May 2021 Examination

PAPER 4

Corporate Taxation

Part I Suggested Answers

1.

The anti-avoidance provisions apply if any of the following major changes are made:

in the type of property dealt in (½)
in the type of services provided (½)
in the type of facilities provided (½)
of customers (½)
of outlets (½)
of markets (½)

The period under review will be a five year period (½) beginning no more than three years before the change in ownership of the company. (½)

4 marks

2.

Year ended 31 December 2020	£	£	
Dr Bank	200,000		(½)
Cr Grant account (deferred income)		200,000	(½)
Dr Grant account (deferred income) (200,000 x 2%)	4,000		(½)
Cr Grant income (P & L a/c)		4,000	(½)

2 marks

3. The historic test should be applied to find the end of the month when the £85,000 threshold was exceeded for Cotton Ltd (½):

	£	
July 2020	5,000	
August 2020	12,000	
September 2020	15,000	
October 2020	21,000	
November 2020	19,000	
December 2020	30,000	
At the end of December	102,000	(1)

Notification would be required by 30 January 2021 (1) and registration would have been effective from 1 February 2021 (½).

3 marks

4.

	AIA	General pool	Special rate pool	Allowances	
	£	£	£	£	
WDV b/f		1,931,110	96,356		
Additions					
-machinery	205,000				**(½)**
-hot and cold water system	400,000				**(½)**
- car			25,000		**(½)**
Disposals					
-antique desk		(2,800)			**(1)**
	605,000	1,928,310	121,356		
Allowances					
AIA @ 100%	(605,000)			605,000	**(½)**
WDA @18%		(347,096)		347,096	**(½)**
WDA @6%			(7,281)	7,281	**(½)**
WDV c/f		1,581,214	114,075		
Total allowances				959,377	

4 marks

5. **Bruin Ltd**

First instalment payment

Repayment interest is at bank base rate minus 0.25% with a minimum of 0.5%. (currently 0.5%) **(½)**

Final instalment payment

HMRC charge interest at bank base rate plus 1% on underpaid instalment payments. ie currently at 1.1% **(½)**

These rates apply from the instalment due date **(½)** until date of payment/ repayment or **(½)** the normal due date for the accounting period ie nine months and one day from the end of the period **(½)** ie 1 April 2021 **(**if still unpaid/ not repaid)**.**

After 1 April 2021, the tax underpaid has interest calculated at the normal rates ie 2.6%. **(1)**

The company should pay the amount on the interest demand within 30 days **(½)**. If not interest is charged on this interest. **(½)**

Max 4 marks

6. Haddel Ltd

	£	£	
Accounting profit		351,425	
Add back:			
Depreciation	35,000		(½)
Bonuses (not paid within nine months of the year end (½))	21,000		(½)
Entertaining customers	4,500		(½)
		60,500	
Deduct:			
Profit on sale of fixed asset	3,725		(½)
		(3,725)	
Tax-adjusted trading profit before capital allowances		408,200	(½)

Note:
Provision allowable as calculated in accordance with FRS 102 (½)
Legal fees on renewal of a 'short' lease (50 years or less) are allowable (½)

4 marks

7. James pays:
Class 2 National Insurance contributions (1)
Class 4 National Insurance contributions (1)

Zohaib pays:
Class 1 primary National Insurance contributions (1)

3 marks

8. Simone and Honeyford Ltd can make a joint election (½) to defer the gain under the gift relief provisions (½). The effect of this gift relief claim is to reduce the base cost of the assets transferred to the company by the amount equal to the chargeable gain which would otherwise have accrued to Simone.(½) When Honeyford Ltd disposes of those assets there will be a higher corporation tax liability (½). It does not reduce the base cost of Simone's shares in Honeyford Ltd (½). The time limit for claiming gift relief is four years from the end of the tax year of disposal. (½)

3 marks

9. The amount of gain that Jane can defer is the lower of the following three amounts: (½)

i. the gain of £45,000	(½)
ii the amount reinvested in shares of Otley Ltd being £85,000	(½)
iii the specific amount claimed.	(½)

Therefore should claim an amount that preserves her annual exempt amount (½) ie £32,700 (£45,000 - £12,300) (½).

3 marks

10. Musicarma Ltd

Double tax relief is given as the lower of **(½)** :
UK Corporation Tax on the overseas income **(½)**; and
Overseas tax **(½)**

This is done on a source-by-source basis **(½)**

It is likely that the dividend income is exempt and so there will be no relief in the UK for overseas tax paid on this income. **(½)**
Where a company has made a qualifying charitable donation this should be allocated first to UK income **(½)**, then to overseas income with the highest overseas tax rate **(½)**. This will maximise the available DTR **(½)**

4 marks

11. 1 June 2018 – 31 May 2019 (½)
    1 June 2019 – 31 October 2019 (½)
    1 November 2019 – 31 October 2020 (½)
    1 November 2020 – 31 March 2021 (½)

    2 marks

12.

	£	
Interest on the loan to purchase a factory	-	(½)
Interest received on over payment of corporation tax	1,200	(½)
Bank interest received	3,000	(½)
Interest paid on loan to purchase a rental property 450,000 x 6.25%	(28,125)	(1)
Repayment of the £30,000 loan	-	(½)
Non-trade loan relationship deficit	(23,925)	(½) + (½)

Notes:
Interest on the loan to purchase a factory used in the company's trade is a trading loan relationship and therefore deductible against the company's trading profits.
The repayment of a loan is not a loan relationship as no profits or losses arise on the repayment of the loan

4 marks

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Corporate Taxation

Part II Suggested Answers

13.

1. As both companies are within 75% (½) common ownership and are within the charge to corporation tax (½), the succession rules will apply. This will have the following consequences–
    - Capital allowances on plant and machinery used in the business will be shared on a time apportionment basis. (½) No balancing adjustment will arise. (½)
    - Trading losses will transfer with the trade. (½) No terminal loss relief will be available for the Woodworker Ltd. (½)
    - There may be a restriction of the loss transferred (½) as Woodworker Ltd's liabilities exceed the assets. (½) In this case the losses that can be transferred will be reduced by the excess of liabilities over assets (including consideration) not transferred. (½)

    Maximum 4 Marks

2. Assets were transferred between Ideal Spaces Ltd and Box Tree Ltd at "no gain, no loss", (½) as they are in the same 75% group(½). However as Ideal Spaces Ltd is now selling the shares in Box Tree Ltd a degrouping charge must be considered (a degrouping charge will arise if the company which acquired an asset leaves the group(½) within 6 years of the transfer(½) and it still owns the asset. (½)). If a charge arises it will be assessed on Ideal Spaces Ltd. (½) Any gain would be added to the consideration for the shares being sold. (½)

    There will be no degrouping charge on Property 1 as the transfer took place more than 6 years ago. (½)

    The transfer of property 2 was within 6 years (½) of the sale of the shares and so the degrouping charge must be considered as follows

	£	
Proceeds (Value at date of transfer)	933,000	(½)
Less Cost	(350,000)	(½)
Less Indexation (10%)	(35,000)	(½)
Chargeable Gain	548,000	

    The total consideration for the sale of the Box Tree Ltd shares is therefore £3,800,000 plus £548,000= £4,348,000 (½)

    Maximum 6 Marks

3. There is potentially a conflict of interest (½) for the firm in being asked to advise both parties. The firm should check the terms of its engagement which might prohibit this. (½)

    If the engagement letter does not expressly prohibit this, the firm should consider three options:

    - Act for one party only, which generally would be Ideal Spaces Limited as it was the original client. (½) The managers proposing to make the purchase should be informed of this immediately to avoid any suggestion of acting improperly. (½)
    - Act for both parties. This would have to disclosed to both parties so they can consider if they wish to have alternative advisors. (½) The firm would also have to be satisfied that this conflict could be managed. (½) For example, separate teams should act for each client with "ethical walls" in place. (½) Clients should agree in writing that the firm can act for both parties and no preference is shown. (½)
    - If conflict cannot be managed, (½) the firm should act for neither party. (½)

    Maximum 5 Marks

4. The allotment and issue of shares requires a formal process, which involves the person wishing to subscribe making an offer for the shares, (½) the acceptance or allotment of the shares, (½) and the name of the shareholder being entered in the company's register. (½)

The directors must have the authority to issue shares(½) (under the Articles or shareholder resolution) (½)and consideration should be given to any existing pre-emption rights(½) which give the current shareholders the right to subscribe for shares before new shareholders. (½)

The key attributes of the share classes being considered are:

- Preference shares – these have some preference or additional benefit over ordinary shares, for example a fixed dividend , which is paid in priority to dividends on ordinary shares.(½)
- Deferred shares – these carry rights that only take effect at some defined date in the future. (½)
- Convertible shares – the carry rights to be converted in the future into eg ordinary shares. (½)
- Redeemable shares – they are issued on the assumption that they will be bought back in the future (usually by the company). (½)

Maximum 5 Marks

(Total 20 marks)

14.

1. The Structures and buildings Allowance (SBA) available
   North Property:
   Qualifying expenditure: Land preparation cost £250,000 + Construction cost £2,000,000 = £2,250,000 (2 x ½)
   (note – cost of acquiring land and obtaining planning permission are not allowable)
   Brought into use on 31 .1 .2021 so SBA available for 2 months
   £2,250,000 x 3%(½) x 2/12(½) = £11,250

   South Property
   Brought into use 31 October 2020(½)
   Purchase price £1,600,750(½) x 3% x 5/12 (½) = £20,009(½)

   Maximum 4 Marks

2. SBA on Midlands Warehouse (to be sold 30 June 2021)
   For Woodbridge Logistics Ltd =
   £4,000,000 x 3% x 3/12(½) = £30,000 (½)

   For Deben Trucks Ltd
   Year of purchase
   £4,000,000 (½) x 3% x 6/12(½) = £60,000

   Maximum 2 Marks

3. Corporation Tax payable on WL Logistics Ltd

	£	
UK Net property Income (W1)	150,250	(½)
Non Trading Loan relationship	(22,000)	(½)
Overseas properties – see below		
Chargeable gain (W2)	2,505,258	
TTP	2,633,508	(½)
Corporation Tax payable (19%)	500,367	(½)

Overseas properties

	£	
Rental Income		
£72,650 + £13,000	85,650	
Security, Legal and other fees (£80,000 + £25,000)	(105,000)	
Loss – to be carried forward against overseas property business (½)	19,350	(½)

W1

Net Property income - UK properties

	£	
Eastern House		
(9/12x35,000)+(3/12x40,000)	36,250	(½)
Western House		
£120,000-£6,000	114,000	(½)
	150,250	

W 2 – Chargeable Gain on Border House

	£	£	
Proceeds		4,750,000	
Less: Selling costs (£15,000 + £17500)		(32,500)	(½)
		4,717,500	(½)
Less:			
Cost(½)	1,000,000		
Incidental costs of acquisition			
Legal fees	12,000		
Surveyors fees	6,000		
		(1,018,000)	(½)
Enhancement expenditure		(400,000)	(½)
Unindexed gain		3,299,500	
Indexation			
On Cost			
1,018,000 x 0.669		(681,042)	(½)
((278.1-166.6)/166.6)			
On Enhancement expenditure			
£400,000 x 0.283		(113,200)	(½)
((278.1-216.8)/216.8)			
Indexed Gain		2,505,258	(½)

Maximum 8 Marks

4. The key factors that should be taken into consideration when determining the employment status of Priti Kumar are

   i) Mutuality of Obligation(½) . Is Woodbridge Logistics Ltd obliged to provide Priti Kumar with work? Is she obliged to accept it? If so, this would indicate employment. If there is no guarantee of work, or she can refuse work, this would indicate self employment (½)

   ii) Wage(½). Is Woodbridge Logistics Ltd paying Priti Kumar directly or paying a third party (who is not an agent of Priti Kumar)? If a non-agent third party is paid then this would not constitute employment (½)

   iii) Personal Service(½). Does Ms Kumar have to personally undertake the work or can she send a substitute to do it? The right of substitution would suggest self-employment. (½)

   iv) Control(½). An employee will generally have little day to day control over their work, the employer will normally tell the employee what needs to be done and when. (½)

   v) Other factors include – integration into the business; financial risk; providing own equipment; opportunity for profit; number and length of engagements. (max 1)

   Maximum 4 Marks

   (Total 12 marks)

15.

Email

To: Managing Direct, Green Media Ltd

From: XYZ Tax consultants

Thank you for your email. I can respond as follows

(1 mark for presentation)

1) VAT on bad debts – Green Media Ltd can claim bad debt relief for VAT on any debt which is six months old (ie more than six months have passed since the later of the date of the supply and due date for payment). (2 x ½)

   Further conditions must be met, being:

   - Green Media must have supplied the goods/services which have been invoiced. (½)
   - Green Media must have accounted for and paid the VAT to HMRC. (½)
   - The debt has been written off in Green Media's accounts, (½) and transferred to a separate bad debt account. (½)
   - The value of the supply must not be in excess of the normal selling price (½)
   - Debt must not have been sold on (½)
   - The claim for bad debt relief must be made within 4 years and six months (½)

   The relief is obtained by adding the amount of the VAT to the box 4 input tax figure on the VAT return. (½)

   There is no obligation for Green Media Ltd to tell the customers that it is claiming VAT bad debt relief. (½)

   Please contact me if you wish to discuss this further
   Regards
   A Tax Advisor

   Marks will be given for any relevant point

   Maximum 5 Marks

2) The penalties that Green Media Ltd will be subject to will depend on how late the return is and whether any previous returns were filed late. The penalties are as follows:

- There is an initial penalty of £100, (½) and this applies even when there is no tax to pay. (½)
- This increases to £200 (ie an extra £100) if the return is more than three months late. (½)
- The £100 and £200 penalties are increased to £500 and £1,000 (½) respectively for a third (or later) consecutive return. (½)
- If the return is later than 18 months after the end of the accounting period (ie usually more than 6 months late) (½) there is an additionally penalty of 10% of the tax unpaid at that point (½)
- If the return is later than two years after the end of the accounting period (ie usually more than 12 months late) (½) the tax geared penalty doubles to 20% of the tax unpaid at the 18 month date. (½)
- Penalties can be appealed against and will not be charged if the company has a reasonable excuse for late filing. (½) but what constitutes a reasonable excuse is considered on a case by case basis. (½)

Maximum 5 Marks
Marks will be given for any relevant points

(Total 10 marks)

16.

1. Group relief

The maximum group relief available to be surrendered by the group companies is:

		£
Dunlin Ltd – full loss in the year can be surrendered		1,011,000(½)
Egret Ltd – loss restricted to the period up to arrangements are in force to sell(½)		
Lower of : (½)		
7/12 x £1,700,000 = £991,666(½)		991,666
And Puffin Ltd profit		
7/12 x £3,650,000 = £2,129,167(½)		
Wading ltd		
Losses in the common periods(½)		
1.3.2020- 30.4.2020		
Lower of		
2/12 x £2,604,500 = 434,083(½)	434,083(½)	
2/12x £3,650,000 = 608,333(½)		
1.5.2020- 28.2.2021		
10/12 x £828,000 = £690,000(½)	690,000(½)	
10/12 x £3,650,000 = £3,041,875(½)		
		1,124,083

Maximum 6 marks

Tutorial note:

The question asked for the maximum possible group relief that could be surrendered to Puffin Ltd from each subsidiary – with the intention being to consider each amount in isolation. ie to apply the rules re overlapping accounting periods and arrangements. This is how it was interpreted by virtually all candidates. In exceptional circumstances some candidates looked at a total that could be surrendered by assuming that the maximum surrender is made by all companies. So for example if Dunlin Ltd first surrendered its full loss of £1,011,000 and then Egret Ltd were to surrender as much loss as possible then this would be calculated as follows (with the additional aspect highlighted in yellow:

	£
Egret Ltd – loss restricted to the period up to arrangements are in force to sell(½) Lower of : (½) 7/12 x £1,700,000 = £991,666(½)	991,666
And Puffin Ltd profit	
7/12 x (£3,650,000 - £1,011,000) = £1,539,417(½)	

Both approaches were able to gain full marks.

2. Consortium relief
   Diverse and Red Ltd can claim consortium relief as they hold at least 5%(½) of the shares each.

   French Societe SA cannot claim consortium relief as it is an overseas company. (½)

   Blue Ltd cannot claim as it does not hold at last 5% of the shares. (½)

   Mr Jones cannot claim as an individual. (½)

   The maximum loss available for surrender by Yellow Fin is :

		£
Trading loss	(½)	1,200,750
Property Income		(40,000)
Gain		(75,000)
	(½)	1,085,750

The consortium relief available to Red Ltd is:
Lower of (½)
£1,085,750 x 21%(½) (see note) = £228,008

And

Red profit £400,000(½)

Note – Red Ltd share of the profit is restricted to its lowest interest, being its voting rights ie 21% (½)

Yellow Fin Ltd loss carry forward memorandum

	£
Loss	1,085,750
Consortium relief to Red (½)	(228,008)
Loss c/f(½)	857,742

Maximum 6 marks

(Total 12 marks)