



Practical Tax People
Association of
Taxation Technicians

May 2017 Examination

PAPER 4

Corporate Taxation

Part II Suggested Answers

Question 1

To: Alice Scott
From : Tax manager
Date: Today
Subject: Repurchase of shares

(Communication and presentation)

Marks
1

Dear Alice

Thank you for your email. I have addressed your points below:

1) Treatment of a share repurchase

If the following conditions are met, the repurchase will be treated as a capital transaction and the shareholder as having made a chargeable disposal: ½

- Coburg Ltd is an unquoted UK resident trading company. ½ }
- The shareholder is UK resident and has held their shares for at least five years. ½ }
- The shareholding must be substantially reduced i.e. the shareholder after the repurchase owns not more than 75% of the shareholding before. ½ }
- The shareholder is not connected with the company after the repurchase, which means they cannot own more than 30% of the shares. ½ } max 3
- The repurchase is for the benefit of the trade, or ½ }
- The whole or substantially the whole of the proceeds are used to discharge an inheritance tax liability of the shareholder arising from the death of another person within two years after death. ½ }

The treatment will not apply where the main purpose is the avoidance of tax. ½ }

If the above conditions are not met, the repurchase will be treated as an income distribution in the hands of the shareholder. ½

However, the repurchase of a corporate shareholder's shares is always treated as a capital transaction. 1

Max 5

2) Repurchase of the Saxe Ltd shares:

The repurchase results in a chargeable gain subject to corporation tax as follows: ½

	£	
Proceeds £23 x (3,100 – 500)	59,800	½
Less: Cost 2,600 x £1	(2,600)	½
Unindexed gain	<u>57,200</u>	
Less: Indexation 269.0 – 201.6/201.6 x £2,600	(869)	1
Indexed gain	<u>56,331</u>	

However, the gain may be covered by the substantial shareholding exemption subject to obtaining further information as to whether Saxe Ltd is a trading company. 2 x ½

Max 3

3) Repurchase of Marie Dagmar's shares

Marie's shares have been held for less than five years and therefore the repurchase will be treated as an income distribution. 2 x 1/2

Marie will be treated as receiving a distribution equal to the difference between the repurchase price and the original subscription cost i.e. $\pounds(23 - 1) \times 2,900 = \pounds63,800$ 1/2

Depending on Marie's marginal rate of tax, the distribution is taxed at 7.5%, 32.5% and/or 38.1% after a tax free dividend allowance of $\pounds5,000$. 2 x 1/2

There will also be a capital loss arising on the difference between the original subscription cost and the amount paid by Marie for her shares i.e. $\pounds(1 - 20) \times 2,900 = \pounds55,100$. 2 x 1/2

4) Legal requirements

Any company can fund a share repurchase from:

- Distributable profits, or 1/2
- The proceeds of a new issue of shares for the purpose of funding the repurchase. 1/2

The procedure for an off-market purchase for a private company is:

- The buy-back approved by ordinary resolution (excluding those whose shares are being purchased). }
- The contract must be available for at least 15 days prior to the meeting. }
- A return is made to the Registrar within 28 days. } max 2
- The shares must be cancelled or held, in certain circumstances, as treasury shares. }
- On cancellation, an amount equal to the nominal value must be transferred to a capital redemption reserve, unless the repurchase is made partly out of capital. }

A private company may fund a share repurchase via a permissible capital payment. 1/2

Credit will be given for additional valid points regarding a share purchase for a private company

Max 3

Question 2

1)					Marks
		Mansell Ltd	Hunt Ltd	Senna Ltd	
		£	£	£	
Trading profit		130,300	nil	12,000	½
Overseas rental income £78,200 x 100/92		85,000	-	-	½
Interest receivable		3,000	700	600	½
Less: qualifying charitable donations		(500)	(700)	(200)	½
		217,800			
Less: group relief		(183,800)		(12,400)	1 + ½
Taxable total profits		34,000	nil	nil	
Corporation tax at 20%		6,800	nil	nil	½
Less: DTR, lower of £34,000 x 20% = £6,800					
Overseas tax paid: £85,000 x 8% = £6,800		(6,800)			1
Corporation tax payable		nil	nil	nil	
<i>No relief for the capital loss</i>					½
<i>The group relief surrendered to Mansell Ltd is restricted to £183,800 to preserve corporation tax of £6,800, exactly equal to the double tax relief credit.</i>					
				£	
Hunt Ltd loss				310,000	
Less: group relief to Mansell Ltd				(183,800)	
group relief to Senna Ltd				(12,400)	
Remaining loss available to carry forward				113,800	½

Max 5

2)						Marks
	Y/E 31.12	P/E	Y/E	Y/E 31.3.	Y/E	
	2014	31.3.2015	31.3.2016	2017	31.3.2018	
	£	£	£	£	£	
Trading profit	132,500	27,000	750	12,000	nil	½
Interest income	1,200	500	-	600	900	½
Less: current year loss relief					(900)	½
Less: terminal loss relief 9/12 x 133,700	(100,275)	(27,500)	(750)	(12,600)	-	3 x ½
QCDs	(700)	(lost)	(lost)	(lost)	-	½
Taxable total profits	32,725	nil	nil	nil	nil	

Max 3

3)	Marks
The tax director is correct in that tax losses represent value if they are carried forward and offset against future trading profits.	1/2
A purchaser of Senna Ltd would look to utilise any unrelieved trading losses by offsetting them against future trading profits arising from the same trade.	1/2
However, where there is a change in the ownership of Senna Ltd (which would be the case if the company were to be sold outright) then the use of the losses may be restricted.	1
If, within the three years before or after the change in ownership, there is a major change in the nature or conduct of the trade, then the losses being carried forward in Senna Ltd cannot be relieved against future trading profits, thereby negating their value.	1/2
The change within three years before the change in ownership may apply given the possibility that there may be attempts to change Senna Ltd's products and target customers, prior to the potential sale.	1/2

Max 3

4)	Marks
<u>Setting up the overseas operations as a branch</u>	
The branch is a permanent establishment located overseas but controlled from the UK.	1/2
Any losses will be available for UK trading loss relief in Mansell Ltd's corporation tax computation and profits from year two will be subject to UK corporation tax.	1/2
Double tax relief will be available on any overseas tax paid, subject to a maximum of the UK tax on the overseas profits.	1/2
It is possible to elect for profits arising from foreign PEs of a UK company to be exempt, however if this election is made then losses will also be excluded.	1/2
The rent on the office premises will be deductible in computing the branch profits and capital allowances will be available on plant and machinery.	1/2
<u>Incorporation of an overseas subsidiary</u>	
The subsidiary is to be incorporated overseas and is not centrally managed and controlled from the UK. Therefore it is not UK resident.	1/2
No UK loss relief is available and UK capital allowances are not available on plant and machinery purchased by the subsidiary. Any rent paid will be deductible according to the local tax rules for the calculation of the subsidiary's profits.	1/2
The profits of the subsidiary are normally only taxed when remitted to the UK and double tax relief may be claimed.	1/2
However, profits remitted in the form of dividends are normally exempt from UK corporation tax.	1/2

Max 5

Question 3

1)

Marks

The Corporation Tax treatment of the redundancy package is as follows:

- The one-off pension scheme payment is deductible as wholly and exclusively for the purpose of the trade. $\frac{1}{2}$
- The restrictive covenant payment is deductible, in the same way. $\frac{1}{2}$
- The ex gratia payment is deductible, in the same way and not restricted to the £30,000 Income Tax limit for tax free payments. $2 \times \frac{1}{2}$

For Income Tax purposes, the restrictive covenant payment is fully taxable.

1

2)

Marks

In determining whether a company is required to make quarterly instalment payments, the £1,500,000 limit is divided by the number of related companies (including itself) at the end of the preceding accounting period. $\frac{1}{2}$

Companies are related where one is controlled by another or they are under common control. This includes companies that are related for any part of the accounting period (i.e. joiners and leavers). $\frac{1}{2}$

Control is generally defined as ownership of >50% of the ordinary share capital. For sub-subsidiaries, the effective ownership must also be >50% $\frac{1}{2}$

Therefore, Radium Ltd has two related companies, Prix Ltd and Noble Ltd. The effective ownership of Curie Ltd is only 45%. The £1,500,000 limit will be divided by three for the purposes of determining whether Radium Ltd should make quarterly instalment payments. $\frac{1}{2}$

The shareholdings of Irene in Rad Ltd and Glow Ltd have no effect when assessing the number of related companies. $\frac{1}{2}$

However, Prix Ltd is related to Radium Ltd, Noble Ltd and Curie Ltd. $\frac{1}{2}$
Curie Ltd is related to Prix Ltd $\frac{1}{2}$

Max 4

3)

Marks

Glow Ltd is required to register for VAT if the value of taxable supplies in the previous 12 months exceeds the registration threshold of £83,000. $\frac{1}{2}$

At the end of October 2016, Glow Ltd's total taxable supplies are £82,900 and therefore one month of turnover in November 2016 (£7,000) will mean the registration threshold is exceeded at the end of that month. $\frac{1}{2}$

Therefore notification is required by 30 days from the end of November 2016 i.e. 30 December 2016 and registration will take effect from 1 January 2017. 1

The future test looks at whether the anticipated value of taxable supplies exceeds £83,000 in the next 30 days alone. That is not the case with the new contract with Noble Ltd. $\frac{1}{2}$

Max 3

4)	Marks
<u>Accounting advice:</u>	
The input tax of £1,200 x 20/120 = £200 on the accounting advice is recoverable as pre-registration input tax. The amount was incurred for services provided within 6 months of registration.	1/2 1/2
The VAT exclusive amount of £1,000 will be deductible for Corporation Tax purposes.	1/2
<u>Renovation costs:</u>	
This input tax may relate to both goods and services. Both are recoverable. In the case of services, as described above and input tax on any capital assets still on hand in the business on registration is recoverable making a total of £12,960 x 20/120 = £2,160	1/2 1/2
These appear to be capital costs so will not be deductible for Corporation Tax purposes.	1/2
<u>Catering equipment:</u>	
Assuming the equipment is still on hand on registration, the input tax of £3,900 x 20/120 = £650 will be recoverable.	1/2
The VAT exclusive cost of £3,250 qualifies for the annual investment allowance at 100%, unless otherwise used.	1/2
<u>Tax fees:</u>	
The fees were incurred by Irene, who is presumably not VAT registered and therefore no input tax can be recovered. She is the ultimate consumer for VAT purposes.	1/2
The tax advice fees are not deductible by Irene for Income Tax purposes.	1/2

Max 4

Question 4

	£	Marks
1)		
<u>Ellie</u>		
Deemed proceeds (MV)	54,240	3 x ½
(454 + 450) / 2 = 452p x 12,000		
Less: Cost	<u>(6,200)</u>	½
	48,040	
Less: Holdover relief	<u>(48,040)</u>	1
Gain	<u>Nil</u>	

Holdover relief is available as Storey plc qualifies as Ellie's personal company, given she owns at least 5% of the votes. 2 x ½

<u>Peacock Ltd</u>	£	
Proceeds	103,240	
Less: Cost	<u>(111,720)</u>	
Loss	<u>(8,480)</u>	½

As the disposal is out of at least a 10% holding and the shares have been held for 12 months in the 24 months prior to the disposal, the substantial shareholding exemption will apply and Peacock Ltd's loss will not be allowable for corporation tax purposes. 3 x ½

1

	£	£	Marks
2)			
Proceeds: 2% x (15-1) x £20,000		5,600	½ + ½
Less: Cost			
£237,000 (W1) x 5,600 / (20,000 + 200,000)		<u>(6,033)</u>	4 x ½
Loss		<u>(433)</u>	

Indexation cannot increase the loss

W1

Cost of Kare Mews		280,000	
Gain on Henderson Road	60,000		
Less: Rollover	<u>(43,000)</u>	(43,000)	1
Proceeds not re-invested £(297,000 – 280,000)	<u>17,000</u>		½
Revised base cost of Kare Mews		<u>237,000</u>	

Max 4

	Marks
3)	
The information in the email indicates that this is tax evasion, the deliberate concealment of a taxable amount for the year, and is illegal. It will result in an irregularity on the 2017 tax return.	½
	½
Assuming the amount is not trivial and specific authorisation to disclose is required, the client should be asked for authority to disclose or for the client to make the necessary adjustment.	½
	½
If the client is still unwilling after oral advice and written advice outlining the consequences, then the firm should cease to act.	½
	½
The client should be advised in writing and HMRC should be informed, without reasons.	½ ½
Consideration should be given as to whether a report should be made to the MLRO/NCA	½

Max 4