The Chartered Institute of Taxation

Advanced Technical

Taxation of Larger Companies and Groups

November 2023

Suggested solutions

ANSWER TO QUESTION 1

1)

Under UK domestic law a company is UK tax resident if:

- it was incorporated in the UK, or
- it is centrally managed and controlled in the UK.

Dujon plc is UK incorporated and is therefore prima facie UK resident for domestic law purposes.

Before 1 July 2022, Belgium also regarded Dujon plc as Belgian resident. It was therefore a dual resident company.

It is necessary to refer to the UK-Belgium tax treaty, Article 4(3) of which contains a "tie-breaker" rule that determines conclusively where Dujon plc is resident. The rule states that a dual-resident company should be deemed resident in the state where its place of effective management ("POEM") is situated.

An entity's POEM is the place where the key management and commercial decisions that are necessary for the conduct of the entity's business as a whole are in substance made. This is concerned with the entity's highest level of control, and not day-to-day operational management.

Dujon plc is managed by its Board of Directors, who have formal responsibility for strategic decision making and exercise it through their board meetings.

Before 1 July 2022, the board met in Belgium. There is no indication that other informal decision making took place outside Belgium – three-quarters of the directors were Belgian residents, and while it is likely the UK directors exercise some authority from the UK, they were a minority of the board, and major proposals were subject to board approval.

Dujon plc was therefore Belgian resident and only liable to UK Corporation Tax on profits from any UK permanent establishments ("PE"), of which it had none.

From 1 July 2022, Dujon plc's board meetings took place in the UK. Two-thirds of the directors, including those with the most influential executive roles, became UK resident. Although some of those directors occasionally work outside the UK, it appears their duties are limited. It appears the company's POEM therefore moved to the UK although this will depend on a full analysis of the facts. Dujon plc became UK resident under the treaty tiebreaker, and liable to UK Corporation Tax on its worldwide profits from 1 July 2022.

Dujon plc's Belgian office is a foreign PE. While foreign PE profits and losses are by default chargeable to Corporation Tax, Dujon plc could exempt any trading profits by making an irrevocable election.

Ordinarily any intangible fixed assets or chargeable assets of a company that migrates to the UK are recognised at their accounting value or historical cost respectively. However, because Dujon plc migrated from an EU Member State both its trademarks and shares in subsidiaries will be recognised for UK tax purposes at their market value at 1 July 2022 provided they were subject to an exit tax in Belgium.

Dujon plc is not entitled to Corporation Tax relief for losses incurred before 1 July 2022, because they arose when it was not chargeable to Corporation Tax.

2)

Dujon plc should notify HMRC that it is chargeable to Corporation Tax within 12 months of the end of its accounting period ("AP") ended 30 June 2023. Non-deliberate failure to notify can attract a penalty of up to 30% of any tax unpaid 12 months after the AP end.

For the AP ended 30 June 2023, the company must file a company tax return comprising its accounts, tax computation and form CT600, by 30 June 2024. Late filing attracts an immediate penalty of £100, rising to £200 after 3 months, and tax-geared penalties if the return is not filed within 18 months of the year end.

The normal due date for Dujon plc's Corporation Tax is 9 months and 1 day after the AP end, that is, 1 April 2024. If a company is "large" (if its taxable profits exceed £1.5 million divided by the number of associated companies including itself), it must make Quarterly Instalment Payments.

3)

Dujon UK Ltd owns 100% of Finco Inc. The controlled company exemption therefore applies to dividends received by Dujon UK Ltd from Finco Inc.

Because Finco Inc is a non-UK resident company and controlled by a UK resident company, it is a Controlled Foreign Company ("CFC"). Dujon UK Ltd may therefore be subject to a UK CFC charge.

Several exemptions may prevent a CFC from being chargeable:

- The exempt period exemption applies during the first 12 months that a company is a CFC, provided that after that period the CFC is not subject to a charge. This will not apply to Finco Inc because it is newly incorporated and not already carrying on a business.

- The tax exemption applies if the CFC pays local tax of at least 75% of the amount that would have been paid had the CFC been UK resident. Given the Utopian tax rate is 1%, this exemption will not apply.

- Finco Inc's profits exceed £50,000 and 10% of its operating expenditure, so the low profits and low profit margin exemptions do not apply.

- Utopia is not an excluded territory.

All of Finco Inc's profits are Non-Trading Finance Profits ("NTFPs"). NTFPs are subject to a CFC charge if:

- SPFs relevant to the NTFPs are carried out in the UK. That is not the case here.
- They arise from UK capital investment. All of Finco Inc's capital was provided by a connected UK-resident company, so its NTFPs are all chargeable.

Dujon Chile SA is a non-UK resident connected company and Finco Inc's loan to it is chargeable solely because it arises from UK capital and not because of UK SPFs. The loan is therefore a qualifying loan relationship ("QLR"). 75% of the profits from a QLR may be exempted from the CFC charge provided Finco operates from business premises in Utopia, which it does. No exemption applied to the deposit interest.

Dujon UK Ltd will be taxed on Finco Inc's chargeable profits at the main UK Corporation Tax rate, with a credit for any Utopian tax paid by Finco Inc on those profits.

Dujon UK Ltd cannot reduce its CFC charge by claiming group relief in respect of Dujon plc's losses.

MARKING GUIDE

TOPIC	MARKS	SUB-TOTAL
Migration of residence		
- Pre-July, UK resident by virtue of statutory incorporation rule	1.0	
- Pre-July, also Belgian resident by virtue of management, hence dual resident	0.5	
- Residence determined by treaty tiebreaker, which is POEM	0.5	
- Explain definition of POEM	1.0	
- Application of POEM to facts	1.0	
- Pre-July, Belgian resident therefore no liability to UK CT	0.5	
- Explain effect of 1 July changes on POEM	1.0	
- Post-July, UK resident and therefore liable to UK CT on worldwide income	0.5	
- Belgian office constitutes a foreign PE; relevance of foreign PE exemption	1.0	
- Tax basis of CG and IP assets on migration	1.0	
- Treatment of pre-arrival losses	1.0	9
Administration		
- Requirement to notify chargeability, with deadline and no penalty	1.0	
- Requirement to file CT return, with deadline and penalty	1.0	
- Payment due date; possibility of QIPs	1.0	3
CFC charge		
- Controlled company exemption applies to Dujon International Ltd's dividends from Finco Inc	1.0	
- Explanation of why Finco Inc is a CFC	1.0	
- Explanation of entity-level exemptions	2.0	
- Finco Inc's NTFPs are chargeable because of UK connected capital	1.0	
- Business premises condition met therefore may elect for partial exemption	0.5	
- Chile loan is QLR so can benefit from 75% partial exemption	1.0	
- Chargeable profits are subject to inclusion at full UK CT rate	0.5	
- Dujon UK Ltd receives credit for Utopian tax paid	0.5	
- CFC charge cannot be reduced with UK losses	0.5	
		8
TOTAL		**20**

ANSWER TO QUESTION 2

1)

RZ Ltd

The RZ Ltd disposal proceeds should include:

- All ascertainable consideration; and
- The value of the right to receive any unascertainable consideration.

Consideration is ascertainable only where all events that affect its amount have occurred before the date of the disposal.

The £75m payment is ascertainable, while the deferred consideration is unascertainable: the amount depends on RZ Ltd's future profits, which cannot be determined until after 31 December 2022.

The gain is therefore:

	£m
Fixed consideration	75
Value of deferred consideration rights	31
Total	106
Less: cost	(50)
Unindexed gain	56
Indexation (278.1-265.5)/265.5	(2.37)
	53.63

Rutak plc owned more than 10% of RZ Ltd and RZ Ltd was a trading company throughout the 12-month period ending with the disposal date (RZ Ltd carried on a trade and did not have substantial non-trading activities). The gain is therefore exempt under the Substantial Shareholding Exemption (SSE).

Deferred consideration

Rutak plc's receipt of the £36 million payment is the disposal of a separate asset, being its right to receive the deferred consideration. A gain arises, with the acquisition cost equal to the value of the rights recognised on the first disposal:

	£m
Proceeds	36
Less: cost	(31)
Gain	5

SSE does not apply because the asset disposed of was the contractual right to receive the consideration, and not shares or an interest in shares.

Rutak Estates Ltd

SSE does not apply because Rutak Estates Ltd is not a trading company – its sole activity is letting property.

If a company issues new shares in exchange for shares in a target company, a gain will not arise provided the purchaser holds, or will in consequence of the transaction hold, at least 25% of the ordinary share capital of the target. Instead, the seller treats the new shares as the same asset as the shares it sold, with the same purchase date and base cost.

This treatment does not apply if the exchange has a main purpose of tax avoidance, which does not appear to be the case here. Companies can apply to HMRC for an advance clearance confirming that this requirement is met.

If the purchaser provides cash consideration as well as the new shares, that is treated as a part disposal of the original shareholding. The base cost of the original shareholding is apportioned between the cash and the new shareholding in proportion to their market values at the date of disposal.

The gain on the cash element of the proceeds is therefore:

	£'000
Proceeds	3,000
Less: cost (W1)	(2,500)
Unindexed Gain	500
Indexation (278.1-268.4)/278.1	(90.35)
Indexed Gain	409.65

Wyke plc

Rutak plc owns Wyke plc shares purchased in several tranches, so it is necessary to identify which shares were sold on 10 July 2023.

The shares sold are treated as a part disposal of a "s104 pool" comprising all of Rutak plc's shares in Wyke plc (W2). The shares received for Rutak Estates Ltd are deemed to have been acquired on 10 February 2017 and are included in the pool at their base cost (W1).

The gain is therefore:

	£'000
Proceeds	30,000
(1,500,000 x £20)	
Less: cost	
1,500,000 shares (s104 pool) (W2)	(10,500)
Indexation (10,780-10,500)	(280)
Gain	19,220

W1: Base cost

Allowable cost = Total cost x (MV chargeable consideration) / (MV total consideration)

= (1,000,000 x £20) x £3,000,000 / (£3,000,000 + 1,000,000 x £21)

= £20,000,000 x 0.125

= £2,500,000

Base cost of new shareholding = £20,000,000 - £2,500,000
= £17,500,000

W2: s104 pool

Date	Shares acquired	Price per share £	Total cost £'000	Indexed cost £'000
10 February 2017	1,000,000		17,500	17,500

Indexation (1)				254
				17,754
1 June 2017	1,000,000	1	1,000	1,000
			18,500	18,754
Indexation to Dec 2017 (2)				399
				19,153
1 July 2018	1,500,000	4	6,000	6,000
Total	3,500,000		24,500	25,153
Disposal	(1,500,000)		(10,500)	(10,780)

(1) Indexation = (272.3-268.4)/268.4) x 17,500 = 254,284
(2) Indexation – (278.1-272.3)/272.3 x 18,754 = 399,460

Base cost of 1,500,000 shares = £24,500,000 x 1,500,000/3,500,000
= £10,500,000

2)

Stamp Duty (SD) is chargeable on instruments that transfer stock or marketable securities. Zeal plc is therefore liable to SD on the stock transfer form that effected its purchase of RZ Ltd shares.

SD is charged at a rate of 0.5%, rounded up to the nearest £5. This is applied to the chargeable consideration given for the transfer. In this case that is £75 million since unascertainable amounts are ignored. Zeal plc's SD liability is therefore £375,000.

There is no formal mechanism for assessing SD, however, until the stock transfer form has been stamped, RZ Ltd's register of shareholders cannot be amended. The form should be presented for stamping within 30 days of the date it was executed, otherwise a penalty may be charged. For delays of up to 12 months, this is 10% of the unpaid duty, capped at £300.

MARKING GUIDE

TOPIC	MARKS	SUB-TOTAL
<u>Chargeable gains on share transactions</u>		
RZ Ltd		
- Calculation of gain on disposal	1.0	
- Explanation of treatment of earn out	1.0	
- Disposal qualifies for SSE, with explanation of conditions	1.5	
- Explain treatment of realisation of deferred consideration as disposal of separate asset	1.0	
- Realisation of deferred consideration is not a disposal of shares therefore SSE not available	0.5	
Rutak Estates Ltd		
- SSE does not apply because investee is not a trading company	0.5	
- Explain conditions for s135 treatment, note met in this scenario	1.5	
- Possibility of obtaining statutory clearance	0.5	
- Explain effect of s135 treatment	1.0	
- Treatment of cash proceeds as part disposal, with gain calculation	1.5	
Wyke plc		
- Base cost: application of s104 share pooling rules		
- Calculation of chargeable gain	1.5	
	0.5	
		12
<u>Stamp duty</u>		
- SD applicable to stock transfer instruments	0.5	
- Rate applicable to shares	0.5	
- Chargeable consideration	0.5	
- Treatment of deferred consideration	0.5	
- No formal assessment process, but stamping required to update register	0.5	
- Penalties	0.5	3
TOTAL		**15**

ANSWER TO QUESTION 3

1)

Options, futures or contracts for differences (CFDs) that are accounted for as derivatives – such as Pulu Ltd's jet fuel contract – are taxed under the derivatives contracts regime.

The general rule is that profits and losses on a company's derivative contracts, and related expenses, are brought into account as income. The amounts charged are those recognised in the company's income statement in accordance with generally accepted accounting principles (GAAP).

Pulu Ltd applies fair value accounting to the futures contract and would therefore recognise the following amounts in its income statement:

Accounting period ("AP") ended 31 March 2022:

Profit/(loss) = (£142 - £63) x 1 million barrels = £79 million

AP ended 31 March 2023:

Profit/(loss) = (£125 - £142) x 1 million barrels = (£17 million)

There is a timing mismatch between recognition for tax purposes of gains and losses on the futures contract and those on the fuel purchase it is intended to hedge: derivative movements are taxed immediately whereas the fuel expense is only relieved when it is incurred.

The Disregard Regulations allow companies to address this mismatch by deferring recognising gains or losses on hedging instruments.

Regulation 8 applies to commodity or debt contracts which have a hedging relationship with a forecast transaction or firm commitment. A hedging relationship exists if the derivative contract is subject to hedge accounting or intended to act as a hedge. The latter is the case here. Under regulation 8, gains and losses on the hedge are disregarded for tax. Where the hedged item represents expenditure that is deductible from the company's taxable trading profits, the hedge gains and losses are brought back into account under regulation 10 when that expenditure is deducted.

In Pulu Ltd's case, applying regulation 8 would mean the £79 million gain in the AP ended 31 March 2022 would not be recognised and taxed. Instead, a net gain of £62 million (£79 million - £17 million) would be recognised in the AP ended 31 March 2023 (assuming the fuel is all used in that period). This would partly offset the fuel expense of £127 million, resulting in an effective cost of £65 million (£65 per barrel).

To apply regulation 8, Pulu Ltd must have made an election before entering into the futures contract, unless it is a new adopter of fair value accounting, in which case extended time limits apply.

2)

Structures and Buildings Allowance (SBA) is available in respect of qualifying expenditure on the construction of non-residential buildings provided construction began on or after 29 October 2018 and the building's first use is non-residential.

Pulu Ltd is entitled to SBA as follows:

	£
Non-residential buildings (Note 1)	600,000
Site preparation (Note 2) (£75,000 x 2/3)	50,000
SBA qualifying expenditure	650,000
Potential SBA at 3% per annum	19,500
SBA available (time apportioned 6m/12m) (Note 4)	9,750

Notes:

1. Expenditure on the two non-residential buildings qualifies for SBA, but the accommodation block does not.

2. Expenditure on site preparation qualifies for SBA, unless it is expenditure on reclamation or remediation, or on landscaping other than to create a structure. The £75,000 incurred by Pulu Ltd was to enable structures to be constructed. The portion attributable to the non-residential buildings qualifies.

3. Expenditure on land and obtaining planning permission does not qualify for SBA.

4. The allowance is time-apportioned from 1 October. SBA is only available from the date the buildings were first brought into non-residential use for the purposes of a qualifying activity (which includes Pulu Ltd's aviation trade).

5. To claim SBA, Pulu Ltd must prepare an allowance statement. This must identify the building in question and state:

    i. The date of the earliest contract for construction of the building,
    ii. The amount of qualifying expenditure incurred, and
    iii. The date on which it was first brought into non-residential use.

Pulu Ltd may also claim plant and machinery allowances:

		Main pool	Allowances
	£	£	£
TWDV b/fwd		4,320,000	
Super-deduction expenditure:			
Computer systems (Note a)	100,000	-	-
30% uplift	30,000	-	-
Super-deduction	(130,000)	-	130,000
AIA expenditure:			
Simulator (Note b)	800,000	-	-
100% AIA	(800,000)	-	800,000
WDA at 18%	-	(777,600)	777,600
TWDV c/fwd	-	3,542,400	-
Total allowances	-	-	1,707,600

Notes:

a) The computer systems were new plant and machinery purchased between 1 April 2021 and 31 March 2023, and therefore qualify for the 130% super-deduction.

b) The simulator does not qualify for the super-deduction because it was second-hand. However, Pulu Ltd is entitled to 100% AIA on up to £1 million of expenditure.

MARKING GUIDE

TOPIC	MARKS	SUB-TOTAL
<u>Hedging</u>		
- Definition of derivative contract for tax purposes – types and accounting condition	1.0	
- Under derivative contracts regime, GAAP debits and credits recognised as income	1.0	
- Explain mismatch between tax treatment of hedge and hedged item	0.5	
- Explain scope and relevance of Disregard Regulation 8	1.0	
- Note intended hedge, even though accounting designation not possible	0.5	
- Effect of Regulation 8 on FV profits and losses, and recycling	1.0	
- Requirement to elect in, including deadline	1.0	
- Calculation of amounts disregarded/brought into account for each period	1.0	7
<u>Capital allowances</u>		
- SBAs available where construction post October 2018, first use non-residential	1.0	
- Land and planning permission excluded from qualifying expenditure	0.5	
- Site preparation – qualifying unless land alteration	1.0	
- Construction cost included, except for residential building	1.0	
- SBA available from date brought into qualifying use; time apportionment required	0.5	
- SBA computation including 3% rate	1.0	
- Explain requirement for and content of SBA statement	1.0	
- PMAs – computers eligible for 130% SD	0.5	
- PMAs – simulators second hand; no SD but AIA available	0.5	
- PMAs – computation	1.0	8
TOTAL		**15**

ANSWER TO QUESTION 4

Brent plc corporation tax computation for the year ended 31 March 2023

	Notes	£'000	£'000
Loss before tax as per accounts			(55,750)
Adjustments			
Depreciation		1,250	
Amortisation	1	3,600	
Gain on sale of freehold property	2	(4,000)	
Loss on sale of shares in Derry Ltd	3	1,500	
National minimum wage fine	4	2,500	
Bonus payments	5	950	
Capital in revenue	6	50	
Depreciation of revenue expenditure capitalised	7	(200)	
			5,650
Adjusted trading profit before capital allowances			(50,100)
Capital allowances	9		(3,103)
Trading profit			(53,203)
Chargeable gain	2		1,685
Total loss for the year			(51,518)
Carried back to year ended 31 March 2022	10		10,000
Trading losses carried forward	10		(41,518)
Corporation tax repayment at 19% Year ended 31 March 2022			1,900

Notes

1) Amortisation in relation to the registered designs is allowable on an accounts basis so no adjustment required. Goodwill acquired with qualifying intellectual property ("IP") after 1 April 2019 is eligible for an annual deduction of 6.5% of the cost of the goodwill. This is restricted where the cost of goodwill exceeds six times the cost of qualifying IP acquired at the same time. The calculation is therefore as follows:

   (a) £10 million (qualifying IP) * 6 / £75 million (goodwill) = 4/5 (allowable fraction)
   (b) Allowable goodwill deduction at 6.5% = £4.875 million, but restricted to 4/5 so £3.9 million
   (c) Goodwill amortisation charge in the accounts = £7.5 million
   (d) Adjustment of £3.6 million is required (£7.5 million less £3.9 million).

2) The chargeable gain on the sale of the freehold property is as follows:

	£'000
Sale proceeds	6,000
Incidental costs of disposal	(50)
Net sale proceeds	5,950
Cost	(2,500)
Gain before indexation	3,450
Indexation from July 1998 to December 2017 (see below)	(1,765)
Chargeable gain	£1,685

   Indexation working - 0.706 x £2,500,000 = £1,765,000

3) The sale of the shares of Derry Ltd is covered by the substantial shareholding exemption (SSE) because:

   (a) Brent plc has held a shareholding of at least 10% for a continuous period of twelve months in the six years prior to the disposal, and
   (b) Derry Ltd had been a trading company throughout Brent plc's relevant period of ownership.

   The capital loss on the sale, including the professional fees on disposal, is not therefore allowable for chargeable gains purposes.

   The accounting loss of £1.5 million is disallowed in arriving at the adjusted taxable profits.

4) The amount payable for the breach of the national minimum wage is disallowed as under case law precedents; fines are not incurred wholly and exclusively for the purposes of the payer's trade.

5) Employee remuneration paid more than nine months after the end of the accounting period is only allowable in the period it is paid. The £950,000 bonus payable on 1 February 2024 is therefore disallowed in the year ended 31 March 2023.

6) Small items of plant expensed of £50,000 are not allowable as their useful lives exceed one year and they are capital. They are, however, eligible for capital allowances.

7) For revenue expenditure that has been capitalised, a deduction is due for the accounting depreciation charged on those assets in the period (£200,000).

8) The following amounts are allowable trading expenses:

Item	£'000	Explanation
Bonus payable on 30 October 2023	600	Paid within nine months of the year end.
Legal fees on the renewal of a short lease	15	Not regarded as capital.
Employee discounts on retail goods	1,750	Incurred wholly and exclusively for the purposes of the trade.

9) The capital allowances computation is as follows:

	Main plant and machinery pool	Super-deduction	Special rate plant and machinery pool	Short life asset pool	Total allowances
	£'000	£'000	£'000	£'000	£'000
TWDV b/f on 1 April 2022	5,000	-	2,000	500	-
Additions (see below)	-	1,025	250	-	-
Annual investment allowance	-	-	(250)	-	250
Super-deduction	-	(1,333)	-	-	1,333
	5,000	-	2,000	500	1,583
WDA @ 18%	(900)	-	-	-	900
WDA @ 6%	-	-	(120)	-	120
Balancing allowance	-	-	-	(500)	500
TWDV c/f on 31 March 2023	4,100	-	1,880	-	3,103

Additions	Super- deduction	Special rate plant and machinery pool	Other
	£'000	£'000	£'000
Store and warehouse racking and rails	700	-	-
General store lighting	-	250	-
Store tills and counters	175	-	-
Office equipment	100	-	-
Fixed immovable partition walls - non qualifying	-	-	150
Redecoration of existing stores - revenue in capital	-	-	750
Capital items expensed	50	-	-
	1,025	250	900

Annual investment allowance claimed instead of SR allowance on special rate plant and machinery additions as this gives 100% relief compared to 50% first year allowance and 6% writing down allowance.

10) After offset against the current year capital gain, the trading loss can be carried back to fully offset taxable profits arising in the year ended 31 March 2022. The temporary carry back to the next two preceding years is, however, no longer available as it only applies for years up to 31 March 2022.

The unrelieved losses can be carried forward to set off against future profits subject to limitations (broadly for each accounting period the sum of £5 million plus 50% of the profits exceeding £5 million).

MARKING GUIDE

TOPIC	MARKS	TOTAL
Adjustment to profits		
- Depreciation	0.5	
- Amortisation	3.0	
- Fine	0.5	
- Bonus	1.0	
- Capital in revenue/deferred revenue expenditure	2.0	
- Profits/Losses on disposals	0.5	
		7.5
Allowable expenses		
- Legal fees on short lease	1.0	
- Employee discounts/Bonus	1.0	
		2.0
Capital allowances		
- Correct categorisation of qualifying additions	2.5	
- Super-deduction calculation	1.0	
- Annual investment allowance calculation	1.0	
- Writing down allowance calculations	1.0	
- Balancing allowance	1.0	
		6.5
Chargeable gains		
- Property	1.0	
- Substantial shareholding exemption	1.0	
		2.0
Loss utilisation		
- Loss carry back/carry forward	1.0	
- Tax refund	1.0	
		2.0
TOTAL		**20.0**

ANSWER TO QUESTION 5

UK incorporated companies in a group are subject to the senior accounting officer ("SAO") provisions for a financial year if in the preceding financial year their aggregated relevant turnover exceeds £200m and/or their relevant balance sheet total exceeds £2bn.

Relevant turnover is as per the financial accounts of the companies.

Relevant balance sheet total is the sum of the assets in the financial accounts of the companies but excludes investments in subsidiary companies.

A group includes a company and its 51% subsidiaries. It excludes companies incorporated outside the UK.

The status of each company is as follows:

Company	Subject to SAO rules	Reason
Barnet plc	✓	UK incorporated and balance sheet total exceeded
Harrow Ltd	✓	UK incorporated and balance sheet total exceeded
Enfield Plc	×	Not a 51% subsidiary
Berlin GmbH	×	Not UK incorporated
Athens SA	×	Not UK incorporated (UK residence irrelevant)

Relevant turnover and balance sheet totals are:

Company	Relevant Turnover	Relevant Balance Sheet Total
	£m	£m
Barnet plc	-	1,500
Harrow Ltd	150	600
Enfield plc	-	-
Berlin GmbH	-	-
Athens SA	-	-
Total	£150	£2,100

Barnet plc and Harrow Ltd are subject to the SAO rules for the year ended 31 March 2023 because in the previous financial year the relevant group balance sheet total exceeded £2bn (even though the relevant group turnover total did not exceed £200m).

Barnet plc must notify HMRC of the name of the SAO for each company prior to the filing deadline for its accounts for the year ended 31 March 2023. As Barnet plc is a public company this date is 30 September 2023. It can decide to appoint one SAO covering all companies in the group.

The SAO has a main duty of ensuring that reasonable steps have been taken to ensure that the company establishes and maintains appropriate tax accounting arrangements (including keeping accounting records) that enable the company's relevant liabilities to be calculated accurately in all material respects. Relevant liabilities include Corporation Tax, VAT, PAYE, Insurance Premium Tax, Stamp Duty Land Tax, Stamp Duty Reserve Tax, Petroleum Revenue Tax, and Customs and Excise Duties.

The SAO must provide a certificate stating whether or not the companies had appropriate tax accounting arrangements in place during the year ended 31 March 2023 or the respects in which they did not. Assuming one group certificate is filed, this must be done prior to the filing deadline for the accounts of Barnet plc which is 30 September 2023.

The SAO is liable for penalties for a failure to ensure the maintenance of appropriate accounting arrangements or failure to provide an accurate certificate on time. The penalty is £5,000 for each offence.

The company is liable for a fine of £5,000 if it fails to provide the name of the SAO on time.

MARKING GUIDE

TOPIC	MARK
Identify £200m/£2bn qualification tests	1
Relevant turnover total £150m	1
Relevant balance sheet total £2.1bn	1
Correct reason for categorisation of each company	
- Barnet plc & Harrow Ltd	1
- Enfield plc	1
- Berlin GmbH & Athens SA	1
Identify notification of SAO and certificate submission requirements (0.5 for each notice)	1
Correct submission deadlines (0.5 for each notice)	1
SAO main duty	1
SAO fines	1
TOTAL	**10**

ANSWER TO QUESTION 6

As Bexley plc controls its subsidiaries and undertakes transactions with them it must make an adjustment in its tax computation if any of those transactions:

1) differ from an equivalent arm's length amount; and
2) confer a potential UK tax advantage.

Any adjustments must result in the transactions being restated to arm's-length amounts.

Arm's length prices must be determined consistently with OECD guidelines. Comparability analysis should normally be carried out using:

- comparable uncontrolled price ("CUP");
- resale price ("RPM"); or
- cost-plus.

The CUP compares the price charged in a controlled transaction with the price charged in an uncontrolled transaction. It requires that there are no differences in the transactions being compared or the effect on the price of any differences can be accurately adjusted for. The CUP is the most direct and reliable transfer pricing method.

The RPM starts with the price at which a product purchased from an associated entity is resold to an independent entity and reduces this by the "resale price margin". This represents the amount of income an independent reseller would seek in order to cover its costs and leave an appropriate profit.

The cost-plus calculates the arm's length price of a controlled transaction by considering the costs of the supplier in the transaction and adding a mark-up to cover functions performed, assets used, and risks borne. The comparability of transactions is important, though like the RPM, fewer adjustments are required to account for differences than with the CUP.

The margins for both RPM and cost plus should be calculated by reference to similar uncontrolled transactions.

<u>Jixi Ltd</u>

Bexley plc should not pay more than an arm's length price for the shoes.

Jixi Ltd's assets are employed in an established manufacturing process with access to proprietary shoe technology. It does not have supplier, stock, logistics or currency risks. Its sole debtor is Bexley plc and therefore has limited credit risk. It has invested in production facilities and staff which could become difficult to redeploy should Bexley plc cease to do business with it, but it has contractual protection in the case of an early closure. Overall, a cost-plus basis of charging would be appropriate. The mark-up on costs would be driven by the risks borne by Jixi Ltd but would also have to reflect a return for assets employed. This should be tested by reference to appropriate comparability benchmarking.

The CUP would be unlikely to be appropriate as there is no other manufacturer of Bexley Shoes and it is likely to be difficult to adjust for differences in a similar transaction.

The RPM would not be appropriate because Jixi Ltd is conducting a manufacturing process.

<u>Hamra Ltd</u>

Bexley Plc's prices to Hamra Ltd must not be less than an arm's length price.

Hamra Ltd acts as a distributor undertaking a number of functions and bearing various risks:

(a) It develops overseas markets so is exposed to market, selling, and credit risks.
(b) It delivers products to its customers and is therefore subject to logistic risks (such as shipping delays and cost increases).

(c) Its purchases and sales are in foreign currency, so it is exposed to currency risk.
(d) Purchase orders are based on sales estimates and therefore it is subject to stock risk.

The main assets used in Hamra Ltd's business do not involve significant investment.

There are no internal CUPs as Bexley plc makes retail sales in the UK whilst the sales to Hamra Ltd are wholesale. Due to the unique and distinctive brand name and the exclusivity arrangements there are unlikely to be any external CUPs, and it would be difficult to adjust for the differences.

As Hamra Ltd makes sales to third parties, does not add value to the products, and there is a short time between purchase and sale, an RPM methodology would be appropriate. The resale minus margin could be determined by taking into account its various functions, assets and risks and comparing these to arm's length comparators.

A cost-plus method could also be appropriate assuming all of the relevant costs are included in the cost base and a comparative margin can be benchmarked.

Bexley plc has granted Hamra Ltd the exclusive right to use the Bexley Shoes brand and therefore an amount not less than an arm's length price should be charged for this. A comparability study should be conducted to determine the price. Bexley plc could reflect this in the price of goods sold by adjusting the resale minus margin/cost-plus margin or by charging a separate license fee.

Novena Ltd

Novena Ltd is conducting contract research. Bexley plc provides funding, decides on areas to be researched, bears risks of abortive expenditure, owns any intellectual property, and benefits from profits arising from commercial exploitation. An appropriate pricing methodology would be cost-plus, with Bexley plc reimbursing all of Novena Ltd's research costs with the mark up based on the complexity of the work. This could be determined by a comparability study to ensure that Bexley plc was not paying more than an arm's length price.

The CUP may be feasible if a comparator can be found (for example, charge out rates for third party organisations conducting similar research on a contract basis) but it is likely to be difficult to adjust for differences in a similar transaction.

The RPM would not be appropriate as there is no resale transaction.

Head Office

Head Office services are considered low value-added group services and OECD guidelines allow for a simplified approach.

This may be done by:

(a) calculating and pooling costs incurred by Bexley plc in performing each service;
(b) applying an allocation method to apportion the pooled costs to each subsidiary (for example, turnover, number of employees, etc); and
(c) applying a 5% mark up to the allocated costs.

If the simplified approach is not used the transactional methods would have to be evaluated.

Head office costs associated with the managing its subsidiaries should not be recharged by Bexley plc as these are conducted for the benefit of Bexley plc.

MARKING GUIDE

TOPIC	MARKS	TOTAL
UK legislative requirement		2
Role of OECD guidance		1
Brief explanation of the three transaction methods (either separately or as part of the specific scenarios) CUP RSM Cost-plus	 1 1 1	
		3
Jixi Ltd -justification for recommended transactional method -explanation of relevance of other two methods	 2 1	
		3
Hamra Ltd - justification for recommended transactional method - explanation of relevance of other two methods - brand charging	 2 1 1	
		4
Novena Ltd - justification for recommended transactional method - explanation of relevance of other two methods	 2 1	
		3
Head Office		
-identification of simplified low value option	1	
-simplified low value-added calculation methodology	2	
-stewardship costs	1	
		4
TOTAL		**20**