



November 2021 Examination

PAPER 4

Corporate Taxation

Part I Suggested Answers

1.	AIA	General pool	Special rate pool	Allowances
	£	£	£	£
WDV b/f		2,874,125	74,845	
Additions				
Computer equipment		70,000		(½)
Manufacturing equipment		140,000		(½)
Air conditioning system	300,000		450,000	(1)
Disposals:				
Computer equipment		(5,000)		(½)
	300,000	3,079,125	524,845	
Allowances				
AIA @ 100%	(300,000)			300,000 (½)
WDA @ 18%		(554,243)		554,243 (½)
WDA @ 6%			(31,491)	31,491 (½)
WDV c/f		2,524,882	493,354	
 Total allowances			<u>885,734</u>	

4 marks

2.	£	£	
Dr Profit and loss account reserve	(½) 250,000		(½)
Cr Ordinary share capital		250,000	(½)

The number of shares in issue and their total nominal value has increased from £500,000 to £750,000, (½) but the profit and loss account reserve has decreased by an equivalent amount from £1,700,000 to £1,450,000 (½). No change has taken place in the total value of the net assets which remains at £2,200,000. (½)

Candidates may describe using the following:

Net assets	<u>2,200,000</u>
Share capital	750,000
Profit and loss account reserve	<u>1,450,000</u>
	<u>2,200,000</u>

3 marks

3. Class 1A NIC (½) is payable by Beach Ltd on the cash equivalent of the benefit of the car (½) and the cost to Beach Ltd of the gym membership (½) at a rate of 13.8 % (½). No NIC is payable in respect of the fuel as it is for business purposes. (½)

The Class 1A NIC is payable by 19 July following the end of the year (or 22 July if paid electronically). (½)

3 marks

4.

1) The place of supply determines whether or not VAT needs to be accounted for to HMRC.
(1) If the place of supply is the UK the VAT must to be accounted for to HMRC. (1)

2) The general rule for goods is as follows:

Goods leaving the UK = UK place of supply (½)

Goods arriving in the UK = No UK place of supply. (½)

Bumble Ltd's sales have a UK place of supply (½) and Bumble Ltd's purchases have an overseas place of supply. (½)

4 marks

5. The desk is a non-wasting chattel, but as the proceeds exceed £6,000 the gain is the lower of the gain calculated in the usual way compared with $\frac{5}{3} \times$ (gross proceeds - £6,000).

Gain calculated in the normal way:

	£	
Proceeds	7,800	
Less: costs of sale	<u>(750)</u>	(½)
	7,050	
Less: cost	(2,500)	
Gain before indexation	<u><u>4,550</u></u>	(½)

Compared to: $\frac{5}{3} \times (\text{£}7,800 - \text{£}6,000) = \text{£}3,000$ (1)

Lower gain is therefore £3,000. (½)

The painting is also a non-wasting chattel; however as the proceeds are less than £6,000 they are deemed to be £6,000.

	£	
Deemed proceeds	6,000	(½)
Less: costs of sale	<u>(250)</u>	(½)
	5,750	
Less: cost	(9,000)	(½)
Allowable loss	<u><u>(3,250)</u></u>	

4 marks

6. **Corporation tax:**

The following companies are able to surrender trading losses to Sungold Ltd:

Strillo Ltd (75% subsidiary)
Ferline Ltd (Indirect relationship of 85%) (1)

Sungold Ltd only has an effective 56.25% interest in Tomande Ltd (ie less than 75%) therefore this does not form part of the group. (½)

Ferline Ltd is part of the group for corporation tax purposes as a group can be established by using Romello GmbH (even though it is not UK resident). However, losses cannot be surrendered by Romello GmbH unless it has losses which relate to a UK permanent establishment. (1)

Capital gains tax:

The following companies are able to surrender assets at a nil gain/nil loss to Sungold Ltd:

Strillo Ltd
Ferline Ltd
Tomande Ltd (1)

Tomande Ltd is part of the group for capital gains tax purposes as there is a direct relationship of over 75% and an indirect relationship of over 50%, 56.25% in this case. (½)

Romello GmbH is part of the group for capital gains tax purposes, however Romello GmbH can only surrender assets at nil gain/nil loss that relate to a UK trade. (½)

Max 4 marks

7.

Proceeds	1,850,000	(½)
Less: Costs of sale	(7,500)	(½)
Less: Cost	(1,200,000)	(½)
Unindexed gain	<u>642,500</u>	
Indexation $((278.1 - 208.0)/208.0) = 0.337 \times 1,200,000$	(404,400)	(1)
Chargeable gain	<u><u>238,100</u></u>	

Corporation Tax payable - $£238,100 \times 19\% = £45,239$ (½)

3 marks

8. As Rushmeadow Ltd is a close company s455 tax will be payable on the loan. The tax is calculated as 32.5% of the loan and is payable by the company. (½)

The amount of the loan is taken as the lower of the amount outstanding on:

- The last day of the accounting period; or (½)
- The normal due date. (½)

In this case s.455 tax on £5,000 ie £1,625 will be due on 1 October 2021. (½)

The repayment of the loan will result in the s.455 being refunded to the company (½) by reducing

the corporation tax liability for the year ended 31 December 2021. (½)

The company would get relief for the Class 1A National Insurance, that would be payable on the loan to Nicola, in calculating the corporation tax liability. (½)

Max 3 marks

9. As Kittiwake Ltd has augmented profits of over £1.125million (£1.5m x 9/12) and below £15 million (£20m x 9/12) (½) it is a large company for this purpose (½).

[Note: additional marks will be awarded for correctly mentioning that it is not the first year that the company is large, or that its tax liability is more than £10k, however there is a maximum of 1 mark available for the conditions including the above]

It should have paid its corporation tax by instalments on the following dates:

On the 14th day of month 7 after the beginning of the accounting period: 14 January 2021. (½)

3 months later: 14 April 2021. (½)

3 months and 14 days after the end of the accounting period: 14 July 2021.(½)

Max 2 marks

10. The impact of the election for Pulp Ltd, is that a lower effective rate of Corporation Tax applies to the profits arising from the patents (½). The lower rate is currently 10%. (½)

The relief is given by allowing a deduction in the calculation of trade profits of Pulp Ltd (½), which is calculated as follows:

Relevant IP Profits (½) x (Main rate of Corporation Tax-IP rate of CT) (½) / Main rate of CT (½)

3 marks

11. Scarlett Ltd – Total taxable profits for the year to 31 March 2021.

Trading profits	£	200,000	(½)
UK property business income (25,000-1,500-1,100)		22,400	(½)(½)(½)
		<hr/>	
		222,400	
Less: Non-trade loan relationship deficit		(400)	(½)(½)
Less: Qualifying charitable donations		(600)	(½)
		<hr/>	
Total taxable profits		<u>221,400</u>	

Corporation tax payable 221,400 x 19% = 42,066 (½)

4 marks

12. Firefly Ltd is a company with investment business (½) which is defined as company whose business consist wholly or partly of making investments. (½)

The Corporation Tax computation of Firefly Ltd will list the various types of taxable investment income that the company derives. (½) The expenses that relate to each specific source of income are deducted from that source, i.e. any expenses relating to the rental properties will be deducted from the rental income. (½)

The costs of running the office will be treated as management expenses (½), as are the capital allowances relating to the running of the whole business (½) and they are available to deduct against the total profits They can only qualify for a deduction to the extent that they are not

incurred for an unallowable purpose. (½)

Dividend income is normally exempt income and is not included in TTP. (½) When shares are disposed of in the future, these disposals may result in capital gains or losses. (½)

Max 3 marks



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Part II Suggested Answers

13.

1.)

			£	
Trading profit before adjustments			1,625,000	
Less Capital Allowances (see working 1)		(401,500)		(1/2)
Further deduction for R&D costs £100,000 x 230% = £230,000 (1/2) less deduction already taken £100,000		(130,000)		(1/2)
Trading profits			1,093,500	
Overseas rental income £500,000 + tax £125,000 (1/2)			625,000	(1/2)
Chargeable Gain (see working 2)			366,802	(1/2)
Total Taxable Profits			2,805,302	(1/2)
Corporation Tax payable				
X 19% (1/2)			396,207	
Less Double tax relief Lower (1/2) of				
UK tax £625,000 x 19%	118,750 (1/2)		(118,750)	
and				
Overseas tax £625,000 x 20%	125,000 (1/2)			
Tax payable			277,457	(1/2)

Working 1

Capital Allowances

	WDA £	
Car - CO ₂ emissions 155g/km – WDA 6%	1,500	(1/2)
R&D capital expenditure – 100% FYA	400,000	(1/2)
Total WDA	401,500	

Working 2

Chargeable Gain

	£	£	
Proceeds	2,000,000		
Less Cost	(1,057,000)		
		943,000	
Indexation			

£1,057,000x (278.1 - 229/229) (0.214)		(226,198)	(1/2)
Less losses (no restriction)		(350,000)	(1/2)
Chargeable gain		366,802	

8 Marks

2.) Ethics

It is possible that the client is requesting the firm to advise on tax planning which is contrary to the five Standards for tax planning. The standards for tax planning are:

- Client specific. (1/2) In order to meet the standard, the planning should be specific to the client's circumstances and an "off the shelf" scheme is unlikely to meet this requirement. (1/2)
- Lawful. (1/2) The client states that HMRC has a different view of the law, which does not necessarily indicate behaviour which may breach the standards. However, the client should be made aware of the likely risks and costs that might be incurred to deal with a dispute with HMRC. (1/2)
- Disclosure and transparency. Tax advice must not rely for its effectiveness on HMRC having less than the relevant facts. Any disclosure must fairly represent all relevant facts (1/2)
- Tax planning arrangements. The client believes that this scheme exploits a loophole using a structure. Advisors should not encourage (1/2) tax planning that uses a loophole which could be contrary to the intention of parliament in enacting the legislation (1/2) and/or which uses a contrived structure that seeks to exploit any shortcomings (or "loopholes") in the law. (1/2)
- Professional judgement and appropriate documentation. An advisor should always use their professional judgement. (1/2) We should ensure that we document our views (1/2)

5 marks

3.) If the contract to provide tax advice is between the firm and Blackchurch Ltd, the shareholders will not have a contractual relationship (1/2) with the firm and so cannot sue for breach of contract (1/2).

However it is possible that the firm owes the shareholders a duty of care. (1/2) If they are owed a duty of care, The shareholders could sue for negligence relating to a breach of that duty. (1/2)

To be successful the shareholders must show –

- That the firm owed a duty of care (1/2) to the shareholders. As they are not a party to the contract, they must show that they were sufficiently closely affected (1/2) by the lack of tax advice.
- They must show that the firm breached the duty of care. (1/2) for example, did the firm fail to provide the advice that would normally be expected from a professional firm? (1/2)
- The shareholders must show that they have suffered a loss. (1/2) In this case, has the value of their shares really decreased due to the suggested lack of advice? (1/2)

5 Marks

(Total 18 marks)

14.

1.) Capital treatment applies (½) because:

- The repurchase is for the benefit of the trade (½) Ahmed has held the shares for more than 5 years, (½)
- He is UK resident (½)
- He will not be connected to the company after the sale as his ownership will be of 22.5% of the shares (ie 2,000/16000) (½) - less than 30% of the shares (½)
- The sale is a substantial reduction of his shareholding (½) – his post sale shareholding is less than 75% of the pre-sale holding (½). Pre- sale Ahmed had 30% of the shares, and post sale 12.5% (½) which is less than (75% x 30% = 22.5%) (½)

The CGT on the proceeds will be

	£	
Proceeds £17 x 4,000	68,000	
Less cost £3.50 x 4,000	(14,000)	
Chargeable	54,000	
Tax at CGT rate of 20% (½)	10,800	(½)

6 marks

2.) Sale of first tranche of shares – 23,000 shares – on 30 November 2021

Conditions for SSE - InvestingCo Ltd held at least 10% of the shares (½)

- The shares have been held for a 12-month period in the last 6 years (½)
- Langsales Ltd is a trading company. (½)
- SSE applies to this disposal. (½)

Sale of the second tranche of shares – 2,000 shares – on 1 December 2022

- Although the holding is now less than 10 there has been a 12-month period in the previous six years where InvestingCo Ltd held at least 10% of the shares. (½)

So SSE applies to the second disposal. (½)

3 marks

3.) a.) This is the granting of a major interest in a qualifying conversion and so a zero rated supply. (1)

b.) As this is not the first grant of a major interest in a dwelling it is an exempt supply. (1)

c.) This is the supply of a new commercial building (i.e. less than 3 years old) so this is a standard rated supply (1)

d.) This is a standard rated supply to Brickie Ltd and, as the machine relates to the making of zero rated supplies, the input VAT can be reclaimed. (1)

e.) The reclaim of input VAT charged on a car where private use is allowed (even if there is no actual private use) is “blocked” i.e. cannot be reclaimed. (1)

Note – Brickie Ltd is partially exempt business for VAT purposes. Marks will be given for any relevant points regarding partial exemption.

Maximum 5 Marks

4.) The items are treated as follows:

- a.) Payment in lieu of notice – this will be taxable in full (½) as it relates to the salary that Jo would have received had they worked the notice period (½)
- b.) The statutory redundancy pay is exempt but under s.401 ITEPA (½) it reduces the £30,000 limit for non-contractual payments. (½)
- c.) Ex-gratia – The remaining tax free amount after applying the statutory redundancy pay is £24,000. Therefore £24,000 of the ex-gratia is tax free (½) and £8,000 is taxable (½)
- d.) This is a restrictive covenant payment as Jo is being compensated for giving up their right to work for another company. (½) This amount will be taxed in full by virtue of section 225 ITEPA. (½)

4 Marks

(Total 18 marks)

15.

- 1.) Taxable profits of the companies, and loss c/f

Castle Ltd		£	£	
Profit			15,000,000	
Maximum loss offset - deductions allowance	2,500,000			(½)
Plus 50% (½) x (15,000,000 – 2,500,000) (½)	6,250,000			
Maximum loss offset	8,750,000			
			(8,750,000)	
Taxable			6,250,000	(½)

Castle – loss carried forward memorandum

		£	
Loss brought forward	30,000,000		(½)
Utilised in year by Castle Ltd	(8,750,000)		
<i>memo – available to Clifton</i> <i>(£30m - £8.750m = £21.250m)</i>			
Utilised in the year by Clifton Ltd	(14,750,000)		
Loss carried forward	6,500,000		(½)

Castle Ltd		£	£	
Profit			27,000,000	
Group relief offset (W1)			(14,750,000)	
Taxable			12,250,000	(½)

(W1) Group relief that can claimed by Castle Ltd

Lower of				
Maximum loss offset - deductions allowance	2,500,000			(½)
Plus 50% (½) x (27,000,000 – 2,500,000) (½)	12,250,000			

	14,750,000		
AND			
Available loss (1/2)	21,250,000		
Therefore maximum loss offset		14,750,000	(1/2)

6 marks

- 2.) Gain on sale - this is a part disposal of the asset. The gain is as follows (ignoring indexation allowance)

		£	
Proceeds		900,000	(1/2)
Less cost		(257,143)	(1/2)
£600,000 (1/2) x £900,000(1/2) / (£900,000 + £1,200,00) (1/2)			
Gain		642,857	(1/2)

3 marks

- 3.) a.) Gift relief is available on the transfer of business assets. A business asset includes trading companies (1/2), either any number of shares if the company is unquoted (1/2) or at least 5% of a quoted company. A joint election should be made (1/2) within 4 years from the end of the tax year of the disposal. (1/2)

Base cost of the shares that Tim acquired on the gift, assuming gift relief is claimed on the transfer between Harri and Tim - £40,000 (being Harri's base cost) (1) (Value at transfer £800,700- rolled over gain £760,700)

Gain arising on Tim-

		£	
Proceeds on sale		950,000	(1/2)
Less base cost		(40,000)	
Chargeable gain		910,000	(1/2)

4 Marks

16.

Email Presentation (1)

To Jemila Jones

From A Tax Advisor

Date 3 November 2021

Subject Queries re overseas business

Dear Jemila

Thank you for your email. I have the following comments-

- 1.) A company incorporated in the UK will automatically be resident in the UK (½) for the purposes of corporation tax. This will not be relevant to you because Acamb Ruritania SA will be established under the laws of Ruritania. (½) However, it is also possible for a company which is incorporated overseas to be UK tax resident (½) if the UK is the place of central management and control. (½) “Central management and control” is not a defined concept and as such its meaning is established through case law. It is generally taken to mean where the highest level of management decisions are taken. (½) So if Acamb Ruritania SA is controlled by a Ruritanian based board (and management decisions are taken outside of the UK) it will not be UK tax resident. (½) However, if the UK based board of directors of the UK company make the management decisions (½) the company would be UK resident (½). It is of course possible for Acamb Ruritania SA to be both UK and Ruritania resident for tax purposes. (½)

Maximum 4 Marks

- 2.) You have identified an issue with transfer pricing. (½) For any large companies (such as the Acamb Computer group) (½) all trading with connected companies (½) must be at an arm's length price. (½) “Arm's length” effectively means the equivalent price that would be paid by a third party transacting on similar terms. (½) If an artificially low price is charged to Acamb Ruritania SA in order to realise profits in that low tax jurisdiction (½), a transfer pricing adjustment must be made in the tax computations of the UK company (as a tax advantage is being achieved there) (½). This adjustment would have the effect of increasing profits to an amount that would have been recognised if the arm's length price had been charged. (½) It may be possible for an equivalent adjustment to be made in the tax computations of Acamb Ruritania SA to reduce the profits to reflect the sales being arm's length; however, this would depend on the rules in Ruritania and may not be automatic. (½) This transfer pricing rule relates to both the sale of goods intercompany and the provision of the services (½) such as the marketing department.

4 Marks

- 3.) If the return had been submitted on time (ie 30 June 2020) the enquiry window would have closed on 30 June 2021. (½) However as the return was late (½) ie it was submitted on 1 September 2020, the enquiry window is extended to the 12 months from the quarter day. (½) following the date of the filing. (½) HMRC therefore had until 31 October 2021. (½) to open an enquiry. As this was done on 1 October 2021, HMRC was within time. (½)

3 Marks

If you require any further information, please do email me

Regards

A Tax Advisor

(Total 11 Marks)