conclusions

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

- Write on one side of the paper only. Do not write in the margins.
- All workings should be shown and made to the nearest month and pound unless the question specifies otherwise.
- Candidates who answer any law elements in this paper in accordance with Scots law or Northern Ireland law should tick the appropriate box on the cover sheet.
- Scots Law candidates may provide answers referring to Land and Buildings Transaction Tax rather than Stamp Duty Land Tax.
- Unless otherwise indicated by the provision of additional information, you may assume that 2018/19 legislation (including rates and allowances) continues to apply for 2019/20 and future years. Candidates answering by reference to more recently enacted legislation or tax cases will not be penalised.

You are a tax manager in the accountancy firm, DS&Z (UK) LLP, and Chanman UK Ltd is one of your firm's clients. Your tax partner, Bruce Ballymore, has received a letter (**EXHIBIT A**) from Jenny Jorkins, the Head of Tax at Chanman UK Ltd, regarding the potential acquisition of the business of Danbridges Ltd.

Danbridges Ltd is a high street jewellery retailer with a well-known and respected brand, but has been performing poorly for some time; it has recently gone into administration.

The Directors of Chanman UK Ltd believe that they can turn Danbridges Ltd's business around, allowing the Chanman group to expand profitably in the UK jewellery market.

Bruce has asked you to read the letter from Jenny and prepare a draft report to her.

The following exhibits are provided to assist you:

EXHIBIT A: Letter from Jenny Jorkins to Bruce Ballymore

EXHIBIT B: Extracts from the IFRS statutory accounts of Danbridges Ltd for the year ended 31 December 2018

EXHIBIT C: Extracts from the financial due diligence report on Danbridges Ltd

EXHIBIT D: Pre-seen information

Requirement:

Prepare a draft report to Jenny Jorkins, for review by Bruce Ballymore, which advises on how to structure the potential acquisition of Danbridges Ltd's business to achieve the best possible tax outcome.

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Continuation

EXHIBIT A

Letter from Jenny Jorkins to Bruce Ballymore

Bruce Ballymore
DS&Z (UK) LLP
1 Corporal Lane
Donchester

Jenny Jorkins
Chanman UK Ltd
Brigadier Road
Donchester

1 November 2019

Dear Bruce

Proposed acquisition of business of Danbridges Ltd

As you are aware, it is a strategic priority for Chanman UK Ltd to increase its market share of the UK jewellery market. We have a large online presence but very few high street stores in the UK. For this reason we have been keeping an eye on Danbridges Ltd as a potential takeover target as it principally operates through high street stores but has very little online presence.

We are aware that Danbridges Ltd's business has been deteriorating in recent years, with falling sales and profits. It has now gone into administration and the administrator is looking for a buyer. We are confident that if we made a fair offer it would be accepted.

We would like to purchase the whole business, as the Danbridges brand is still valuable. Management believe we have the expertise to make the business profitable again. If we can achieve that, utilising synergies with our existing business, we will significantly increase our UK market share.

Our corporate restructuring team has already commissioned an independent financial due diligence report on Danbridges Ltd, extracts of which are enclosed (**EXHIBIT C**). There are a number of points in the report that we need to consider carefully. For instance, we would want to make use of the brought forward tax losses. It is likely that we would sell the unoccupied and the worst performing stores. We would also look to rationalise the product offerings to remove loss-making items.

If we were to proceed, we would fund the acquisition using existing cash reserves, which have been growing steadily in recent years. We would make the acquisition through a new UK company, Chanman Retail Ltd, which could be incorporated as early as next week, as a wholly owned subsidiary of Chanman Europe Ltd.

We are not yet sure whether to acquire the entire share capital of Danbridges Ltd, or the trade and assets only. We would be open to considering sensible alternatives, particularly if, for example, we could acquire the tax losses if we bought the trade and assets rather than the shares of the company.

Could you advise on how to structure the acquisition to achieve the best possible tax outcome?

I look forward to hearing from you soon.

Yours sincerely

Jenny Jorkins

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EXHIBIT B

Extracts from the IFRS statutory accounts of Danbridges Ltd for the year ended 31 December 2018

Income statements for the year ended 31 December

	<u>2018</u> £million	<u>2017</u> £million
Turnover	99	110
Cost of sales	<u>(83)</u>	<u>(84)</u>
Gross profit	16	26
Administrative expenses	(32)	(27)
Distribution costs	(12)	(11)
Net financial expense	<u>(2)</u>	<u>(2)</u>
Profit/(loss) before tax	<u>(30)</u>	<u>(14)</u>

Balance sheets as at 31 December

	<u>Notes</u>	<u>2018</u> £million	<u>2017</u> £million
Intangible assets	1	11	19
Property, plant and equipment	2	<u>45</u>	<u>50</u>
Total non-current assets		56	69
Inventories	3	42	50
Trade and other receivables		12	12
Cash and cash equivalents		<u>1</u>	<u>1</u>
Total current assets		55	63
Total assets		111	132
Borrowings		(35)	(31)
Trade and other payables		(36)	(33)
Provisions	4	<u>(12)</u>	<u>(10)</u>
Total liabilities		(83)	(74)
Net Assets		<u>28</u>	<u>58</u>
Called-up share capital		2	2
Share premium account		8	8
Retained earnings		<u>18</u>	<u>48</u>
Total Equity		<u>28</u>	<u>58</u>

Notes

- 1) Intangible assets comprise computer software and goodwill. The goodwill arose in 2013 when Danbridges Ltd acquired the trade and assets of Rings And Stuff Ltd, a jeweller that had commenced trading in 2005. The goodwill was impaired by 50% in 2018. The book value of all intangible assets is equal to the market value.
- 2) All property, plant and equipment are stated at historic cost less accumulated depreciation.
- 3) As at 31 December 2018, approximately 15% of inventory is valued below cost. For the remaining inventory, market value is equal to cost.
- 4) Provisions comprise warranties and guarantees, relating to products sold, and a restructuring provision.
- 5) No deferred tax asset has been recognised in respect of the accumulated trading losses and capital losses, as future utilisation is uncertain.

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EXHIBIT C

Extracts from the financial due diligence report on Danbridges Ltd

Scope and process

This report is based on the significant and material findings of the due diligence review performed on accounting, financial and tax information of Danbridges Ltd.

For the purpose of this report, we have reviewed the audited accounts for the year ended 31 December 2018, the unaudited forecasts for the year ended 31 December 2019, and information and explanations provided by the administrators and the directors of the company.

Background

Danbridges Ltd was incorporated on 2 October 1991 and is a high-street retailer of jewellery and watches. Danbridges Ltd operates through 80 stores throughout the UK. It also has a relatively small online sales activity. It has no other activities.

Danbridges Ltd is a wholly owned subsidiary of Dangroup AB, a large retailing company headquartered in Sweden. Danbridges Ltd is the only UK subsidiary in the group and holds no investments in any companies.

Forecast income statement for the year ended 31 December 2019

	£million
Turnover	89
Cost of sales	<u>(80)</u>
Gross profit	9
Administrative expenses	(28)
Distribution costs	(12)
Net financial expense	<u>(2)</u>
Profit/(loss) before tax	<u>(33)</u>

Forecast balance sheet as at 31 December 2019

	£million
Intangible assets	8
Property, plant and equipment	<u>38</u>
Total non-current assets	46
Inventories	36
Trade and other receivables	10
Cash and cash equivalents	-
Total current assets	46
Total assets	92
Borrowings	(41)
Trade and other payables	(44)
Provisions	<u>(12)</u>
Total liabilities	(97)
<u>Net assets</u>	<u>(5)</u>
Called-up share capital	2
Share premium account	8
Retained earnings	<u>(15)</u>
<u>Total equity</u>	<u>(5)</u>

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Corporation Tax matters

There are no open enquiries on any company tax returns for the periods up to and including the year ended 31 December 2015, all of which were filed within the statutory deadlines.

Filing status for years ended 31 December:

- 1) 2016 – the company tax return was submitted on 31 December 2017. HMRC has opened an enquiry into this return (see below);
- 2) 2017 – the company tax return was submitted on 1 October 2018;
- 3) 2018 – the company tax return was submitted on 31 July 2019.

On 1 December 2018, HMRC opened an enquiry into the tax return for the year ended 31 December 2016. HMRC has requested transfer pricing documentation for the acquisition of inventory from Danbrucke LLC, a related party tax resident in Luxembourg, expressing concerns that the price paid for the goods is higher than arm's length. The enquiry is still on going because there is no transfer pricing documentation covering the transactions. All of Danbridges Ltd's purchases have been made from Danbrucke LLC.

Tax losses as at 31 December 2018 comprise the following:

- 1) Trading losses of £45 million;
- 2) Capital losses of £12 million.

Other points to note:

- Current forecasts indicate that by 31 December 2019, accumulated trading losses will have increased to £72 million.
- There are no assets currently held by Danbridges Ltd that were transferred to it within the last six years by another company in the same UK capital gains group.

Chargeable assets

The only chargeable assets held by Danbridges Ltd are properties used as high street stores. Danbridges Ltd owns 20 properties and 60 properties are held on long-term leases.

We have seen an analysis prepared by Danbridges Ltd that estimates the market value of each of their stores. The analysis was prepared last year when Danbridges Ltd was considering disposing of some of its stores.

The analysis showed that, for the 20 properties owned by Danbridges Ltd, the average estimated market value was £1 million, and the average chargeable gain (after indexation) expected to be realised on disposal of each of these properties was £400,000.

For the 60 properties held on long-term leases, the average market value of the lease premium was £650,000. No net chargeable gain or loss is expected to arise on assignment of these leases.

The analysis also noted that five of the owned properties are currently unoccupied as a result of previous store closures.

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Value Added Tax matters

- 1) The company has been registered for VAT since 1 January 1992.
- 2) VAT registration number 3711413114.
- 3) No option to tax has been exercised on any land or buildings.
- 4) There are no freehold properties that are “new” (i.e. less than three years old).
- 5) There are no properties that are subject to the Capital Goods Scheme.
- 6) The company is not partially exempt.

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EXHIBIT D

Pre-seen information

UK companies

Chanman UK Ltd, Chanman Europe Ltd

Background

Chanman UK Ltd was incorporated in England on 1 March 2001. Its principal activity is as an online retailer of jewellery but it does own three high-street stores, which account for approximately 4% of total revenue and 1% of total pre-tax profit.

Chanman Europe Ltd was incorporated in England on 23 August 2000. Its principal activity is as a holding company for the group's European subsidiaries and its only source of income is dividend income from subsidiaries.

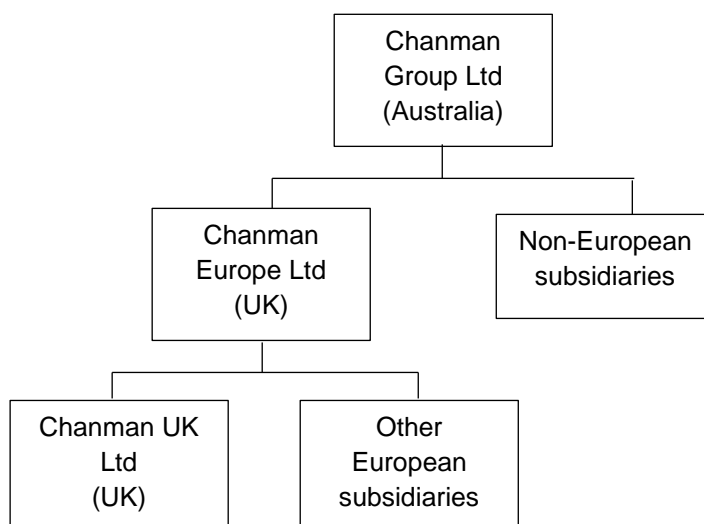
Tax residence

Both companies are tax-resident in the UK.

VAT

Chanman UK Ltd is the representative member of a VAT group comprising itself and Chanman Europe Ltd. No options to tax have been made.

Summarised group structure



Chanman Group Ltd

Chanman Group Ltd is incorporated and tax-resident in Australia, and its shares are listed on the Australian Securities Exchange. It holds a large number of subsidiaries located across Europe, Asia, North America and Oceania. All subsidiaries are wholly owned.

There are no other companies in the group that are either incorporated or tax-resident in the UK.

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Summarised financial information for Chanman UK Ltd

Income statement for the year ended 30 June:

	<u>2019</u> £million	<u>2018</u> £million
Revenue	236	221
Cost of sales	<u>(135)</u>	<u>(128)</u>
Gross profit	101	93
Administrative expenses	<u>(28)</u>	<u>(28)</u>
Operating profit	73	65
Net financing income	<u>2</u>	<u>1</u>
Profit before tax	75	66
Tax charge	<u>14</u>	<u>12</u>
Profit after tax	<u>£61</u>	<u>£54</u>

Chanman UK Ltd paid a £20 million dividend to Chanman Europe Ltd on 30 June 2019.

Balance sheet as at 30 June:

	<u>2019</u>		<u>2018</u>	
	£million	£million	£million	£million
Intangible assets	58		50	
Property, plant and equipment	<u>20</u>		<u>15</u>	
Total non-current assets		78		65
Inventories	70		60	
Trade and other receivables	27		21	
Cash and cash equivalents	<u>35</u>		<u>25</u>	
Total current assets		132		106
Total assets		210		171
Borrowings	(5)		(7)	
Trade and other payables	(14)		(13)	
Provisions	<u>(9)</u>		<u>(7)</u>	
Total current liabilities		(28)		(27)
Post-retirement scheme deficits		(5)		(8)
Total liabilities		<u>(33)</u>		<u>(35)</u>
<u>Net assets</u>		177		136
Called-up share capital		20		20
Share premium account		26		26
Retained earnings		131		90
<u>Total equity</u>		<u>177</u>		<u>136</u>

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Summarised financial information for Chanman Europe Ltd

Income statement for the year ended 30 June:

	<u>2019</u> £million	<u>2018</u> £million
Dividend income	<u>65</u>	<u>57</u>
Profit before tax	65	57
Tax charge	<u>-</u>	<u>-</u>
Profit after tax	<u>£65</u>	<u>£57</u>

Chanman Europe Ltd paid a £65 million dividend to Chanman Group Ltd on 30 June 2019.

Balance sheet as at 30 June:

	<u>2019</u>		<u>2018</u>	
	£million	£million	£million	£million
Investments	<u>138</u>		<u>138</u>	
<u>Net assets</u>		138		138
Called-up share capital		2		2
Retained earnings		<u>136</u>		<u>136</u>
Total equity		<u>138</u>		<u>138</u>