November 2020 Examination

PAPER 4

Corporate Taxation

Part I Suggested Answers

1.

	AIA	General pool	Special rate pool	Allowances	
	£	£	£	£	
WDV b/f		482,149	102,567		
Additions					
-manufacturing equipment	704,505	45,745			(1)
-air conditioning system	295,495				(½)
-car			29,750		(½)
Disposals					
-manufacturing equipment		(31,323)			(½)
	1,000,000	496,571	132,317		
Allowances					
AIA@100%	(1,000,000)			1,000,000	(½)
WDA @18%		(89,383)		89,383	(½)
WDA @6%			(7,939)	7,939	(½)
WDV c/f		407,188	124,378		
Total allowances				1,097,322	

(Max 4 marks)

2. Martha

The factors indicating that Martha is self-employed in relation to this work are:

Mutuality of obligation - no apparent mutuality of obligation (this is the only piece of work for Bird Ltd so far, lasting month, no indication of offering or accepting more) (½)

Provision of own equipment – Martha uses her own computer equipment to diagnose the issue. (½)

Basis of payment – Martha is paid a fixed fee for the work. (½)

Financial risk – Martha will not be paid if the issue is not resolved. (½)

Opportunity to profit – Martha will receive the same fee even if she completes the work early. (½)

The number and length of engagements – Martha also has other clients and this is her first contract with Bird Ltd. (½)

(Max 3 marks)

3. Lavender will have an amount taxed as a dividend (½) and a capital gains computation (½) as follows:

Dividend:

	£	
Amount received on share buy-back (1,500 x £5)	7,500	(½)
Less: original subscription price (1,500 x £1)	(1,500)	(½)
Dividend received	6,000	

Capital gains tax:

	£	
Sales proceeds=original subscription price (1,500 x £1)	1,500	(½)
Less: actual cost (1,500 x £1.50)	(2,250)	(½)
Capital loss	(750)	

Poppy will have a capital gain as follows:

	£	
Sales proceeds (1,000 x £5)	5,000	(½)
Less: cost (1,000 x £1.20)	(1,200)	(½)
Capital gain	3,800	

There are no Income Tax implications for Poppy.

(Max 4 marks)

4. Under the annual accounting scheme, as Florence Ltd has been VAT-registered for many years, the monthly instalments due for the year ended 31 March 2021 **(½)** are based on the total VAT due for the year ended 31 March 2020 **(½)**. 90% of the amount **(½)** is paid by direct debit in nine equal instalments of £4,000 (£40,000/10) **(½)** on the last day of months 4 to 12 of the VAT year. i.e. 31 July 2020 to 31 March 2021 **(½)**.

There is only one VAT return every year. **(½)** The balance of VAT due £7,000 (£43,000 – (£4,000 x 9)) **(½)** is submitted with the single annual VAT return by the last day of the second month following the year end ie 31 May 2021 **(½)**.

A business may apply to make only 3 interim payments instead of 9 **(½)** paying 25% of the estimated tax (i.e. £10,000) on the last day of the 4th, 7th and 10th months (i.e. 31 July 2020, 31 October 2020 and 31 January 2021) with the balance of £13,000 being paid by 31 May 2021. **(½)**.

(Max 4 marks)

5. Mobile phone £500 – exempt from NI as exempt benefit (½)
Company car benefit £4,000 – Class 1A (½)
Interest free loan £5,000 – Exempt (½) as the loan is less than £10,000 (½)
Premium bonds £2,000 – Class 1 (½) as they are surrenderable for cash. (½)

(Max 3 marks)

6. Accounting entries to reflect the payment of Corporation Tax in Endeavour Ltd.

	£	
Dr Corporation Tax creditor	66,000	(½)
Dr Corporation Tax charge (P&L account)	9,650	(½)
Cr Bank	75,650	(1)

(Max 2 marks)

7.

	£	
Proceeds	230,000	(½)
Less: Costs of sale	(5,750)	(½)
Less: Cost 415,000 x (230,000/(230,000+325,000))	(171,982)	(1)
Unindexed gain	52,268	
Indexation ((278.1 – 261.4)/261.4) = 0.064 x 171,982	(11,007)	(1)
Chargeable gain	41,261	

(Max 3 marks)

8. Baritone Ltd will need to purchase the replacement warehouse within 36 months of the sale of the original warehouse i.e. by March 2023. (½)

As Baritone Ltd will not have reinvested all of the proceeds from the original warehouse into the replacement one, Baritone Ltd will need to identify the amount of cash retained by the company (1). This is the sale proceeds of the original warehouse less the cost of the new warehouse. (½) (Baritone Ltd will have retained £485,000 - £394,000 = £91,000).

The £91,000 of cash retained is a chargeable gain when the original warehouse is sold (½). The rollover relief claimed will be the difference between the chargeable gain calculated before rollover relief (½) (proceeds less cost and indexation) and the proceeds not reinvested. (½)The amount of rollover relief is then rolled over into the base cost of the new warehouse. (½)

(Max 4 marks)

9. As Sculthorpe Ltd has held more than 10% of the shares in Titchwell Ltd (½) for a 12 month period (½) in the last six years (½) and Titchwell Ltd is a trading company (½) the substantial shareholdings exemption (½) applies so there is no Corporation Tax (½).

(Max 3 marks)

10. To be a close company, Ruthen Ltd must be a UK resident company, which it is, (½) and be under the control (½) of five or fewer of its participators (½) or any number of directors who are also shareholders. (½)

The directors only own 48% of Ruthen Ltd (½) so it is not under the control of its directors. (½)

Phil and associates	27%	(1)
Karen	8%	
Rebecca	7%	
Richard	6%	
Amanda	4%	
	52%	

Control requires more than 50% ownership (½) so Ruthen Ltd is under the control of five or fewer participators and there for is a close company. (½)

(Max 4 marks)

11. As Hamilton Ltd has sold goods to Princess Ltd in excess of their arm's length price (½) , the companies are not SMEs (½) and Hamilton Ltd controls Princess Ltd/the companies are connected (½) the transfer pricing rules will apply (½) as there is a tax advantage to Princess Ltd (½).

A transfer pricing adjustment will need to be made by Princess Ltd (½) on the basis that the arm's length price was paid (£34,000 - £29,500 = £4,500) increasing the Corporation Tax payable (½).

(Max 3 marks)

12. The period of account must be divided into two accounting periods for the purposes of calculating the corporation tax.

For Klondike Ltd the accounting periods will be:

12 months to 31 March 2020(½)

3 months to 30 June 2020(½)

The corporation tax returns for both of these accounting periods will be due for submission to HMRC on 30 June 2021. 2 x (½)

The corporation tax will be due for payment as follows:

Accounting period	Tax due	
31.03.20	01.01.21	(½)
30.06.20	01.04.21	(½)

(Max 3 marks)

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Corporate Taxation

Part II Suggested Answers

13.

1) Taxable total profits of each company

Jerome Ltd

	£	
Trading Profit	15,000,000	
Property Income	5,320,000	
Total Profits	20,320,000	(½)
Less brought forward trading loss (£2.5m(½) + (50%(½) x (£20,320,000(½)-£2.5m(½))	(11,410,000)	
Taxable total profits	8,910,000	(½)

Harris Ltd

	£	
Trading Profit	nil	
Non Trading loan relationship income	6,500,000	
Less Current year loss	(500,000)	
Total profit	6,000,000	(½)
Maximum group relief available from Jerome Ltd The lower of (½) (i) Maximum allowed (£2.5m (½) + (50%(½) x (£6m(½) -£2.5m(½)) = £4,250,000 and (ii) Available loss 16,500,000 - £11,410,000(½) = £,5,090,000	(4,250,000)	(½)
Taxable total profits	1,750,000	(½)

Klapka Ltd

	£	
Trading profit	nil	
Chargeable gain	6,000,000	
Less capital loss brought forward	(6,000,000)	(½)
Taxable total profits	nil	(½)

Losses carried forward

Jerome Ltd - trading losses

	£	
Brought forward loss	16,500,000	(½)
Less: Current year claim in Jerome Ltd	(11,410,000)	
Less Group relieved to Harris Ltd	(4,250,000)	
Carried forward loss	840,000	(½)

Klapka Ltd - capital losses

	£	
Brought forward loss	10,000,000	
Less: Current year claim against chargeable gain	(6,000,000)	
Carried forward loss	4,000,000	(½)

(Max 10 Marks)

2) As the advisor to the client the following steps should be taken

- Establish the facts(½) – is there in fact an error in the prior year's computations? (½)
- Is the amount of the error trivial/less than £200, as the client says? (½) If so, it could be ignored (½)
- Does the advisor have specific authorisation (½) from the client to disclose the error to HMRC? For example in the letter of engagement. (½) If so the error can be adjusted
- If no authority to disclose errors, the advisor should ask the client to authorise disclosure (½)
- The client should be informed in writing (½) of the consequences of the failure to disclose. (½)
- It might be necessary for the advisor to cease to act if the client refused to disclose the error. (½)
- Notify HMRC ceasing to act as tax agent (½)
- Consider if a Money Laundering Report is necessary. (½)

(Max 5 Marks)

Marks are awarded for relevant points

Total (15)

14.

1) Calculation of UK tax payable

	Total	UK	Overseas 1	Overseas 2
	£	£	£	£
UK trading profit (5,015,000 –15,000) (½)	5,000,000	5,000,000		
UK property business	400,000	400,000		
Non-Trading Loan relationship deficit (½+½) *See W1*	(52,000)	(52,000)		
Overseas income 1 (80,000 × 100/85) (½)	94,118		94,118	
Overseas Income 2 (850,000 + 350,000) (½)	1,200,000			1,200,000
Management Expenses (½)	(5,360,000)	(5,348,000) (½)	(12,000) (½)	Nil
	1,282,118	nil	82,118	1,200,000
UK Tax at 19% (½)	243,602	Nil	15,602 (½)	228,000 (½)
Foreign tax suffered			14,118 (½)	350,000 (½)
Double Tax relief (½ + ½)	(242,118)		(14,118)	(228,000)
Tax payable	1,484	Nil	1,484	Nil

Working 1

NTLR

	£
Interest receivable (½)	143,000
Interest on overdue CT (½)	(5,000)
Interest to buy shares (½)	(190,000)
NTLR deficit	(52,000)

(Max 9 Marks)

2) UK corporation tax treatment of overseas entities.

(a) An overseas branch is not a separate legal entity therefore the branch's results would form part of the results for Kingston Ltd (½) - the profits would be subject to UK tax. (½) Capital allowances if relevant could be claimed. (½) It is possible that the profits of the overseas branch will be subject to overseas tax, but double tax relief would be available. (½) It is also possible for Kingston Ltd to elect to exempt profits of the branch from UK tax. (½) This election is irrevocable (½) and would also apply to any other overseas branches held by Kingston Ltd. (½)

(b) If Kingston Ltd incorporated a company in Otopia, it would be treated as a separate legal entity (½) that would not be subject to UK tax (½) unless its place of management and control is in the UK (½) when it would be UK resident. (½) It would be subject to tax in Otopia. (½) No relief could be taken in Kingston Ltd for the losses incurred in the overseas subsidiary. (½) If the overseas company remits dividends to Kingston Ltd they will normally be UK corporation tax free. (½) An overseas company will be a related 51% group company and so may affect payment dates under the quarterly payments regime. (½)

(Max 6 Marks)

Marks are awarded for relevant points

Total (15)

15.

Email (1 mark for presentation)

To: Susanfinch@commerceltd.com

From: advisor@advisory.co.uk

Date: 1 November 2020

Subject: Investment in assets

Dear Susan

1. Thank you for your recent email regarding the tax treatment of certain elements of the company's expenditure.

Purchase of patent – as a general rule, this will be brought into account for tax purposes when it is recognised in the company's accounts. (½) The tax relief available is either the amount amortised in the accounts (½) or 4% of cost. (½) We would therefore need to know your amortisation policy to advise which would give the greater deduction in the current year. (½)

Purchase of goodwill – there is only limited tax relief available when goodwill is purchased. From 1 April 2019 a deduction is only available for goodwill acquired as part of the acquisition of a business (½) in which there is qualifying intellectual property. (½) The allowable deduction is 6.5% per annum. (½) We would therefore need further details of the circumstances in which the goodwill was acquired and whether the patent and goodwill were acquired in the same business purchase. (½) If so, the 6.5% deduction would be allowed in full as the cost of goodwill is less than six times the cost of the patents (6 × £75,000 = £450,000) (½).

R&D - As a medium sized company, Commerce Ltd could take a deduction for the qualifying expenditure relating to research and development, plus a further deduction equal to 130% of the allowable costs. (½)

We would need further information to confirm if the costs are spent on research and development as defined in accordance with GAAP, and to confirm that it is qualifying expenditure. (½)

Qualifying expenditure must be revenue in nature, and incurred on staff costs, software or consumables, and subcontracted costs. Staff must be directly involved in the R&D project. (½)

If Commerce Ltd has trading losses it could surrender part of the loss in return for a 14.5% tax credit (½) based on the lower of the loss and 230% of the qualifying expenditure(½) (either against tax on other income or as a cash refund). We therefore would need to know the loss situation of the company to ascertain if this was worthwhile. (½)

(Max 7 Marks)

2. The chargeable gain arising on the sale of the shares in DealerCo Ltd is:

	£	£	£
Cash proceeds (½)		400,000	
Purchase cost – January 2001 £ 95,000(½) x (A / (A+B) 400,000 / (400,000 + 200,000) (½)		(63,333)	
Indexation January 2001 to December 2017 (278.1-171.1)/171.1 (½)	x 63,333	(½) (39,606)	
Chargeable gain			297,061

No gain will arise in the current year on the part of the consideration which is settled by the issue of shares in LargerCo Ltd instead £31,667 (£95,000 - £63,333) will be the base cost for future disposal. (½)

Regards

An Advisor

(Max 3 Marks)

Total (10)

16.

1) Taxable profits for 2018/19 and 2019/20

Capital allowances on cessation at 31 January 2020	£
TWDV b/f (½)	8,000
Proceeds (½)	(20,000)
Balancing Charge	12,000

The taxable profit for the 4 months to 31 January 2020 is therefore:

	£
Profits before capital allowances (½)	125,000
Balancing Charge (½)	12,000
	137,000

	£
2018/19	
Year ended 30 September 2018 (½)	95,000
2019/20	
Year ended 30 September 2019 (½)	120,000
4 months ended 31 January 2020 (see working above) (½)	137,000
	257,000
Less overlap relief (½)	(16,000)
Taxable 2019/20	241,000

(Max 4 Marks)

2) The benefit of incorporation relief is to defer the gain made on the chargeable assets (½) by reducing the base cost in the shares by the gain deferred.

The conditions that must be fulfilled for incorporation relief to be available are:

(a) All assets of the business (except cash) must be transferred (½)
(b) The business must be a going concern (½)
(c) The consideration must be wholly or partly paid in shares (½)

(Max 2 Marks)

3) The chargeable gain arising on incorporation

	£	£
Gain on freehold premises		
Consideration (market value) (½)	250,000	
Less Cost (½)	(140,000)	
Gain		110,000
Gain on goodwill		
Consideration (market value) (½)	35,000	
Less cost (½)	nil	
Gain		35,000
No gain on equipment as all below £6,000, or cash		
Total gain		145,000
Less incorporation relief		
Gain x (value of shares/total consideration)		
145,000 (½)x (200,000/325,000) (½)		(89,231)
Total gain		55,769

Base cost of shares

	£
Market value of shares (½)	200,000
Less incorporation relief (½)	(89,231)
Base Cost	110,769

(Max 4 Marks)

4) The transfer of the business could be a transfer of a going concern ("TOGC") for VAT purposes. The effect of a TOGC is that it is outside of the scope of VAT (½) and no VAT is chargeable on the transferred assets. (½) In order for the incorporation to be a TOGC certain conditions must be fulfilled, being-

(a) The business is a going concern (½)
(b) Jas Eats Ltd is, or immediately will become, VAT registered (½)
(c) There is no significant break in trading (½)
(d) The same business is carried on. (½)

If the building has been opted to tax by Jasmine, (½) then in order for the TOGC rules to apply to the building, Jas Eats Ltd will also have to opt to tax the building. (½)

If these conditions cannot be fulfilled, Jasmine will have to charge output VAT on the taxable supplies transferred, (½) which will be input VAT for Jas Eats Ltd. (½)

As Jasmine is no longer running the business, she must deregister for VAT(½). It is possible for Jas Eats Ltd to acquire the VAT registration number of Jasmine's business. (½)

(Max 5 marks)

Marks will be given for relevant points

5) Jas Eats Ltd has a corporate personality which means that it is legally an entity separate from its Jasmine and any other directors or employees. This is sometimes called the veil of incorporation. (1)

The consequences of this include:

(a) Jas Eats Ltd can make its own contracts, (½) but its affairs are conducted by its directors. (½)
(b) Jas Eats Ltd can engage workers (½)
(c) Jas Eats Ltd can own property (½)
(d) Jas Eats Ltd can sue and be sued (½)
(e) Jas Eats Ltd is able to commit a criminal offence. (½)
(f) Jas Eats Ltd continues to exist despite changes to its shareholders (½)
(g) Jas Eats Ltd is liable for its own tax liabilities. (½)

(Max 5 Marks)
Marks will be given for relevant points

Total (20)