November 2018 Examination

PAPER 4

Corporate Taxation

Part I Suggested Answers

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1.

Capital allowances computation for Whitman Ltd:

	FYA	AIA	General pool	Special rate pool	Allowances	
	£	£	£	£	£	
WDV b/f			435,650	335,900		
Additions						
- Ventilation system		200,000		27,500		(½)
- Warehouse racking			35,650			(½)
- Energy saving equipment	50,000					(½)
Disposal						
- Packing machine			(22,000)			(½)
	50,000	200,000	449,300	363,400		
Allowances						
AIA @ 100%		(200,000)			200,000	(½)
FYA @ 100%	(50,000)				50,000	(½)
WDA @ 18%			(80,874)		80,874	(½)
WDA @ 8%				(29,072)	29,072	(½)
WDV c/f			368,426	334,328		
					359,946	

4 marks

2.

By subscribing (½) for shares in Horncastle Ltd, an investor can defer the chargeable gain arising on the disposal of any asset (½).

The investment in Horncastle Ltd must be made in the period beginning one year before (½) and ending three years after (½) the investor has realised a chargeable gain.

To get full relief an amount at least equal to the chargeable gain must be invested in Horncastle Ltd shares. (½) However, the investor can specify the amount (½) they want to defer, for example to use the annual exempt amount or capital losses. The gain arising is deferred until the shares in Horncastle Ltd are sold (½) or otherwise revived. (½)

4 marks

3.

The VAT Flat Rate Scheme is available to Frederick's company if it is expected to have a taxable turnover (exclusive of VAT) in the next 12 months (½) of less than £150,000 (½).

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Once in the scheme, the company can remain in it until the total income (including VAT and exempt supplies) exceeds £230,000. (½)

There is no requirement to keep detailed records of input VAT (½) as the scheme calculates the VAT liability simply by using the flat rate percentage relating to photography (the percentage is specific to a trade and determined by HM Revenue & Customs) (½) and this is applied to total VAT inclusive income. (½) If the company's customers are not VAT registered, there will be no need to issue VAT invoices. (½)

Max 3 marks

4.

1)	Dr Reserves	£250,000	(½)
	Cr Ordinary share capital	£250,000	(½)

2) Balance sheet

	£'000	
Net Assets	1,000	
Share capital	750	(1)
Reserves	250	(1)
	1,000	

3 Marks

5.

Current year trading losses arising in a company are available to be surrendered to other companies in a 75 % group. (½)

If a company enters a group part way through an accounting period, the amount of losses that can be surrendered are restricted to the amount occurring in the period of common ownership on a time apportioned basis. (½) The amount of losses that may be surrendered to a claimant company are restricted to the profit of the claimant company occurring in the period of common ownership on a time apportioned basis. (½)

If a company leaves a group the losses available for group relief are similarly restricted. (½)
A company leaves the group when arrangements come into in force to sell the shares in it. (1)
This could be when heads of terms are agreed but before the sale contract becomes binding. (½)
It is possible therefore that a company may leave one group some time before beneficial ownership passes to the new owner and that some current year losses may not be group loss relieved. (1)

Max 4 Marks

6.

PAM Ltd is charged to tax on its worldwide income. (½) An overseas branch is not a separate legal entity so if PAM Ltd set one up, any profits would be subject to UK tax (½) and losses will be offset against other income in PAM Ltd. (½)

It is possible that the profits of an overseas branch will be subject to overseas tax, but double tax relief would be available. (½) It is also possible for PAM Ltd to elect to exempt profits of a branch from

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UK tax. (½) This election is irrevocable (½) and would also apply to any other overseas branches held by PAM Ltd. (½)

If PAM Ltd set up a company, as a separate legal entity (½) that would not be subject to UK tax as long as it is incorporated abroad and its place of management and control is abroad. (½) No relief can be taken in PAM Ltd for the losses incurred by an overseas subsidiary. (½)

Credit will be given for any other relevant points.

Max 4 Marks

7.

	£	
Proceeds	250,000	(½)
Less: Cost	(72,000)	(½)
Gain	178,000	(½)
Annual exempt amount	(11,300)	(½)
Capital gain	166,700	
Capital Gains Tax (at 10%)	16,670	(½)

The rate of CGT used is the Entrepreneurs' Relief rate of 10% as Maria has owned the shares for more than 1 year; (½) is a director of the company; (½) and owns more than 5% of the shares. (½)

4 marks

8.

Rollover relief is available to defer a gain arising on the sale of an asset by purchasing another asset within a specified period, being 1 year before the disposal of the asset (½) and three years after the disposal. (½)

Both assets must be qualifying assets (½) used for the purposes of the trade. (½)

The base cost of the replacement asset is reduced by the gain deferred, (½) unless the replacement is a depreciating asset. (½) The proceeds of disposal must be fully reinvested to obtain full deferral; (½) otherwise the proceeds not reinvested become immediately chargeable. (½) Rollover relief must be claimed by election. (½)

Credit will be given for any other relevant points.

Max 4 marks

9.

Instalment payments are required to be made by companies with augmented profits (taxable total profits plus dividends received) (½) exceeding £1,500,000. (½)

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Where a company has 51% related group companies, the limit is divided by the number of related companies including the company itself. (½) The number of companies is determined as at the end of the immediately preceding accounting period. (½)

2 marks

10.

Members will be taxed on trading income of the LLP in proportion to their underlying share in the LLP. (½) This will be calculated (and taxed) under income tax rules for individuals and corporation tax rules for companies. (½) Each individual member will also be liable to class 2 and 4 NIC on their share of the profits. (½)

Members can take a tax deduction for interest paid to invest in an LLP. (½)

2 marks

11.

1) Horsley Ltd is a close company as it is under the control (more than 50% of the shares) of five or fewer participators (½) as follows:

• Angela (including connected parties Jeff and David Richards)	42%	(½)
• Annette Jones	5%	(½)
• Elise Martin	5%	(½)

2) There are no tax consequences of a loan made to Annette as a participator if the loan is repaid within 9 months of the year end. (½)

   However if the loan is not repaid, there is a tax charge of 32.5% (½) of the outstanding amount (½) which is payable on the normal corporation tax payment date, i.e. 9 months and one day after the year end. (½)

4 marks

12.

If a company is subject to the personal services companies' rules, it will be liable to Class 1 NIC (½) on any actual salary paid (½) and the deemed payment (½).

The deemed payment will be subject to employer's NIC at a rate of 13.8/113.8. (½)

The £3,000 employment allowance from National Insurance Contributions is not deductible from the employer's NIC due on the deemed payment. (½) However, it is deductible from any salary actually paid, provided the company does not have a sole director/employee. (½)

Credit will be given for any other relevant points.

Max 2 marks

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November 2018 Examination

PAPER 4

Corporate Taxation

Part II Suggested Answers

Question 1

	£	£	Marks
Part 1)			
Adjusted profit before capital allowances		337,900	½
Less: capital allowances			
£75,900 x 18%		(13,662)	1
£12,200 x 8%		(976)	1
Adjusted trading profit		323,262	
Rental income - Earthsea		2,000	½
Rental income - UK		48,000	½
Non-trading loan relationships (W1)		6,410	
Chargeable gains £12,000 – 12,000 capital loss brought forward		nil	2 x ½
		379,672	
Less: QCDs		(1,500)	1
Taxable total profits before group relief		378,172	
Less: group relief (W2)		(290,000)	1
Taxable total profits		88,172	
Corporation Tax payable:			
£88,172 x 19%		16,753	½
Less: DTR Lower of:			½
£2,000 x 19% - UK tax	380		½
£2,000 x 20% - overseas withholding tax	400		½
		(380)	
Corporation Tax payable		16,373	
W1 - NTLR			
Bank interest receivable	8,450		½
Less:			
Interest on overdue Corporation Tax	(370)		½
Interest on loan to purchase shares in Dreams Ltd	(1,670)		½
	6,410		
No adjustment for overdraft interest and loan to purchase P&M			½ x 2
W2 – maximum group relief			
Lower of:			½
Banks Ltd loss: £(290,000)			½
Canal Ltd available profits: £378,172			1
Part 2)			
Augmented profits are compared to £1.5m:			
Taxable total profits (part 1)	88,172		
Add: dividends from non-related companies	3,800		½
Augmented profits	91,972		
However, £1.5m is divided by the number of related companies (>50% ownership) in total five i.e. £300,000			½
(Canal Ltd + Banks Ltd, Street Ltd, Dark Ltd, Espedair Inc)			½
Therefore tax is payable 9 months and 1 day after the end of the accounting period i.e. 1 January 2019.			½

2 marks

Question 2

	£	£	**Marks**
Part 1)			
Income tax:			
There will be a final trading income assessment in 2017/18 for Ania			½
This is based on all of her profits from her business that have not yet been assessed.			½
This includes the profits for the year ended 31 December 2017			½
and the 2 months to 28 February 2018.			½
Overlap profits of £3,900 are deducted from the final assessment			½
Alternatively, candidates may choose to describe Ania's cessation in 2017/18 using computations and credit would be given appropriately:			
Year ended 31 December 2017		30,000	½
2 months to 28 February 2018		15,000	½
		45,000	
Less: overlap profits		(3,900)	½
Trading income assessment		41,100	
Max 2 marks			
Capital Gains Tax:			
On incorporation, a gain will arise on any chargeable assets, which for Ania is just the freehold of the building:			½
Freehold:			
Consideration (Market value)	140,000		
Less: Cost	(120,000)		
		20,000	½
There is no gain on equipment as the cost and value are both below £6,000.			1
On incorporation, a relief applies (unless an election is made to disapply it) to defer Ania's gain against the cost of the shares in Snap Ltd			1
Less: Incorporation relief			
£20,000 x £(159,000 – 30,000)/159,000		(16,226)	4 x ½
Capital gain		3,774	
Less: Annual exempt amount		(3,774)	1
Taxable gain		nil	
Base cost of shares:			
Market value of assets transferred		159,000	1
Less: Incorporation relief		(16,226)	1
Base cost of the Snap Ltd shares		142,774	
10 marks			
Part 2)			
The transfer of Ania's business may be treated in one of two ways.			
Transfer of a going concern (TOGC):			1
If the following conditions are met then the transfer will be outside of the scope of VAT and no VAT can be chargeable on the transfer.			1

Conditions:

- The business is transferred as a going concern ½
- The assets are used to carry on the same type of trade ½
- There is no significant break in trading ½
- Snap Ltd is or becomes VAT registered ½

If the transfer is not treated as a TOGC, then VAT at 20% will be due on the value of the assets transferred as the business is VAT registered. 1

Note: credit is given for other valid points.

5 marks

Question 3

Email: 1 mark communication/presentation

To: Simone@co.uk

From: Adviser@co.uk

Subject: Raising funds

Thank you for your email, I have addressed your issues as follows:

	£	Marks
Sale of shares: The gain on the sale of the shares, were the substantial shareholding exemption (SSE) not to apply would be:		
Proceeds	310,000	½
Less: Cost	(170,000)	½
Less: Indexation £170,000 x 10%	(17,000)	½
	123,000	

If SSE applies:
The gain on the sale of the shares will be exempt from Corporation Tax ½

However, for SSE to apply, Beck Ltd must qualify as a trading company. It owns a building which is rented out and therefore is an investment for these purposes. The trading status may therefore be challenged. 1

In addition, a degrouping charge will arise as the shares in Beck Ltd are sold within 6 years of a nil gain/nil loss transfer of 15 Cook Road to Beck Ltd. ½

	£	Marks
Deemed proceeds (MV @ April 2017)	280,000	1
Less: Cost	(290,000)	½
Loss	(10,000)	½

This allowable loss will arise in Child Ltd on sale of the shares. ½
The loss is deducted from the disposal proceeds. ½
So if the SSE applies, no relief for the loss will be available. ½

If the SSE does not apply, then proceeds are reduced to £300,000 and the gain in Child Ltd becomes £113,000.. ½

Max 8 marks

Sale of assets:

			£	£	
15 Cook Road:					
Proceeds				380,000	½
Less: Cost	-	Original	290,000		½
	-	Uplift to NGNL transfer (£290,000 × 8%)	23,200	(313,200)	½
Less: Indexation £313,200 x 7%				(21,924)	½
Gain				44,876	

No gain on P&M if cost and proceeds not more than £6,000 ½

Credit for mention of possible balancing adjustments
Max 2 marks

Funds:
The funds can be distributed to the shareholders in the form of a dividend. ½
The dividend is not deductible for Corporation Tax purposes and no ½
national insurance is payable. ½
The individual will be subject to Income Tax on the dividend at the dividend rates of 7.5%, 32.5% and 38.1%. 1
However, the dividend allowance of £5,000 is available, effectively taxing £5,000, in any tax band, at 0%. 1
Additional marks for other sensible options.
Max 3 marks

Heads of agreement:
This defines the basic structure of the transaction i.e. the parties and the property to be sold. ½
It also identifies commercial issues which may need to be resolved before a final sale and purchase agreement is drawn up. ½
The heads of agreement are drafted to be "subject to contract" ½
However, the following are typically agreed to be legally binding:

- Confidentiality: regarding disclosure and documents 1
- Exclusivity period: to prevent negotiation with other parties within a specified period 1
- Costs: agreement regarding costs on both sides 1

Max 4 marks

Bonus to Stanley Streep:
A bonus paid to Stanley would normally be a deductible expense for Child Ltd. ½
However, remuneration is deductible as long as it is paid within 9 months of the year end i.e. by 31 March 2019. ½
Therefore the bonus is deductible in the year ended 30 June 2019. ½

The deduction you suggest may represent tax evasion which is illegal. ½ ½
In preparing the Corporation Tax computation for the year ended 30 June 2018, this amount should not be deducted. 1

Max 3 marks

I hope this information is helpful, however if you have any further queries please do not hesitate to contact me.

Best wishes

Max 20 marks

Question 4

Part 1)		Marks
A qualifying company deriving income from qualifying intellectual property rights, such as patents, will effectively be charged at a lower rate of Corporation Tax on those profits if an election is made.		1
Spark Ltd appears to meet the criteria to benefit from this regime.		½
Spark Ltd will calculate its Corporation Tax at 19% and then receive a deduction in calculating its trading profits for the year ended 31 March 2018.		2 x ½
As a result the effective rate of corporation tax on its patents is reduced to 10%		½
Candidates may use computations to explain the effective rate:		
£300,500 x (19% - 10%)/19% = £142,342		2 x ½
	£	
Taxable trading profits	720,000	½
Less: patent box deduction	(142,342)	½
Taxable total profits	577,658	
Corporation Tax payable:		
£577,658 x 19%	£109,755	½
Effectively the royalties are taxed as follows:	£	
£142,342 @ 0%	0	
£158,158 @ 19%	30,050	
	30,050	
Effective tax rate: 30,050/300,500 = 10%		1

Max 5 marks

Part 2)		
For goodwill acquired from 8 July 2015, no deduction is available for Corporation Tax purposes for amortisation or impairment.		1
The treatment that the financial controller is describing applies to goodwill acquired before that date where a deduction is allowable for the amortisation or impairment made in the accounts or instead a straight line deduction of 4% of cost each year.		½ 1

Max 2 marks

Part 3)		
There are penalties due for incorrect returns with an inaccuracy.		½
Both the behaviour of the taxpayer and also disclosure of the error to HMRC may affect the penalty.		½

The potential lost revenue (PLR) as a result of the error is:

£(670,00 – 630,000) x 20% = £8,000	1
As this is a careless error, the maximum penalty for the error is:	½
£8,000 x 30% = £2,400	½
The penalty is in addition to the additional tax due and interest on underpaid tax.	½ ½
The penalty may be reduced, potentially to nil, if Spark Ltd	½
voluntarily discloses the error to HMRC.	½

Max 3 marks