The Chartered Tax Adviser Examination

May 2018

The Application and Interaction of Taxes

TIME ALLOWED – 3 ¼ HOURS

- There are five questions on the paper which are:

  Question 1 Taxation of Individuals, Trusts and Estates
  Question 2 Taxation of Larger Companies and Groups
  Question 3 Taxation of Owner-Managed Businesses
  Question 4 Human Capital Taxes
  Question 5 VAT and other Indirect Taxes

- 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.

- You should answer only **ONE** out of the five questions.

- Each question carries 100 marks.

- Each question includes 22 marks specifically allocated for presentation and higher skills including the format of your answer, layout, style and the suitability and relevance of your advice.

- 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.

- Unless otherwise indicated by the provision of additional table information, you may assume that 2017/18 rates and allowances continue to apply for 2018/19 and future years. Candidates referring to actual or pending rates and allowances for 2018/19 and future years will not be penalised.

1. You are Jessica White, a tax manager in a firm of Chartered Tax Advisers. The Green family, who are clients of your firm, have requested advice in relation to their succession plans. John and Sally Green own a large farm and they currently trade in partnership with their son Alan. Alan has a son called Jack who is two years old. Your Tax Partner, Sam Black, has passed to you a letter from Mr Green which sets out their requirements (**EXHIBIT A**).

Mr and Mrs Green are concerned about Inheritance Tax and would like confirmation of their current position. They have provided an up to date list of their assets (**EXHIBIT B**) and a recent valuation of their farm (**EXHIBIT C**). The farm consists of various different assets including agricultural land and buildings, a farmhouse, a detached cottage, terraced cottages and woodland. The detached cottage is let as furnished holiday accommodation. Some of the terraced cottages are occupied by farm workers, some by tenants and some are derelict, as detailed on the valuation.

Mr and Mrs Green are keen for Alan to take over the farming business and would like to retire in the near future. They also want to ensure there is provision made from their assets for their daughter Anne. Mr and Mrs Green currently do not have any Wills in place.

Sam has also passed you a copy of the most recent accounts for the farming partnership (**EXHIBIT D**).

The family are all UK resident and have a UK domicile of origin.

The following exhibits are provided to assist you:

EXHIBIT A: Letter from Mr Green

EXHIBIT B: List of assets owned by Mr and Mrs Green (excluding Greenacre Farm)

EXHIBIT C: Extract from professional valuation of Greenacre Farm

EXHIBIT D: Extract from Greenacre Farm Partnership Accounts for the year ended 31 December 2017

You are required to draft a report for Mr and Mrs Green responding to their queries and commenting on any other issues relevant to the circumstances.

Marks will be allocated as follows:

Capital Gains Tax	(17)
Inheritance Tax and Trusts	(36)
Income Tax	(16)
Other tax issues	(4)
Law and Ethics	(5)
Presentation and higher skills	(22)
	Total (100)

Continued

1. Continuation

EXHIBIT A

Letter from Mr Green

Sam Black
Black Tax Advisers
1 Black Road
Blacktown
BT1 1BT

Mr Green
Greenacre Farm
Greentown
England
GT1 1GT

1 May 2018

Dear Sam

My wife Sally and I are thinking about our retirement and the future of our farm and our farming business and we think now is the time to get our affairs in order.

Our first concern is Inheritance Tax and whilst we would expect that our farming assets would be protected as a result of reliefs, you have told us before that it may not be that simple! We would therefore like to clarify what our current position is in relation to this.

As you are aware Sally and I own Greenacre Farm. It is currently farmed by our partnership and, on your advice, we brought Alan into the business a few years ago. The farm is not a partnership asset. You will recall I inherited the farm from my father in 1983 and originally operated the business as a sole trader. Sally joined me in partnership in 1996 and at that point, I gifted her a 50% share in the farm.

We would like our son Alan to own the farm and we wonder if we should give this to him now or whether he should inherit this on our death. We do not expect that the farm will ever be sold and would hope that Alan would pass the farm onto his son in future. We currently live in the farmhouse but we would like Alan and his family to live in this following our retirement and we would live in our rental property in Greentown. The outstanding mortgage secured on the farm is currently £148,000 and the borrowed funds were used to purchase the Newfields land.

We would continue to act as partners in the partnership for a period following the gift to Alan but we would hope to fully retire within the next 10 years. We would both continue to provide guidance and advice to Alan. We would leave any funds in our capital accounts on loan to the business and draw on these in future years to fund our retirement. Our only other income will be our State Pensions and a small amount of investment income. If any amounts were left in our capital accounts on our death we would like these to go to Alan.

We are also keen to make provision for our daughter Anne and she should receive all our assets other than the business assets and the farm when we have both died. In addition to this we would like her to own Blue Row Cottages. Ideally we would like to transfer these to her now as she has young children and the income they produce would help with school fees. Anne is a higher rate taxpayer.

I look forward to hearing from you in due course and perhaps we can meet up to discuss this in the near future.

Yours sincerely

John Green

Continued

1. Continuation

EXHIBIT B

List of assets owned by Mr and Mrs Green (excluding Greenacre Farm)

	Mr Green	Mrs Green	Total
	£	£	£
Bankhouse, Greentown (rental property)	200,000	200,000	400,000
Listed stocks and shares	50,000	100,000	150,000
ISA	40,000	30,000	70,000
Bank accounts	50,000	45,000	95,000
Chattels	50,000	50,000	100,000
Total	390,000	425,000	815,000

EXHIBIT C

Extract from professional valuation of Greenacre Farm

Valuation dated 30 April 2018

	Current value	1983 value
	£	£
Farmland 592 acres of grade 2:1 arable land @ £8,500 per acre 100 acres of temporary grass @ £8,530 per acre 15 acres other land @ £700 per acre All farmland is currently occupied by Greenacre Farm Partnership	5,895,500	1,184,000
Newfields 50 acres of grade 2:1 arable land @ £8,500 per acre Currently occupied by Greenacre Farm Partnership	425,000	100,000
Greenacre Farmhouse Attractive detached farmhouse, living room, kitchen, sitting room, five bedrooms, three bathrooms, utility room Occupied by Mr and Mrs Green The valuation reflects the fact this property is relatively close to Greentown and is likely to be attractive to a wide market. The agricultural value of the farmhouse is £455,000	650,000	50,000
Agricultural buildings Range of modern farm buildings. All in good state of repair Currently occupied by Greenacre Farm Partnership	150,000	20,000
Blue Row Cottages Attractive row of eight farm cottages. All two bedroom with good sized living rooms and kitchens and one bathroom Six cottages are let to tenants by the Greenacre Farm Partnership One cottage has always been occupied by a farm worker One cottage has been occupied by Alan Green in recent years and was let prior to this	640,000	80,000
Old Red Cottages Two derelict terraced farm cottages. Currently unused but with potential for future redevelopment	40,000	20,000

Continued

1. Continuation

<u>The Lodge</u> Detached four bedroom cottage, currently let as furnished holiday accommodation	180,000	30,000
<u>Woodland</u> 10 acres of woodland acting as shelter belts to agricultural land and not currently managed commercially	7,000	700
Total Value	7,987,500	1,484,700

EXHIBIT D

<u>Extract from Greenacre Farm Partnership Accounts for the year ended 31 December 2017</u>

<u>Balance sheet information</u>	Notes	£	2017 £	£	2016 £
Fixed assets					
Tangible assets	1		299,000		302,000
Current assets					
Stocks		360,000		305,000	
Debtors		45,900		35,700	
Cash at bank and in hand		150,000		149,000	
		555,900		489,700	
Creditors: amounts falling due within one year		(92,000)		(96,500)	
Net current assets			463,900		393,200
Net assets			762,900		695,200
Capital accounts					
Mr J Green			355,000		325,000
Mrs S Green			339,000		302,000
Mr A Green			68,900		68,200
			762,900		695,200

<u>Note 1</u>

	2017	2016
Plant and machinery:		
Farm machinery and equipment	109,000	129,000
Property improvements:		
Farm Sheds	190,000	173,000
Total fixed assets per accounts	299,000	302,000

<u>Profit and loss information</u>

	2017	2016
Income:		
Grain and livestock sales	675,000	668,000
Rental income from farm cottages	42,000	40,100
Income from holiday let	20,000	21,000
Total	737,000	729,100
Profit:		
Farming	175,800	163,400
Farm cottages	38,000	35,600
Holiday let	11,000	11,000
Total	224,800	210,000

2. You are Pat Brown, a corporate tax manager working in London at a large firm of accountants, Square & Circle LLP. It is a member firm of Square & Circle International LLP, an international organisation with member firms in many other countries.

You previously worked with a smaller firm of accountants, Purple & Yellow LLP, and prior to that with Capex Claims Ltd, a consultancy specialising in advising businesses on optimising their grant income and tax reliefs on large infrastructure projects. Capex Claims Ltd continues to offer commission (based on grants raised and tax savings achieved) to ex-employees who refer work to it. While working with Purple & Yellow LLP, you referred a client to Capex Claims Ltd, and the client spoke very highly of the service quality and tax result achieved. Square & Circle LLP do not offer this specialist service to their clients.

Acforth Industries Inc is a large multi-national publicly quoted company operating in the pharmaceuticals industry, with a track record of developing, testing and bringing to market new drugs. Its turnover is in excess of £5 billion, and it is based in and tax resident in Mulronia, a non–European Union country with which the UK has a double tax agreement. The relevant provisions of the UK – Mulronia Double Tax Agreement are provided at **EXHIBIT C**.

Mulronia's corporate profits tax rate is 15%. Profits and losses of trades carried on outside Mulronia by Mulronia tax-resident companies are exempt from Mulronia corporate tax.

Acforth Industries Inc is an audit and tax client of the Square & Circle International LLP member firm in Mulronia. It is considering beginning a new trade in the UK, having never previously operated in the UK, as set out in the letter and enclosures (**EXHIBITS A and B**) recently received by Johnny Rate, a tax partner at Square & Circle LLP in London. Johnny has asked you to draft a report to Acforth Industries Inc on the tax implications of the proposal.

Coincidentally, your fiancé Steve, who works for a large firm of solicitors in the UK, Round & Round LLP, has recently been involved in advising Acforth Industries Inc on UK employment law. Following the completion of that assignment, Steve bought shares in Acforth Industries Inc through the Mulronia stock exchange.

The following exhibits are provided to assist you:

EXHIBIT A: Letter from Chief Executive Officer of Acforth Industries Inc

EXHIBIT B: Projected financial results for Acforth Industries Inc's proposed UK trade

EXHIBIT C: Extracts from UK – Mulronia Double Tax Agreement

You are required to:

1) Draft a report for the Chief Executive Officer of Acforth Industries Inc in response to the questions raised in his letter, for review by the Tax Partner.

2) Prepare a memo to the Tax Partner to accompany the draft report, explaining other issues that need to be addressed and suggesting appropriate solutions.

Continued

2. Continuation

Marks will be allocated as follows:

Requirement 1	
Taxes on company	(53)
Payroll and personal tax	(18)
Requirement 2	(7)
Presentation and higher skills	(22)
	Total (100)

EXHIBIT A

Letter from Chief Executive Officer of Acforth Industries Inc

Acforth Industries Inc
High Street
Mulronia City
Mulronia

Mr J Rate
Tax Partner
Square & Circle LLP
Any Street
London

24 April 2018

Dear Mr Rate

Acforth Industries Inc is a long-standing client of the Square & Circle International LLP firm in Mulronia. They have suggested that I write to you to seek tax advice on a proposed investment we wish to make into the UK to create a new trade.

We have not yet decided whether Acforth Industries Inc should carry on the trade in the UK or to set up a new, separate company for this purpose. We have also not decided on the form of the necessary upfront investment.

Details of Investment

It is our intention to build a factory in the UK to develop and manufacture new drugs for sale in global markets. We are prepared to invest up to a maximum of £90 million, all of which will come from Acforth Industries Inc's existing cash resources. This sum will need to cover the following costs:

1) Long lease or rental of land. We have already identified a suitable site in central England and have obtained the necessary planning permission to build a factory. The site is not in an Enterprise Zone. In order to acquire an interest in the land, we will have to make an inducement payment of £2 million to the existing tenant farmer, and then enter into a lease to occupy the land. The freeholder has offered to grant a 99-year lease either for a lease premium payment of £12 million and a peppercorn rent (£1 per annum), or we could enter into a rental agreement for 99 years at £600,000 per annum. (The net present value of 99 years at £600,000 per annum is approximately £12 million.)

2) Demolition of the existing farm buildings in advance of construction of the factory, at an estimated cost of £400,000.

3) Construction of a bespoke factory including clean room manufacturing facilities and other manufacturing plant, at a total cost of £23 million.

Continued

2. Continuation

4) Purchase of a suite of patents registered in the UK, EU and non-EU countries, from an academic at Camford University in the UK, for £3 million.

5) Funding of operations i.e. to cover initial operating expenditure, until the UK business is self-financing, up to £48 million.

The projected financial results for the proposed UK business are enclosed for information (**EXHIBIT B**).

Employee issues

Mulronia nationals who are currently employed by Acforth Industries Inc in Mulronia, will move to the UK to take up full-time employment in the UK with effect from 1 August 2018. They will fill five senior management posts in the UK. We expect them to remain in the UK for at least three years and they will have no overseas duties. They have not previously been resident in the UK. We propose to:

1) Provide them with options over shares in Acforth Industries Inc under our existing Mulronia share option scheme. Under the scheme, discretionary options, without limit, can be awarded to an individual employee. The total current market value of the shares earmarked within the scheme for these transferring employees is £5 million.

2) Provide a relocation package, paid for in the UK, as follows:

   (a) We will purchase five family homes costing up to £1 million each, to house each transferring employee and his or her family, They will occupy the houses rent-free.

   (b) We will pay each transferring employee a removal grant of £20,000 to cover removal costs, transporting furniture to the new home, etc.

We will of course also need to recruit significant numbers of local employees once we have opened our factory.

Continued

2. Continuation

<u>Advice required</u>

Can you please let me have a report explaining the tax implications of our proposed investment?

The report should provide:

1) Advice on whether we should trade in the UK through a separate limited company or through a branch of Acforth Industries Inc. If a limited company is recommended, how should we should finance our investment (debt or equity), and what is the availability of tax deductions in respect of each of the specific areas of proposed expenditure at 1) to 4) above; together with any other tax planning and tax mitigation opportunities arising from the proposed investment and trading activity of which we should be aware.

2) A projection of our UK Corporation Tax liabilities and loss availability for all years up to and including the year ended 31 December 2022.

3) Advice on the UK payroll and personal tax implications of the share option awards and relocation packages, for both the transferring employees and us.

I look forward to hearing from you.

Yours sincerely

C D Triangle
Chief Executive Officer

Continued

2. Continuation

EXHIBIT B

Projected financial results for Acforth Industries Inc's proposed UK trade

Period to	31/12/2018 £'000	31/12/2019 £'000	31/12/2020 £'000	31/12/2021 £'000	31/12/2022 £'000
Sales	0	0	0	1,000	100,000
Payroll including cost of relocation packages and employees' houses	(7,000)	(10,000)	(10,000)	(16,000)	(30,000)
Trade materials		(100)	(1,000)	(1,000)	(20,000)
Building depreciation	-	(1,000)	(1,000)	(1,000)	(1,000)
Intellectual Property depreciation	(150)	(300)	(300)	(300)	(300)
Other expenses	(1,000)	(1,000)	(1,000)	(1,000)	(1,000)
Profit /(loss)	£(8,150)	£(12,400)	£(13,300)	£(18,300)	£47,700

Notes

1) Any interest costs or rental costs that might be incurred are not included in the above.

2) Payroll costs do not include any costs or accounting deductions for option or share awards.

EXHIBIT C

Extracts from UK – Mulronia Double Tax Agreement

Article 4: Corporate Residence

Where a company is resident of both Contracting States, it will be deemed to be a resident only of the State in which its place of effective management is situated.

Article 7: Business Profits

The profits of an enterprise of a Contracting State shall be taxable only in that state unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein, in which case the profits attributable to the permanent establishment may be taxed in that other State.

Continued

2. Continuation

Article 9: Associated Enterprises

Where

a) An enterprise of a Contracting State participates in the management, control or capital of an enterprise of the other Contacting State, or the same person participates in the management, control or capital of both such enterprises, and

b) Conditions are imposed on transactions between the enterprises of the two Contracting States which differ from those that would be made between independent parties, then

any profits that would have accrued to one of the enterprises but for those conditions may be included in the profits of that enterprise and taxed accordingly.

Article 10: Dividends

Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State shall be taxed only in that other Contracting State.

Article 11: Interest

Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other Contracting State.

However, such interest may also be taxed in the Contacting State in which it arises, and in accordance with the laws of that State, but if the recipient is the beneficial owner of the interest, the tax so charged shall not exceed 10% of the gross amount of the interest.

3. You are employed by Beaufort Consultancy, a firm of Chartered Tax Advisers based in the town of Hampden.

Billy Beaufort, the principal partner, has acted for Andrea and Mungo Whitley (both aged 62) and their small engineering company, Whitley Precision Tools Ltd, for many years. They have decided to sell the company either to Harrow Engineering Ltd, an unconnected company, or to their son Joe (aged 42) who currently runs their company.

Andrea and Mungo are also considering emigrating from the UK in the near future. They expect that this move will be for at least three to five years, although it could become permanent.

At a meeting last week, Andrea and Mungo asked Billy to provide some advice in respect of the proposed company sale and their emigration. Billy has agreed that a report will be prepared dealing with the relevant issues and he has asked you to prepare this for his review.

The following exhibits are provided to assist you:

EXHIBIT A: Notes of a meeting between Billy Beaufort and Andrea and Mungo Whitley

EXHIBIT B: Background information

EXHIBIT C: Extracts from the forecast balance sheet of Whitley Precision Tools Ltd as at 31 October 2018

You are required to prepare a report to Andrea and Mungo Whitley, covering the issues raised during the recent meeting with Billy Beaufort.

Marks will be allocated as follows:

Sale of Whitley Precision Tools Ltd

Asset sale	(24)
Share sale to Harrow Engineering Ltd	(19)
Share sale to Joe Whitley	(5)
Emigration	(20)
Other issues	(10)
Presentation and higher skills	(22)
	Total (100)

Continued

3. Continuation

EXHIBIT A

Notes of a meeting between Billy Beaufort and Andrea and Mungo Whitley

Attended by: Billy Beaufort; Andrea Whitley; Mungo Whitley
Date: 16 April 2018

Andrea and Mungo explained that they are planning to retire on 31 October 2018 and are considering:

1) Selling Whitley Precision Tools Ltd (WPTL)

2) Emigrating from the UK

Sale of WPTL

Andrea informed Billy that Whitley Precision Tools Ltd will either be sold to Harrow Engineering Ltd (HEL), an unconnected company, or to Joe Whitley, their son.

Sale to HEL

After initial discussions with Harrow Engineering Ltd it has been agreed that, should it proceed, the sale will occur on 31 October 2018 and would proceed in one of two ways:

1) The company would sell its trade and trading assets (with the exception of trade debtors and cash) at their market value. The consideration would be settled entirely in cash. The company's portfolio of quoted shares would be sold and Whitley Precision Tools Ltd would then be wound up with residual funds distributed to the shareholders.

2) Andrea and Mungo would sell all of their shares to Harrow Engineering Ltd. In this event Harrow Engineering Ltd would either acquire the shares a) for cash consideration equal to the company's market value; or b) for consideration comprising £1,000,000 cash and loan notes for the balance. In the latter case total consideration would be the company's market value plus an additional £50,000. It is intended that the loan notes would be redeemed on 31 October 2020.

Under both options Harrow Engineering Ltd have agreed that Joe Whitley, who has now been running Whitley Precision Tools Ltd for several years, will be retained as an employee in a senior management capacity.

Sale to Joe

As funds will be required to meet their retirement plans if the sale to Harrow Engineering Ltd does not proceed, Andrea and Mungo would sell all of their shares to Joe on 31 October 2018 albeit for half of their market value at that time.

Billy agreed to draft a report to Andrea and Mungo addressing the principal taxation issues of the proposed sale of their Whitley Precision Tools Ltd shareholdings. As a sale to Harrow Engineering Ltd is considered to be very likely to happen, and is more attractive to them as it realises most funds for their retirement, they only require a discussion of the main principles involved in respect of a sale of their shares to Joe. Detailed calculations regarding a potential sale to Joe are therefore not required. They are familiar with any VAT implications so do not require advice in this area.

Continued

3. Continuation

Emigration of Andrea and Mungo

Andrea and Mungo also informed Billy that they are considering emigrating from the UK. They have always taken holidays in the country of Wellingtonia and are seriously considering moving there. The move will be for at least three to five years although this may turn into a permanent move.

If they decide to emigrate they are planning to leave on 31 October 2018 and will then buy a house in Wellingtonia. A friend has already agreed to buy their UK home. The sale of this is most likely to be completed on 31 October 2018 although may take a little longer.

Andrea and Mungo have not sold a house for some time and are unsure of the process. As this will be sold to a friend, they wondered whether a formal written agreement was required and also at which point they will become legally committed to the sale. They also mentioned that a neighbour has a right of way through the rear of their garden. There is no mortgage in relation to this property.

Both Andrea and Mungo will stop working for Whitley Precision Tools Ltd on 31 October 2018. They also confirmed that neither of them will be working in Wellingtonia.

Billy therefore agreed that the report to Andrea and Mungo will also consider the proposed emigration to Wellingtonia. At this stage it was agreed that this part of the report need only consider any UK tax implications, with particular reference to the sale of their UK home and their shareholdings in Whitley Precision Tools Ltd. It was also agreed that the report will outline the process for selling their home to their friend.

EXHIBIT B

Background information

History of Whitley Precision Tools Ltd

The company was incorporated in 1952 with the initial share capital of 1,000 ordinary £1 shares issued to Andrea Whitley's father at par.

Andrea inherited all of the shares from her father upon his death on 1 July 1992 and on 1 July 1995 she gifted 450 of her shares in the company to her husband Mungo Whitley. On 1 July 1992 and 1 July 1995 the shares were valued at £50,000 and £65,000 respectively.

Both Andrea and Mungo have been directors of Whitley Precision Tools Ltd for many years and work full-time for the company.

Whitley Precision Tools Ltd makes up its accounts to 31 October each year.

Corporation Tax

The taxable total profits of Whitley Precision Tools Ltd for the last few years are as follows:

Year Ended	£
31 October 2014	86,424
31 October 2015	68,250
31 October 2016	88,750
31 October 2017	58,750

Continued

3. Continuation

For the year ended 31 October 2018 taxable trading income before capital allowances is forecast to be £65,500. At 1 November 2017 the tax written down value on the company's general and special rate pools amounted to £54,000 and £11,500 respectively.

Andrea and Mungo Whitley

Both Andrea and Mungo Whitley have always been UK resident and domiciled for tax purposes.

They are both higher rate taxpayers.

They bought their current home in July 1995 for £65,000. This is expected to be sold for £650,000. They have always used this home as their main residence.

The only significant assets that they own are their UK home and their shareholdings in Whitley Precision Tools Ltd. They have not made any previous lifetime gifts.

Wellingtonia

Wellingtonia does not have a double taxation treaty with the UK.

Chargeable gains are not subject to taxation in Wellingtonia.

EXHIBIT C

Extracts from the forecast balance sheet of Whitley Precision Tools Ltd as at 31 October 2018

		Notes	Balance Sheet value	Market value
			£	£
Fixed assets	Goodwill			300,000
	Freehold factory	1	225,000	500,000
	Plant and machinery	2	375,000	425,000
	Motor Vehicles	3	75,000	45,000
	Investments	4	25,000	85,000
Current assets	Trade debtors		115,000	115,000
	Stock		55,000	55,000
	Cash and bank		225,000	225,000
			1,095,000	1,750,000
Current liabilities	Trade creditors		(105,000)	(105,000)
	Other creditors		(75,000)	(75,000)
Net Assets			915,000	1,570,000
Capital and Reserves				
Called up share capital			1,000	
Profit and loss account			914,000	
			915,000	

Continued

3. Continuation

The forecast balance sheet is before taking account of any Corporation Tax liability for the year ended 31 October 2018.

<u>Notes</u>

1) The freehold factory is entirely used by Whitley Precision Tools Ltd for its trade and was acquired in July 1995 for £175,000. An extension was added in July 2005 costing £50,000.

2) Plant and machinery includes two computerised lathes that were acquired in January 2018 from an unconnected company that went into receivership. Each lathe cost £110,000 but each has a current market value of £135,000. The balance of plant and machinery comprises many smaller items of equipment each with an individual value of less than both £6,000 and original cost. During the year ended 31 October 2018 the company will not make any further fixed asset additions but will dispose of an item of equipment originally costing £40,000 for proceeds of £25,000.

3) The market value of the motor vehicles includes £10,000 in relation to a vehicle, which is the only asset included in the special rate pool for capital allowances purposes. The company's other vehicles are included within the main pool. All motor vehicles are worth less than original cost.

4) The investments comprise a portfolio of quoted shares. These had been acquired to make use of some surplus funds and had cost £25,000 in July 2005.

4. You are Joe Grassmere, an assistant manager working in a Human Capital team within a firm of Chartered Tax Advisers. Your firm has just started working with Learnshape UK Ltd, which is a company tax resident and registered in the UK.

On 1 April 2018 Learnshape UK Ltd was acquired by BigShape Group Ltd, which is tax resident and registered in Canada. BigShape Group Ltd is listed on the Toronto Stock Exchange. Both companies manufacture educational toys and equipment for pre-school children and, until the acquisition, had been competitors.

Your Tax Partner, Kate Sharp, has recently met with Barry Balbis, the Finance Director and acting Managing Director of Learnshape UK Ltd about the appointment of a new Managing Director. Kate has sent you an email to ask you to prepare a draft report for her review.

The following exhibits are provided to assist you:

EXHIBIT A: Email from your Tax Partner, Kate Sharp

EXHIBIT B: Email from Barry Balbis to Stella Square

EXHIBIT C: Tom Johnson's suggested salary package

EXHIBIT D: Email from Oliver Octagon to Barry Balbis

EXHIBIT E: Extracts from the bilateral social security agreement between UK and Canada

EXHIBIT F: Extracts from the UK/Austria Double Tax Agreement

You are required to prepare a draft report to Barry Balbis at Learnshape UK Ltd advising on:

1) The UK tax and legal implications of Tom Johnson's assignment to the UK.

2) Any areas where you think there could be additional risk or opportunity in the UK for Learnshape UK Ltd or BigShape Group Ltd.

Marks will be allocated as follows:

Requirement 1	Income Tax	(43)
	Other tax and legal considerations	(15)
Requirement 2		(20)
Presentation and higher skills		(22)
		Total (100)

Continued

4. Continuation

EXHIBIT A

Email from your Tax Partner, Kate Sharp

To: Joe Grassmere
From: Kate Sharp
Date: 1 May 2018
Subject: Learnshape UK Ltd

Hi Joe

Please see below my notes following my recent meeting with Barry Balbis at Learnshape UK Ltd.

Barry is the Finance Director of Learnshape UK Ltd and has been with the company for many years. He is also acting Managing Director of Learnshape UK Ltd pending the appointment of a new Managing Director (see below).

Until last week, the Managing Director was Stuart Shape, who had been with the company for many years. He apparently had a disagreement with the directors of BigShape Group Ltd and it was agreed it would be best for him to leave the company immediately. Nothing further has happened with regards to resolving his departure from the company.

Stella Square, who is Learnshape UK Ltd's HR Director also joined us for part of the meeting.

As you know BigShape Group Ltd from Canada bought Learnshape UK Ltd on 1 April 2018. The acquisition was hostile and resulted in Stuart Shape's termination very shortly after the acquisition due to significant managerial differences and tensions with the directors of BigShape Group Ltd.

As part of the integration of the businesses, BigShape Group Ltd want to send a Canadian employee, Tom Johnson, to the UK as the new Managing Director. Barry has been asked to "sort out" all matters relating to Tom's move to the UK including budgeting for the costs.

Whilst Barry accepts the reasons for Tom being assigned to the UK, he is apprehensive and will need a great deal of support and reassurance from us as neither business has worked outside their respective home countries in the past. Despite his concerns, Barry would like to "make the best" out of the situation and assist Tom as much as possible as he wants to see the company continue to be successful.

Tom is a Toronto born Canadian national and he is likely to arrive in the UK on 31 May 2018. He is married to Jessica and has two young children. Jessica and the children will be accompanying him to the UK. They have been renting a house in Toronto which they will relinquish when moving to the UK.

BigShape Group Ltd's management think that Tom will remain in the UK for 18 months for the integration and to appoint a permanent Managing Director but Barry is worried that this timescale is unrealistic given how different the companies are to each other. I will forward to you some emails Barry has sent me which contain additional emails which you will find helpful (**EXHIBITS B, C and D**).

Continued

4. Continuation

Please would you draft a report for my review on the UK Income Tax and National Insurance implications of Tom's move to the UK and also, as this is a new client, it would be a good time to flag any other risks and opportunities which the companies may face.

Many thanks

Kate

EXHIBIT B

<u>Email from Barry Balbis to Stella Square</u>

To: Stella Square
From: Barry Balbis
Date: 28 April 2018
Subject: Tom Johnson

Hi Stella

Further to our meeting, here are my notes regarding Tom's imminent move to the UK:

1) Tom wants to be "tax equalised" and I understand that this means that he only pays at the rate of tax in Canada based on his stay at home package. The Canadian finance team have told me that Tom's effective rate of Canadian tax was 31.5% for 2017, however, they also tell me payroll withholding for Tom would stop in Canada whilst Tom is assigned to the UK.

2) Tom will remain employed by BigShape Group Ltd and paid through the Canadian payroll.

3) I'm guessing he pays his tax with his Canadian tax return.

4) Tom is coming over with his wife Jessica and their two children who are of primary school age. BigShape Group Ltd have suggested they are going to pay for his housing and private school fees here (although I'm not sure why private schools as they were in the English-speaking state system in Canada).

5) See the attached proposed salary package (**EXHIBIT C**).

6) Tom has been told that they may claim child benefit when here.

7) BigShape Group Ltd's boss, Oliver Octagon, wants Tom to "pop to Austria" to work on Project Geometry. Oliver has provided more information on this – see attached email (**EXHIBIT D**).

8) I'm expecting that Canada will bear the costs relating to Tom's role especially for the time he is in Austria.

9) In terms of Tom's role, BigShape Group Ltd expect that this will take 18 months to integrate Learnshape UK Ltd with BigShape Group Ltd's processes and policies but given Oliver's email about time in Austria I suspect that it will take longer. I suggest we go on the safe side and make the secondment for two to three years. Agree?

Continued

4. Continuation

10) We should consider leasing a car for Tom whilst he is here; I know we don't usually have company cars, but I doubt that Tom will want the hassle of buying, insuring, maintaining and then selling it when he leaves the UK. What do you think?

We must make the best of this and ensure that we are able to budget for the costs and see if we can reduce any costs where appropriate.

Best regards

Barry

EXHIBIT C

Tom Johnson's suggested salary package

Items	Amount
The following items are payable in Canadian dollars:	
Salary per annum	CAN$240,000
Bonus per annum (paid November following financial year end 30 September)	Fixed 65% of salary
The following items are payable in Sterling:	
Housing allowance per month	£2,000
Cost of living allowance per annum	£14,000
Private medical insurance per annum	£600
Car allowance per month	£1,000
School fees per annum	£25,000
Relocation allowance (one off)	£20,000
Mileage allowance per mile (expected to travel to customers in UK and Austria up to 6,000 miles per annum)	£0.50

Exchange rates

Spot rate on 31 October 2017	£1 = CAN$ 1.60
Average year to 5 April 2018	£1 = CAN$ 1.75
Spot rate on 28 April 2018	£1 = CAN$ 1.80

On 1 January 2018, Tom was granted options over 10,000 BigShape Group Ltd shares with an exercise price of CAN$2.50 per share. The options vest on 1 January 2021. The current market value of BigShape Group Ltd shares is CAN$4.70 per share.

Continued

4. Continuation

EXHIBIT D

Email from Oliver Octagon to Barry Balbis

To: Barry Balbis
From: Oliver Octagon
Date: 25 April 2018
Subject: Tom and Project Geometry

Barry

How are you?

Further to our call last week I was wondering if Tom could do us a favour and pop over to see the guys at Department of Education in Austria (DOEA) to work on Project Geometry whilst he's with you in the UK.

To give you some background, we are hoping to sell BigShape Group Ltd's products to the DOEA. You may know that the DOEA purchase all equipment for state nursery schools in Austria. Project Geometry, we hope, will be a contract with the DOEA to exclusively provide pre-school nursery equipment for the next two years. The equipment will be for BigShape Group Ltd products. Tom has been part of the discussions with DOEA.

Tom is happy to pop over to Austria as it's not far and won't take much time. We have provisionally booked some time with the DOEA teams. I am expecting he will need to go to Austria for a working week every month to see the various DOEA teams from July 2018 until he leaves the UK. As you know Project Geometry will involve a contract between BigShape Group Ltd and the DOEA so Tom's time there will be useful immediately and when we set-up the distribution centre in Austria.

Thanks Barry – thanks again for stepping in following Stuart's departure – you're a star!

Oliver
Oliver Octagon
Sales Director of BigShape Group Ltd, Canada

Continued

4. Continuation

EXHIBIT E

Extracts from the bilateral social security agreement between UK and Canada

Article 4: General Provisions

1. Subject to paragraphs (2) to (4) and Articles 5 to 7, where a person is employed, liability for contributions for him or her shall, in respect of that employment, be determined only under the legislation of the Party in whose territory he or she is so employed. Where a person is subject only to the legislation of the United Kingdom in accordance with this paragraph, that legislation shall apply to him or her as if he or she were ordinarily resident in the territory of the United Kingdom.

2. Where a person is ordinarily resident in the territory of one Party and is self-employed in the territory of the other Party, or in the territory of both Parties, liability for contributions for him or her shall, in respect of that self-employment, be determined only under the legislation of the Party in whose territory he or she ordinarily resides. Where a person is subject only to the legislation of the United Kingdom in accordance with this paragraph, that legislation shall apply to him or her as if he or she were self-employed earner in the territory of the United Kingdom but without imposing any liability in respect of profits or gains immediately derived from such employment in Canada.

3. Where a person is employed in the territory of one Party and self-employed in the territory of the other Party for the same activity, liability for contributions for him or her shall, in respect of that activity, be determined only under the legislation of the Party in whose territory he or she ordinarily resides.

4. Where, under Article 5, a person is employed in the territory of the United Kingdom while remaining liable for contributions under the legislation of Canada, the legislation of the United Kingdom shall not apply to him or her and he or she shall not be liable, nor entitled, to pay contributions under the legislation of the United Kingdom.

Article 5

Detached Workers

Subject to Articles 6 and 7, where a person compulsorily insured under the legislation of one Party, and employed by an employer with a place of business in the territory of that Party, is sent by that employer, either from the territory of that Party, or from a third country not party to this Convention, to work in the territory of the other Party, the legislation of the former Party concerning liability for contributions shall, in respect of that employment, continue to apply to him or her as if he or she were employed in the territory of that Party, provided that the employment in the territory of the other Party is not expected to last for more than five years, and the legislation of the latter Party shall not apply to him or her.

Continued

4. Continuation

EXHIBIT F

Extracts from the UK/Austria Double Tax Agreement

Article 4

Fiscal Domicile

(1) For the purposes of this Convention, the term "resident of a Contracting State" means, subject to the provisions of paragraphs (2) and (3) of this Article, any person who, under the law of that State, is liable to taxation therein because of his domicile, residence, place of management or any other criterion of a similar nature; the term does not include any individual who is liable to tax in that Contracting State only if he derives income from sources therein. The terms "resident of the United Kingdom" and "resident of Austria" shall be construed accordingly.

(2) Where by reason of the provisions of paragraph (1) of this Article an individual is a resident of both Contracting State, then his status shall be determined in accordance with the following rules:

(a) he shall be deemed to be a resident of the Contracting State in which he has a permanent home available to him. If he has a permanent home available to him in both Contracting State, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closest (centre of vital interests);

(b) if the Contracting State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either Contracting State, he shall be deemed to be a resident of the Contracting State in which he has a habitual abode

(c) if he has a habitual abode in both Contracting States or in neither of them, he shall be deemed to be a resident of the Contracting State of which he is a national;

(d) if he is a national of both Contracting State or of neither of them, the competent authorities of the Contracting State shall endeavour to settle the question by agreement.

(3) Where by reason of the provisions of paragraph (1) of this Article a person other than an individual is a resident of both Contracting State, then it shall be deemed to be a resident of the Contracting State in which its place of effective management is situated.

Article 5 Permanent Establishment

(1) For the purposes of this Convention, the term "permanent establishment" means a fixed place of business in which the business of the enterprise is wholly or partly carried on.

(2) The term "permanent establishment" shall include especially:

(a) a place of management;
(b) a branch;
(c) an office;
(d) a factory;
(e) a workshop;
(f) a mine, quarry or other place of extraction of natural resources;
(g) a building site or construction or assembly project which exists for more than twelve months.

(3) The term "permanent establishment" shall not be deemed to include:

Continued

4. Continuation

(a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;
(b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;
(c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
(d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or for collecting information, for the enterprise;
(e) the maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information, for scientific research or for similar activities which have a preparatory or auxiliary character, for the enterprise.

(4) A person acting in a Contracting State on behalf of an enterprise of the other Contracting State -- other than an agent of an independent status to whom the provisions of paragraph (5) of this Article apply -- shall be deemed to be a permanent establishment in the first-mentioned State if he has, and habitually exercises in that State, an authority to conclude contracts in the name of the enterprise, unless his activities are limited to the purchase of goods or merchandise for the enterprise.

(5) An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission agent or any agent of an independent status, where such persons are acting in the ordinary course of their business.

(6) The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.

Article 15 Income from Employment

(1) Subject to the provisions of Articles 16, 18, 19, 20 and 21, salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.

(2) Notwithstanding the provisions of paragraph (1) of this Article, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:

(a) the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in the fiscal year concerned of that other State; and

(b) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State; and

(c) the remuneration is not borne by a permanent establishment or a fixed base which the employer has in the other State.

(3) Notwithstanding the preceding provisions of this Article, remuneration in respect of an employment exercised aboard a ship or aircraft in international traffic may be taxed in the Contracting State of which the person deriving the profits from the operation of the ship or aircraft is a resident.

5. You are Tim Jones, a tax manager in a firm of Chartered Accountants. Dunchester Rugby Football Club is a new client secured by the audit partner, Richard Waters, who has received a letter (**EXHIBIT A**) from the Club's newly appointed Secretary, Bill Hayley, seeking advice on the tax implications of various transactions contemplated by the Club.

Richard has passed the letter to you and asked you to prepare a draft report addressed to the Committee for his review, which advises on the various issues arising from Bill's letter.

The following exhibits are provided to assist you:

EXHIBIT A: Letter from Bill Hayley to Richard Waters

EXHIBIT B: Dunchester Rugby Football Club Partial Exemption Annual Adjustment 31 May 2017

You are required to prepare a draft report advising on issues arising from Bill Hayley's letter.

Marks will be allocated as follows:

VAT	(48)
Corporation Tax	(18)
Other Taxes and Other Matters	(12)
Presentation and higher skills	(22)
Total	(100)

EXHIBIT A

<u>Letter from Bill Hayley to Richard Waters</u>

Mr R Waters	The Club Secretary
Lewis Waters LLP	Dunchester Rugby Football Club
10 High Street	222 Low Street
Dunchester	Dunchester
Cheshire	Cheshire
CD22 0NB	CD20 3DD

23 April 2018

Dear Richard

It was very good to meet you at Saturday's match and, as agreed, I have set out here the matters which we discussed and our requirements.

Continued

5. Continuation

Background

Dunchester Rugby Football Club is a members' club affiliated to the Rugby Football Union. It is a company limited by guarantee and is a registered charity; its principal objective being "the promotion of community participation in sport and the provision of facilities for recreation or leisure time in the environs of Dunchester." The trustees are the Club's Executive Committee which is elected by the members. The Club is VAT-registered. It does not have any interest in other companies.

Membership

In the financial year ending 31 May 2017 we had subscription income of £42,000 from 450 members.

In return for their subscription, members receive the following benefits:

1) The right to attend the Club's AGM and to vote.

2) Entry to the Club's ballot for international tickets allocated to the Club by the Rugby Football Union. Tickets allocated to Club members through the ballot are purchased by them at cost.

3) The Club's bi-monthly magazine "Swing Low".

4) The right to participate in training sessions and Club matches.

5) Insurance cover against an injury sustained while training with, or playing for the Club. For the forthcoming 2018/19 playing season, cover will be extended to permanent or temporary disability consequential upon injury sustained during training and matches.

For the financial years 2017 – 2019, the direct cost of members' benefits of value were/are projected to be:

Cost of members' benefits (net of VAT)	2016/17	2017/18	2018/19
	£	£	£
Cost of playing facilities (including coaching costs)	62,000	63,000	64,000
Production and delivery of Swing Low	3,600	3,800	4,000
Insurance cover – playing members	2,170	3,200	9,500
	£67,770	£70,000	£77,500

Sale of current facilities

Due to constraints at our current ground, we are moving. We sought, and secured, planning consent to construct 50 residential units on our existing site. To do so, we incurred professional fees of £40,000, plus VAT.

We will sell the site for £1.9 million to Douglas Homes Ltd which is owned by James Douglas. James is Chairman of the Club but, for the avoidance of doubt, he has no control over the Club. The Club has not opted to tax the site and the heads of terms do not preclude it. The professional fees associated with the sale are expected to be £20,000, plus VAT.

Continued

5. Continuation

Construction of new clubhouse

The new ground and clubhouse will be completed in 2019 and we will move there for the start of the 2019/20 season. To that end:

1) The Club has a secured a 99-year lease of land on the edge of Dunchester for a premium of £175,000 (the seller has agreed not to charge VAT), with a peppercorn rent payable annually thereafter.

2) At a cost of £650,000 (excluding VAT), we will construct a new clubhouse (I have included below the proportion of the total floor area of identified parts of the building, excluding common areas) comprising:

   (a) On the ground floor; four changing rooms (15%); hall (20%); fully equipped kitchen (10%), toilet facilities (5%), a toilet suitable for disabled persons (2%), an official's room (4%) and a store and boiler room (4%). In order to meet disability regulations, a lift will be installed to provide disabled persons access to the first floor.

   (b) On the first floor, a bar and seating area (20%), Club office (10%) and two private rooms for Committee meetings, hire on match days, etc. (10%).

The projected cost of £650,000 comprises £550,000 relating to the construction of the facility, with the balance payable to building consultants.

Given the Club's new location, its history and the lack of equivalent facilities in the locality (the closest equivalent community hall is seven miles away), our research suggests that the clubhouse will be used extensively by the local community. Such use would be consistent with our charitable objectives and would also meet the public benefit obligation pertaining to charities. We have already had expressions of interest for the use of the main hall from a dance school and for boxercise classes. The local multiple sclerosis society is looking to use one of the upstairs meeting rooms twice a week and a local disability sports association is already committed to hire the main hall one day a week outside the rugby season.

To encourage wider community use, the rates charged for the hire of the clubhouse will be well below commercial charges (use by Club members will be subject to the same rates). Once the Club's fixture list is available, it will reserve the times that it requires the clubhouse for its own use. The balance of time will be available for external use. In the longer term the external community use of the clubhouse (based on hours' usage per week) is likely to exceed that of the Club.

The new kitchen facilities will enable the Club to provide catering for events (weddings, etc.) and increased capacity on match days. Currently, our liquor certificate restricts the sale of alcohol to members and guests. On completion of the new facility, we will apply for a premises licence, thereby allowing us to sell liquor to the public generally.

The Club requires from your firm:

1) An estimate of the Stamp Duty Land Tax (SDLT) chargeable on the acquisition of the 99-year lease.

2) VAT advice in relation to the disposal of the current facilities and the construction of the new clubhouse.

Continued

5. Continuation

Also, at present, the Club reclaims VAT in full on bar and catering purchases. It does not deduct VAT on the maintenance of the pitches, purchase of players' kit and other playing expenses. VAT on general overhead expenses is deducted by reference to the total standard and zero-rated income as a proportion of total income, with members' subscriptions treated as exclusively exempt from VAT. Since the exemption on members' subscriptions has a significant impact on the amount of VAT recoverable on overhead expenses, may we apportion this income to reflect the benefits which accrue to members?

The current methodology has not been formally approved by HM Revenue & Customs but it has been operated by the Club for many years. I have attached the workings (**EXHIBIT B**) relating to the four quarters to 31 May 2017.

<u>New pitches</u>

At a projected cost of £475,000, plus VAT we will construct three pitches with floodlights and some spectator seating. In line with our current treatment, we will not reclaim the VAT incurred on these works.

One practice pitch (as well as the clubhouse) will be rented at weekends during the summer by a local cricket club. For one weekend in July each year, for a nominal payment of £10, we will allow the Parish Council to use two of the pitches to host the “Dunchester Carnival”. During the rugby season, one of the practice pitches will be hired at a modest rent to Dunchester School for two afternoons during school terms.

These external hires will be exempted from VAT to ensure that the tax is not an additional cost for these entities.

<u>Recovery of VAT on capital projects</u>

Given that we will incur VAT of approximately £225,000 in the next 12 months on the construction of the clubhouse and the pitches, we propose to reclaim the VAT on the basis of our existing method. We anticipate that our income in 2017/18 and 2018/19 will be similar to that for 2016/17, subject to the loss of sponsorship income of £50,000 from Douglas Homes Ltd (see below). Could you assess how much VAT we might reclaim on these costs, based upon the adjusted income figures for 2016/17?

<u>Projected growth</u>

Our strategic plans for 2019 – 2023 show the following:

1) In 2019/20, we expect to have 650 members generating subscription income of £64,000. As a consequence, we expect increased income from admission charges, match day programme sales and the hire of our facilities.

2) The Rugby Football Union will make grants to the Club of £100,000 for the 2019/20 season, rising to £180,000 by 2023/24. This will cover part of our employment costs in developing a rugby academy to secure increased participation in the sport and our outreach programme to schools and sports centres in the North West.

3) Income from the sale of alcohol and catering will rise to £150,000 in 2019/20 on account of our improved bar and catering facilities and increased custom.

Continued

5. Continuation

4) £400,000 will be received at the commencement of the 2019/20 season from the sale of the Club's naming rights (see below).

5) The Club will conclude a fresh sponsorship agreement with Douglas Homes Ltd covering the playing seasons 2019/20 – 2022/23 inclusive. Under its terms, the Club will receive £10,000 each season in return for advertising on the match pitch perimeter hoardings, match programmes and the first team players' kit.

We require your advice on whether, in light of this projected growth, we can continue to use our current method of calculating input VAT (I do not require you to estimate VAT reclaimable in 2019/20, but rather to identify matters which we should consider)?

<u>Naming rights</u>

Minato Holdings is a very substantial Japanese international conglomerate. Its UK subsidiary, Chiyoda Ltd, is a significant local employer. Chiyoda Ltd's managing director, Koki Tanaka, is a recent convert to rugby and now plays for the Club's veterans' first team. Minato Holdings own Minato Bulls, a Top League rugby club in Japan and, of course, Japan will host the 2019 World Cup. Koki has persuaded Minato Holdings to purchase the naming rights to the Club's new playing facilities, including the clubhouse. It has been agreed that the facility will, for the five years commencing 1 October 2019, be referred to as "Minato Fields" on all Club signs, promotional material, etc. in return for a payment of £400,000. In order to make the package more attractive, it has also been agreed that:

1) From the commencement of the 2020/21 season, we will admit to our rugby academy up to three of Minato Bulls' junior players, subject to them having the necessary ability; and

2) For six home matches, Chiyoda Ltd may reserve one of the clubhouse meeting rooms, and be served lunch and drinks free of charge.

Under the current draft agreement, the Club will contract with, and issue its invoice to Minato Holdings. For internal reasons, however, payment will be made by Chiyoda Ltd.

I presume VAT will not be chargeable of the sale of the naming rights given that Minato Holdings is based in Japan and, for accounting purposes, the Club may take credit in full for the payment received in the 2019/20 financial year?

<u>Corporation Tax</u>

There are some Corporation Tax issues that we would like your advice on:

1) <u>Charge to Corporation Tax</u>

As a charity, the Club has proceeded on the basis that all of its income streams are exempt from Corporation Tax. It has not received notices to file Corporation Tax returns, nor has it voluntarily filed returns to claim available tax reliefs.

My attendance at a recent charity tax update and the Club's increased commercial activity from 2019/20 has caused me to reflect upon the Club's Corporation Tax position. It is clear that the Club's extension of its catering and bar activities in 2019/20 will no longer be exempt from Corporation Tax, nor will the sponsorship income which it receives from Douglas Homes Ltd and the proposed sale of the Club's naming rights.

Continued

5. Continuation

2) Sponsorship – Douglas Homes Ltd

We were promoted to RFU's National Division 1 this season. The promotion was helped by two sponsorship payments of £50,000 each made in September 2015 and September 2016 by Douglas Homes Ltd following the relegation of the Club at the end of the 2014/15 season which threatened its financial stability and ability to retain good players. Under the sponsorship agreement, Douglas Homes Ltd advertised on perimeter boards and the first team shirts. The company attracted a fair amount of favourable publicity from helping the Club to return to Division 1 and, I am advised, has secured additional business on account of the promotion.

Douglas Homes Ltd's new Finance Director has raised with James Douglas whether these sponsorship payments are tax deductible, along with those proposed for the 2019/20 – 2022/23 seasons. Given the publicity and goodwill which has, and will accrue to the company from the payments, it seems to me self-evident that they are deductible. Since the extent to which the company is able claim a deduction for these payments could impact upon completion of the proposed sponsorship deal relating to the 2019/20 - 2022/23 seasons, can you provide some assurance both to the Club and Douglas Homes Ltd on these matters? The Club will of course meet your fee relating to this part of your advice.

From the Club's perspective, I am satisfied that this income is not exempt from Corporation Tax. Given the lapse of time and that this was the Club's sole source of income subject to tax in the financial years ending 31 May 2016 and 2017, should we leave matters as they are?

Insurance Premium Tax ("IPT")

From the start of the 2018/19 playing season, the medical cover currently included in members' subscriptions will be extended to cover temporary and permanent disability resulting from participation in the sport. We have received a quote for the cover, with the full premium subject to IPT. We would welcome your views on this.

Machine Games Duty

We recently acquired a game machine which offers a range of games with differing stakes (a limited number of games have a stake of £10 – perhaps not surprisingly, to date nobody has ever played such a game), and prizes. Do we apportion the net takings by reference to the types of machine?

We require a report on the issues arising from these matters for consideration by the Committee at its meeting on 20 June. Please do not hesitate to contact me if you require any further information.

Best wishes

Bill Hayley

Continued

5. Continuation

EXHIBIT B

Dunchester Rugby Football Club

Partial Exemption Annual Adjustment 31 May 2017

1) Summary of income (net of VAT):

	Total	Standard/zero-rated income	Exempt income
	£	£	£
Members' subscriptions	42,000		42,000
Sponsorship – Douglas Homes Ltd	50,000	50,000	
Bar and catering receipts	70,000	70,000	
Social Committee events income	25,000	25,000	
Admission income to cup games	2,000	2,000	
Hire of clubhouse	1,500		1,500
Programme sales	1,200	1,200	
Hire of pitch to Dunchester School	800		800
Bank interest (gross of tax)	50		50
	£192,550	£148,200	£44,350

2) Recovery rate £148,200/192,550: 76.97%.

3) Analysis of VAT incurred (net of VAT):

	Total	Taxable	Exempt	Overhead
	£	£	£	£
Bar/catering consumables	7,000	7,000		
Social Committee events	1,000	1,000		
Playing consumables:				
(a) players' kit purchases and cleaning	1,000		1,000	
(b) maintenance of pitches	1,000		1,000	
(c) balls and playing equipment	1,500		1,500	
(d) travel expenses	1,000		1,000	
Clubhouse maintenance	2,000			2,000
Accounting fees	400			400
Administrative and office expenses	800			800
Electricity and gas	250			250
Cleaning, etc.	300			300
Professional fees – planning application	8,000		8,000	
	£24,250	£8,000	£12,500	£3,750

4) Input tax reclaimable on overheads: £3,750 @ 76.97% = £2,886.