The Chartered Tax Adviser Examination

May 2018

Taxation of Major Corporates

Advisory Paper

TIME ALLOWED – 3 ¼ HOURS

- The first 15 minutes is designated as reading time. During this time you may read your question paper and legislation, annotate your question paper and use your calculator. You are not permitted to write in the answer booklet. The Presiding Officer will inform you when you can start writing.
- You should answer all **SIX** questions.
- Start each answer on a fresh page and do not write in the margins.
- All workings should be shown and made to the nearest month and pound unless the question specifies otherwise.
- Marks are specifically allocated for presentation.
- 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 front of each answer booklet.
- 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 the in-house Tax Manager at Gosling Ltd, a wholly-owned UK resident subsidiary of Buzzard plc. Buzzard plc is the parent company of an international group specialising in chemical engineering. Gosling Ltd was acquired by Buzzard plc from an unrelated party on 1 November 2017, and following its acquisition, Gosling Ltd changed its year-end from 31 December to 30 April to align with the rest of the Buzzard group.

You are currently preparing the tax provision for Gosling Ltd's IFRS statutory accounts for the 16 months ended 30 April 2018. You have the following notes on your file in relation to fixed assets:

1) Summarised information in respect of property, plant and equipment per the draft statutory accounts:

	Land and buildings £'000	Plant and machinery £'000	IT equipment £'000	Total £'000
Net book value at 1 January 2017	33,565	66,780	9,025	109,370
Additions in the period (Note 2)	900	2,741	1,135	4,776
Disposals in the period (Note 3)	-	(400)	(120)	(520)
Depreciation charge for the period	(1,720)	(14,600)	(1,710)	(18,030)
Net book value at 30 April 2018	£32,745	£54,521	£8,330	£95,596

At 1 January 2017, all of the plant and machinery and all of the IT equipment qualified for capital allowances, but none of the land and buildings qualified for capital allowances.

2) Additions in the period comprise the following items:

	Date of acquisition	Acquisition cost £'000
Land and buildings (Note 1):		
Thermal insulation in all factories	18/05/2017	600
Improvement work to factory ceilings	18/05/2017	300
Plant and machinery:		
Air conditioning equipment in Laboratory A (Note 2)	21/02/2017	732
Distillation equipment (Note 3)	26/11/2017	1,834
Lifts in distillation factory	31/01/2018	175
IT equipment:		
Computers and accessories	01/08/2017	1,135

Notes

1) The land and buildings additions are being depreciated over 10 years on a straight-line basis.

2) The air conditioning equipment is listed on the Energy Technology Product list.

3) The invoice for the distillation equipment, which was payable on 1 May 2017 when the equipment was delivered and installed, was not paid until 1 May 2018 due to a dispute with the supplier.

Continued

1. Continuation

3) The following disposals were made in the period:

	Date of disposal	Sales proceeds £'000	Original cost £'000
Ammonia treatment system	28/02/2017	750	650
Computers (Note 4)	31/07/2017	-	300

4) 200 computers were acquired during the year ended 31 December 2014 at a cost of £2,000 each; an election was made to treat these as short life assets. On 31 July 2017, 150 of these computers were scrapped and replaced with newer models; the remaining 50 continue to be owned by Gosling Ltd. These are the only assets for which a short life asset election has been made.

5) Prior to the acquisition by Buzzard plc, Gosling Ltd was in a group with no other UK group companies and so was able to make full use of that group's annual investment allowance. However, no amount of the Buzzard group's annual investment allowance will be allocated to Gosling Ltd.

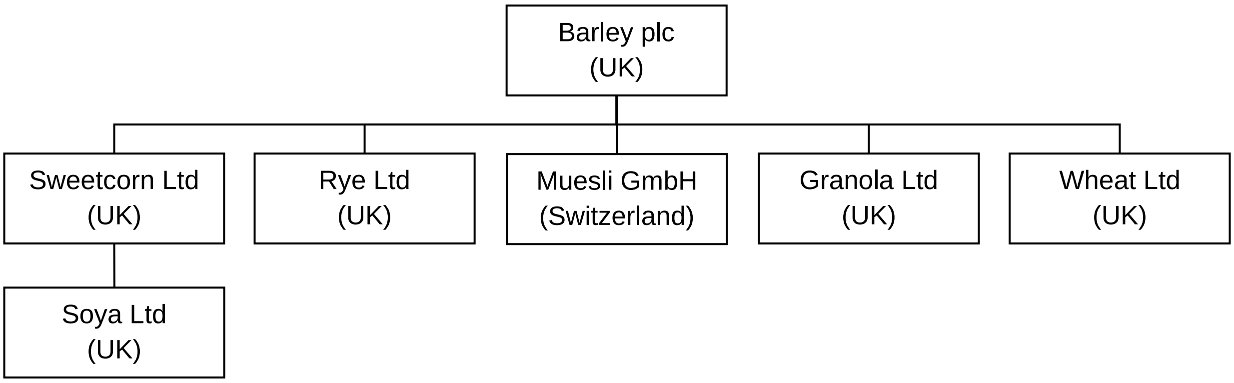
6) The tax written down values at 1 January 2017 were as follows: General pool £73,295,000; special rate pool £12,512,000; short life assets £221,000.

7) All deferred tax balances are calculated using a Corporation Tax rate of 19%.

8) Maximum capital allowance claims should be made.

You are required to calculate the opening and closing deferred tax asset/liability and movement in deferred tax in respect of property, plant and equipment for inclusion in Gosling Ltd's IFRS statutory accounts for the 16 months ended 30 April 2018. Include explanations where appropriate. (15)

2. Barley plc is the holding company of a large multinational group and is listed on the London Stock Exchange. A relevant extract from the group structure, together with the country of incorporation and tax residency for each company, is as follows:



Barley plc holds a 5% shareholding in Wheat Ltd. All other companies in the group are wholly-owned subsidiaries. All companies are trading, except for Muesli GmbH and Barley plc; the non-trading activities of these companies do not constitute a substantial amount of non-trading activity for the group as a whole.

Barley plc is in the process of undergoing a reorganisation for genuine commercial reasons, with the following transactions planned:

1) Barley plc intends to accept an offer from a third party to purchase the shares in Sweetcorn Ltd for £35 million, having acquired the shares for £15 million in June 2001. However, the purchase price is dependent on the following transactions being completed before the sale takes place:

   (a) Firstly, Sweetcorn Ltd does not own any property; it leases its business premises from Granola Ltd. The business premises will therefore be transferred to Sweetcorn Ltd at their market value of £11 million. The base cost of the business premises in Granola Ltd is £7.5 million. There will be no joint election under s.198 CAA 2001 in respect of fixtures.

   (b) Secondly, as the purchaser does not wish to acquire Soya Ltd, the shares in Soya Ltd will be transferred to Barley plc at their market value of £13 million. Sweetcorn Ltd acquired the shares for £8 million in December 2013.

2) Barley plc has accepted an offer from Clementine Ltd, a third party, to acquire 40% of the shareholding in Rye Ltd. As consideration, Barley plc will receive shares in Clementine Ltd worth £7 million. Barley plc paid £8 million for the entire shareholding of Rye Ltd in July 2017.

3) Barley plc has accepted an offer from a third party resident in Switzerland to acquire its shareholding in Muesli GmbH. Muesli GmbH was incorporated by Barley plc in May 2016 with share capital of £500,000, and has been carrying out very technologically advanced research and development with the eventual aim of developing a marketable product. It has not yet commenced trading activities. The agreed purchase price is £6 million payable upfront, plus a further £2 million if Muesli GmbH completes development of a marketable product and commences trading within five years of the sale.

4) Barley plc has also accepted an offer from a third party to acquire its 5% shareholding in Wheat Ltd, which it acquired for £6 million in October 2013. The purchase price is £9 million payable upfront, and Barley plc will be entitled to a further payout on a future flotation of Wheat Ltd, the payout being determined by the share price on flotation.

You are required to explain the tax implications of the proposed transactions on the Barley group. You do NOT need to consider indexation, VAT or payment dates.

(20)

3. You are a tax adviser working for Taxing Tax LLP, a firm of Chartered Tax Advisers. You have just returned from a meeting with Emma Scarlett, the Finance Director of Paddle plc, one of your clients. The meeting had been arranged by Emma to discuss Crawl Ltd, a wholly-owned UK resident subsidiary of Paddle plc.

Crawl Ltd, a manufacturer of gym equipment, has been loss-making for the past three years. After a number of unsuccessful attempts to improve profitability, the Board of Directors of Paddle plc has agreed to place the company into a members' voluntary liquidation. The Board plans to appoint the liquidator within the next few weeks and the liquidation process is expected to last around nine months.

The Board has not decided whether Crawl Ltd should cease trading now or wait until after the appointment of the liquidator. Although Crawl Ltd is currently solvent and still able to trade, Emma is aware that this may not be the case for long, and they may be forced to cease trading before the appointment.

Crawl Ltd has one subsidiary: a wholly-owned UK resident trading company, Butterfly Ltd, which was acquired four years ago for £15 million. Butterfly Ltd has also been loss-making recently, but the Board wish to retain ownership of this shareholding. The current market value of the shares is estimated to be £8 million.

Crawl Ltd and Butterfly Ltd have no brought forward losses; current year losses in both companies have always been surrendered in full to other UK companies in the group.

The draft step plan for the winding up of Crawl Ltd after it has both ceased trading and gone into liquidation is as follows:

1) The land and buildings, which were acquired 11 years ago for £25 million, will be sold to a third party at their market value of £35 million.

2) The shares in Butterfly Ltd, all plant and machinery, and all stock will be transferred to Splashing Ltd, another wholly-owned UK resident subsidiary of Paddle plc, at net book value (which is equal to their market value).

3) Trade receivables will either be collected or written off and trade payables will be settled.

4) The excess cash will be paid up to Paddle plc as a single distribution.

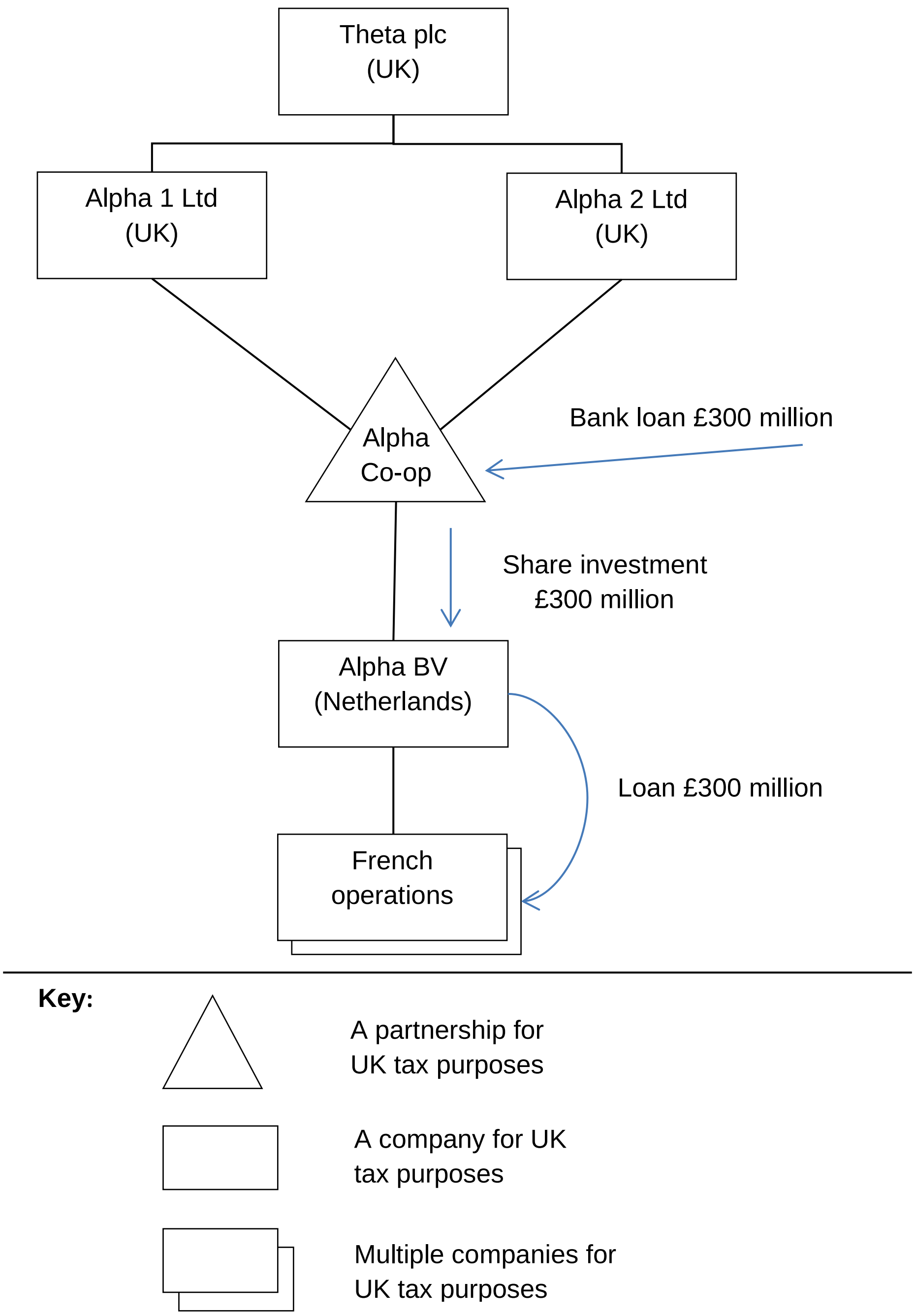
5) Crawl Ltd will then be dissolved.

Emma has asked you what the Corporation Tax consequences of the above matters will be for Crawl Ltd, and whether it matters if Crawl Ltd ceases to trade before or after the appointment of the liquidator.

You are required to write a letter to Emma explaining the Corporation Tax consequences of the above matters on Crawl Ltd, including any recommendations. Calculations are NOT required. (15)

4. You are a tax manager at a firm of Chartered Tax Advisers. Your firm has recently won a new client, Theta plc, and has been asked to manage an accelerated project that has been agreed with the HM Revenue & Customs' Customer Compliance Manager to bring a number of tax issues to resolution. You have been asked to brief your partner on one particular issue, the group's 'Dutch Co-op' financing structure, ahead of a meeting with the Customer Compliance Manager next week. This was a tax planning arrangement implemented by the group.

The abbreviated structure of the Theta plc group, together with the country of incorporation and tax residence of each company, is as follows:



Continued

4. Continuation

The following information has been provided to you:

1) Alpha Co-op is a Dutch Cooperative. The group has obtained clearance from HM Revenue & Customs that it should be regarded as a partnership for UK tax purposes. The group has also obtained a ruling from the Dutch tax authorities that it should be regarded as a company for Dutch tax purposes.

2) Alpha 1 Ltd and Alpha 2 Ltd are investment companies. Their only activity is being members of Alpha Co-op. Each member is entitled to half of the profits of Alpha Co-op.

3) On 1 April 2017, Alpha Co-op borrowed £300 million from a third party bank at an interest rate of 5%. It invested the funds in Alpha BV in exchange for the issue of ordinary shares. The bank loan is guaranteed by Theta plc.

4) Alpha BV is the holding company for the group's French operations. It used the £300 million share investment from Alpha Co-op to lend £300 million to its French subsidiaries. The terms of the loan mirror those of the Alpha Co-op bank loan.

5) Each year Alpha BV voluntarily pays dividends on the ordinary shares sufficient to fund the interest payments on the Alpha Co-op bank loan.

6) Alpha BV pays minimal corporate tax in the Netherlands on the interest income from the £300 million loan. This is because it can obtain tax relief for the interest paid by Alpha Co-op under the Dutch 'fiscal unity' rules.

You are required to prepare a briefing note for your tax partner which:

1) Explains the UK Corporation Tax treatment of Alpha 1 Ltd and Alpha 2 Ltd (ignoring the potential application of any anti-avoidance rules). (6)

2) Explains the UK Controlled Foreign Companies rules in respect of Alpha Co-op and Alpha BV. (8)

3) Sets out potential challenges that HM Revenue & Customs may raise in respect of the structure and potential defences against the challenges. (6)

Total (20)

5. You are a tax manager at a firm of Chartered Tax Advisers and have been asked to prepare the Corporation Tax computations for Faraday plc and Faraday Consulting Ltd for the year ended 30 September 2017. The income statements and relevant notes for the year are set out below.

Faraday plc

Income Statement for the year ended 30 September 2017	Notes	£'000
Turnover		
Rental income	(2)	2,000
Patent income	(3)	4,000
Operating costs		
Audit and tax fees		(90)
Legal and professional fees – building disposal	(2)	(220)
Other income		
Fair value movement on investment property	(2)	180
Profit before tax		£5,870

Notes

1) On 1 October 2016, United Kingdom Electricity plc acquired Faraday plc, along with its wholly owned subsidiary, Faraday Consulting Ltd. United Kingdom Electricity plc has excess losses of £60 million for the year ended 30 September 2017 which could potentially be surrendered as group relief to Faraday plc and Faraday Consulting Ltd.

2) On 31 March 2017 Faraday plc sold a freehold building to a third party for £12 million. Prior to the disposal, the building had been rented to Faraday Consulting Ltd. It had been treated in the accounts as an investment property and recognised at fair value on the balance sheet, with changes in valuation recognised through profit or loss. The building had been acquired on 31 March 1990 for £3.4 million.

3) The company holds the patents for a particular design of wind turbine, which it has been licensing to third parties. During the year it recognised £4 million of royalty income. Faraday Consulting Ltd developed the intellectual property as part of its consultancy business.

Continued

5. Continuation

Faraday Consulting Ltd

Income Statement for the year ended 30 September 2017	Notes	UK	Ireland	Total
		£'000	£'000	£'000
Turnover		55,000	11,000	66,000
Cost of sales				
Staff costs – salary		(30,000)	(5,500)	(35,500)
Staff costs – social security costs		(3,200)	(700)	(3,900)
Staff costs – bonus	(2)	(2,500)	(1,000)	(3,500)
Operating costs				
Office rental	(3)	(6,000)	(1,200)	(7,200)
Lease premium	(3)	(200)		(200)
Depreciation – leased equipment	(4)	(2,500)	(500)	(3,000)
Car rental	(5)	(120)	(40)	(160)
Bad debt	(6)		(600)	(600)
Travel costs	(7)		(100)	(100)
Fine	(8)	(20)		(20)
Entertainment	(9)	(500)	(350)	(850)
Charitable donation	(10)	(100)		(100)
Interest and other financing costs				
Bank loan	(11)	(1,000)		(1,000)
Finance cost – leased equipment	(4)	(400)	(80)	(480)
Profit before tax		£8,460	£930	£9,390

Notes

1) Faraday Consulting Ltd provides consultancy advice for the design of new wind generators. Its main business is in the UK following the expansion of renewable energy over the last decade. It also operates from an office in Ireland to provide consultancy advice in that country.

2) Staff bonuses are paid 12 months after the end of the period. The bonuses for the year ended 30 September 2016 were £2 million in total, of which £800,000 related to the Irish office.

3) On 1 January 2017 it signed a new 10-year lease and paid a lease premium of £2 million.

4) The only fixed assets are computers, which are rented under a four-year finance lease arrangement.

5) The car rental costs include £5,000 for the Managing Director's car, which has CO_2 emissions of 219g/km. The lease was entered into two years ago. All of the other leased cars have CO_2 emissions of less than 130g/km.

6) The Irish office has a debt where the customer is in financial difficulty, for which the accounts recognise an impairment loss of £600,000. The company has not written the balance off and is still chasing for payment.

7) Travel costs include £2,000 in respect of flights and hotel costs for the family of one of the company's employees who has been seconded to the Irish office.

8) The company incurred a fine for breach of health and safety rules.

Continued

5. Continuation

9) Entertainment costs are broken down as follows:

	UK	Ireland
	£	£
Client entertainment	450,000	280,000
Staff entertainment	50,000	70,000

10) The company paid a donation of £100,000 to a UK charity in response to the Hurricane Harvey disaster in the US.

11) The company has a bank loan, which covers the working capital requirements of the business, in particular to fund staff costs ahead of being paid by customers. The UK office is responsible for negotiating the terms of the loan with the bank.

12) The Irish office operates autonomously and has a Euro functional currency. An exchange gain of £4 million arose on the year-end retranslation of the foreign operation's balance sheet and has been recognised in other comprehensive income (rather than in profit or loss).

13) The accounting records of the company estimated the Irish tax to be €150,000 for the year. The company paid €140,000 on 30 April 2018, which was based on the submitted tax computations for the Irish branch.

14) The relevant exchange rates are:

    30 September 2017: £1 = €1.10
    30 April 2018: £1 = €1.05
    Average rate of the year to 30 September 2017: £1 = €1.18

15) The company has not made an election under s.18A CTA 2009.

You are required to prepare a computation of total taxable profits for Faraday plc and Faraday Consulting Ltd for the year ended 30 September 2017, with supporting explanations. (20)

6. You are Charlie Green, the Tax Manager at a firm of Chartered Tax Advisers. One of your clients is Bikes plc, the parent company of an online retailer of bicycles and cycling equipment operating in the UK and continental Europe. The group has just been the subject of a private equity backed buyout. No single investor controls the group.

Last week you met with Katie Murray, the new Finance Director for the group, and have just received the following email from her:

Hi Charlie

It was great to meet you last week. I mentioned that I was looking to set up a share scheme to help incentivise our employees. The package is still taking shape, but the current proposal is to have two separate plans:

1) A share option scheme for the senior leadership team in the UK. They will be granted options to acquire shares in Bikes plc. This is likely to be a Company Share Option Plan (CSOP), although some of the options granted may have to be outside of an approved plan.

2) An approved Share Incentive Plan (SIP). All employees of UK companies in the group will be able to purchase shares in Bikes plc under the plan up to a set limit (£1,000 or 10% of salary if lower) and we will match them two-to-one.

I am familiar with the Income Tax aspects of these plans. However, please can you set out the Corporation Tax treatment for me?

Just to reiterate the point I made last week: our private equity investors are looking at different exit routes, which could involve the group being listed or taken over in three or four years' time.

Thanks for your help with this matter.

Kind regards

Katie

You are required to draft an email to Katie explaining the Corporation Tax consequences of the employee share plans being considered. (10)