May 2017 Examination

PAPER 4

Corporate Taxation

TIME ALLOWED – 3 ¼ HOURS
(for Part I and Part II)

- You are required to answer **all** questions in each part (both parts printed together).
- The first 15 minutes is designated as reading time. During this time you may read your question paper and legislation and annotate your question paper. Calculators may not be used during this time.
- The Presiding Officer will inform you when you can start writing in the answer booklets.
- You are provided with two answer booklets (one for each part of the paper). Make sure you write your answers in the correct answer booklet.
- Please start each answer on a fresh page and do not write in the margins.
- All workings should be shown and made to the nearest month and pound unless the question requires otherwise.

Part I

Write your answers in the Part I answer booklet.

1. Whitby Ltd is part of a national group of companies. In the year to 31 March 2017, the following capital acquisitions took place:

	£
Cold room for storing food	35,000
Shelving/racking	8,250
Front door	2,500
Installation of lift	50,000
Computer equipment (useful life three years)	20,000

At 1 April 2016, the tax written down value on the general pool was £18,000 and the tax written down value on the special rate pool was £20,000.

Calculate the maximum capital allowance claim that can be made by Whitby Ltd for the year ended 31 March 2017, assuming that other group companies have utilised the whole of the annual investment allowance for the year and all other elections are made where possible. (4)

2. Michel Ltd prepares accounts to December every year.

In the year to 31 December 2016, the net profit as shown in the accounts was £69,500. Depreciation charges were £5,000 and capital allowances of £2,000 were claimed. A provision for Corporation Tax of £15,000 had been made in the accounts although the actual Corporation Tax charge was agreed at £14,500.

Show the accounting entries needed to record the payment of Corporation Tax and the Deferred Taxation provision. (4)

3. Everett is planning to incorporate his sole trader business which he has owned for many years. He is undecided whether to transfer his business premises, together with the rest of the assets of the business to the new company.

Explain the two main Capital Gains Tax deferral reliefs available to Everett on the incorporation of his business, clearly identifying which relief would give him the option of retaining the business premises. (4)

4. A mixed partnership is a partnership where one or more of the partners is an individual and one or more of the partners is a company.

Explain how the profits of a mixed partnership are allocated between the partners. (2)

5. Brian provides services through his own personal service company, Kirkstall Ltd, and as a consequence is caught by the IR35 provisions.

   Kirkstall Ltd invoiced sales of £50,000 in the year to 5 April 2017. No payments were made from the company.

   Explain how the IR35 provisions will affect the tax payable by Brian. (2)

6. Oscar Ltd manufactures and distributes bespoke kitchens.

   A desk and painting were bought by the company for their boardroom in January 2010, both costing £500. The desk was sold for £5,000 and the painting was sold for £9,000 in March 2017.

   Calculate the tax payable by Oscar Ltd on the sale of the desk and painting (ignore indexation). (3)

7. Merton Ltd provides their salesmen with company cars. Fuel for business purposes is reimbursed via an expenses claim.

   Explain the National Insurance implications for Merton Ltd of providing their salesmen with company cars and fuel. (2)

8. Bernie's Ltd draws up accounts to 31 December each year.

   In the year to 31 December 2016, the company acquired new business premises on a short term lease, incurring legal fees of £750. As a consequence, part of their existing premises were rented to a third party, with Bernie's Ltd receiving rental income of £7,500 in the year to 31 December 2016.

   The company reported a profit of £64,000 before tax in the year, having provided for depreciation of £14,000. Capital allowances of £5,000 were claimed.

   Calculate the Corporation Tax payable by Bernie's Ltd for the year to 31 December 2016, clearly identifying the figure of trading profit. (4)

9. Vernon has been employed by Norton Enterprises Ltd, a trading company, for the past 10 years and has owned 400 of the company's 1,000 ordinary shares for the past five years.

   On 1 January 2017, Vernon sold his shares to David, an unconnected third party, for £375 per share having acquired them for £25 per share in January 2012. This is Vernon's first chargeable disposal for Capital Gains Tax purposes.

   Calculate the Capital Gains Tax payable by Vernon, assuming he is a higher rate taxpayer. (2)

10. Marvin’s Confectionery Ltd is owned equally by Alf, Rob and Steve.

Alf is provided with a company car although he is not a director or employee of the company.

Explain why and how Alf will be taxed on the provision of the company car and the tax implications for Marvin’s Confectionery Ltd. (3)

11. Carson Ltd was incorporated on 1 September 2014 and began trading on 1 January 2015. Their first set of accounts was drawn up to 30 June 2015. The directors then decided to extend the next accounting period to 31 December 2016.

State the chargeable accounting periods for Carson Ltd up to and including 31 December 2016, giving the filing date for any Corporation Tax returns due. (3)

12. Meyrick Ltd owned 100% of the share capital of Barton Ltd. Both companies draw up accounts to 31 March of each year.

In the year to 31 March 2017, Meyrick Ltd incurred a trading loss of £80,000 whilst Barton Ltd had taxable total profits of £100,000. Meyrick Ltd disposed of Barton Ltd on 30 June 2016.

1) **Explain how to establish the date of disposal of a subsidiary for the purpose of a group relief claim.**

2) **Calculate the maximum group relief claim for the year to 31 March 2017.** (3)

13. A VAT registered business may claim bad debt relief in respect of an unpaid sales invoice.

State the conditions for claiming bad debt relief and the time limits for this claim. (2)

14. Some companies are able to claim a tax credit in respect of their research and development expenditure.

Explain which companies are able to claim a tax credit in respect of their research and development expenditure and how the tax credit is calculated. (2)

Part II

Write your answers in the Part II answer booklet.

Marks are specifically allocated for appropriate presentation.

1. Your firm acts for Coburg Ltd, which is a UK resident unquoted trading company. Its 10,000 shares are owned as follows:

	Number
Saxe Ltd	3,100
Alice Scott	2,000
George Kent	2,000
Marie Dagmar	2,900

Alice Scott is the managing director of Coburg Ltd. Your tax manager received the following email from her today and she has passed it on to you, with a request for a draft response to the client for review by the end of the day:

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

You know that there have been disagreements between myself and the board of directors of Saxe Ltd about the running of Coburg Ltd. We have agreed that this is now untenable so could you advise me of the tax consequences of the following courses of action which we are contemplating? Please outline the various treatments and any conditions regarding a share repurchase by Coburg Ltd so I can take this to the interested parties.

Option A: Coburg Ltd implements a repurchase of all but 500 of the Saxe Ltd shares. These were subscribed for at £1 par value in January 2007 and would be repurchased for £23 per share in June 2017.

Option B: Alternatively, Coburg Ltd implements a repurchase of all of the shares owned by Marie Dagmar. As a member of the board of directors of Saxe Ltd, she is the main cause of conflict. Her shares were purchased in May 2015 for £20 per share and I am told she may be willing to sell for £23 per share in June 2017.

I am also unclear as to the legal requirements that would need to be met by Coburg Ltd in order for us to implement a repurchase of shares.

You are required to prepare a draft email to Alice Scott, suitable for review by your manager, in which you address:

1) **The alternative tax treatments that may apply to the repurchase of the shares, including any conditions that apply.** (5)

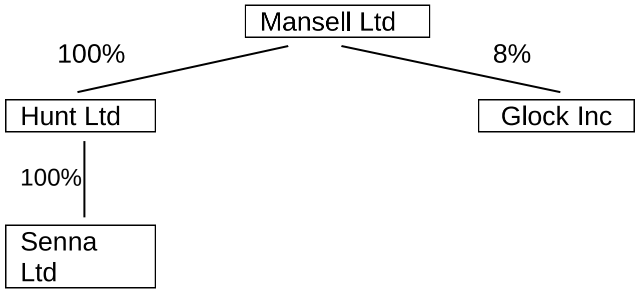
2) **Option A: the specific tax treatment of the repurchase of the Saxe Ltd shares.** (3)

3) **Option B: the specific tax treatment of the repurchase of Marie Dagmar's shares.** (4)

4) **The legal requirements that need to be met for a repurchase of shares by Coburg Ltd.** (3)

Total (15)

2. The following shows the shareholdings owned by Mansell Ltd, a UK resident trading company that manufactures and sells recyclable cardboard packaging to the UK catering industry:



All of the above companies are UK resident, apart from Glock Inc which is resident overseas. The UK companies prepare accounts to 31 March each year.

The results for Mansell Ltd, Hunt Ltd and Senna Ltd for the year ended 31 March 2017 are as follows:

	Mansell Ltd	Hunt Ltd	Senna Ltd
	£	£	£
Trading profit/(loss)	130,300	(310,000)	12,000
Rental income received from Glock Inc	78,200	-	-
Interest income receivable	3,000	700	600
Qualifying charitable donations	500	700	200

The rental income received by Mansell Ltd from Glock Inc was after withholding tax at the rate of 8%. The interest receivable by Hunt Ltd is UK bank interest and the interest receivable by Mansell Ltd accrued on qualifying corporate bonds. Senna Ltd has a capital loss of £5,700 for the year ended 31 March 2017. Hunt Ltd has not paid Corporation Tax for many years.

Senna Ltd manufactures cardboard packaging used by large retailers that dispatch parcels ordered on line and its recent results are as follows:

	Y/E 31 December 2014	P/E 31 March 2015	Y/E 31 March 2016
	£	£	£
Trading profit	132,500	27,000	750
Interest income receivable	1,200	500	-
Qualifying charitable donations	700	300	800

Senna Ltd's accounting period date was aligned to 31 March when the shares were purchased by Hunt Ltd on 12 February 2015.

Continued

2. *Continuation*

Future plans for Senna Ltd

The investment in Senna Ltd has not proved successful and the current plan is that the company will cease trading on 31 March 2018, with estimated trading losses of £360,000 for that final year and interest income receivable of £900.

However if, instead, a buyer for Senna Ltd can be found, the group tax director is keen that the purchase price reflects the value of any trading losses in the company as he knows that trading losses will save tax in the future for the new owner. He has proposed that, in order to attract a buyer, the company could be re-positioned over the coming months as a provider of cardboard packaging in the food industry.

Overseas expansion

Mansell Ltd is looking to set up an overseas sales operation for its products. The tax director is unsure whether this should be by means of an overseas branch of Mansell Ltd or via the incorporation of an overseas subsidiary. It is anticipated that, in both cases, overseas office premises will be rented with plant and machinery purchased in order to equip the overseas offices.

Local staff would run the overseas branch with ultimate decision making power still located in the UK. However, if a local subsidiary is incorporated, a member of the UK executive team will be relocated to run the overseas operations and will have the power to conclude contracts. It is forecast that, under both scenarios, trading losses will be made in the first year, with profits thereafter.

You are required to:

1) **Calculate the Corporation Tax liability for all of the UK companies for the year ended 31 March 2017, assuming losses are surrendered in the most beneficial manner.** (5)

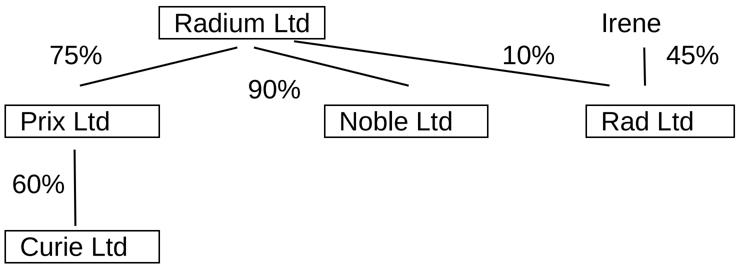
2) **Calculate the taxable total profits for Senna Ltd for all relevant accounting periods, were the company to cease trading and claim terminal loss relief. Assume for this part only that no group relief claims are made for the year ended 31 March 2017.** (3)

3) **Explain whether the tax director is correct with regard to the potential value of Senna Ltd's trading losses, were the company to be sold in 2018.** (3)

4) **Explain the UK tax consequences of Mansell Ltd setting up its overseas operations as either a branch or a subsidiary.** (5)

Total (16)

3. The following shows the shareholdings of the Radium Ltd group and all companies prepare accounts to 31 March:



Irene is the managing director of Rad Ltd which develops software used in computer gaming consoles.

On 1 January 2016, Irene decided to make a career change. She resigned from her position with Rad Ltd, but retained her shares, and received the following termination package from Rad Ltd:

	£
One-off lump sum payment into her occupational pension scheme	10,000
Restrictive covenant payment for agreeing not to work for competitors for the next two years	45,000
Ex gratia payment	31,500

Using the money from her termination package, Irene set up her own wholly owned catering company, Glow Ltd, which started trading on 1 June 2016. The company's turnover for the first five months (all representing standard rated supplies, but stated exclusive of any VAT due) was as follows:

	Turnover £
June	8,400
July	10,000
August	27,000
September	18,000
October	19,500

On 1 November 2016, Glow Ltd accepted a contract with Noble Ltd to supply catering services. The contract will generate turnover of £7,000 per month over the 12 months to 31 October 2017.

You are required to:

1) **Explain the Corporation Tax treatment of the termination package provided by Rad Ltd to Irene and the Income Tax treatment of the restrictive covenant payment.** (3)

2) **Explain the concept of a related company and how it applies to the companies described above, in particular when considering the possibility of quarterly instalment payments of Corporation Tax to be made by Radium Ltd.** (4)

3) **Explain when Glow Ltd would have been required to have registered for VAT purposes.** (3)

Continued

3. *Continuation*

In reality, Glow Ltd voluntarily registered for VAT on 1 June 2016 and reclaimed all of its input tax on expenses incurred from that date. The company has not joined the flat rate scheme.

In May 2016, Glow Ltd incurred the following costs (all shown inclusive of VAT at the standard rate):

	£
Accounting advice	1,200
Renovation costs for converting Irene's garage into a catering kitchen	12,960
Purchase of catering equipment	3,900

Irene also incurred fees of £600 (VAT inclusive) in February 2016 for tax advice regarding the Income Tax treatment of the money from her termination payment that she invested in Glow Ltd.

4) **You are required to explain, with supporting figures, the VAT treatment of the input tax on the items described above and the Corporation Tax and/or Income Tax consequences of the payments made.** (4)

Total (14)

4. You are part of the tax team in your firm that advises Storey plc, a UK trading company. Storey plc's shares are held by both individual and corporate shareholders. Storey plc prepares accounts to 31 May each year and the following occurred during May 2017:

<u>1 May 2017</u>

On 1 May 2017, the following disposals were made when the closing price of shares in Storey plc was 450 - 454:

(a) Ellie made a gift of 12,000 shares in Storey plc to her daughter. The shares had cost Ellie £6,200 in May 2014. This shareholding represented a 5.5% holding in the company. Ellie does not work for Storey plc.

(b) Peacock Ltd, a UK trading company, sold its entire shareholding in Storey plc to an unconnected third party for £103,240. This represented an 11% stake. The shares were purchased in January 2016 for £111,720.

<u>3 May 2017</u>

On 3 May 2017, Storey plc granted a 15 year lease over Kare Mews for a premium of £20,000. Kare Mews is a commercial property the freehold of which Storey plc purchased in April 2006 for £280,000. The value of the reversionary interest was £200,000.

When Kare Mews was purchased, a claim was made to rollover a gain on the sale by Storey plc of another commercial freehold property, 20 Henderson Road, into the purchase of this property. The gain on the disposal of 20 Henderson Road in December 2004 was £60,000 and the disposal proceeds were £297,000.

<u>5 May 2017</u>

On 5 May 2017, the tax controller of Storey plc sent an email to your manager confirming details about the above transactions and also included the following paragraph:

"The lease premium of £20,000 from our sub-tenants of Kare Mews was paid into one of our investment accounts. I intend to keep it in that account and then only transfer it to our main trading bank account after 31 May 2017, in that way delaying any tax consequences on the grant of the premium. Any tax consequences from the receipt will be reported in the year ended 31 May 2018 Corporation Tax Self-Assessment (CTSA) return, rather than the 2017 return. Obviously I should be grateful if you would not disclose what is only a timing difference to HM Revenue & Customs".

You are required to:

1) Calculate the chargeable gains/losses made as a result of the disposals on 1 May 2017, explaining any beneficial claims and elections that can be made, or any reliefs that may apply. (7)

2) Calculate the chargeable gain/loss arising as a result of the grant of the lease on 3 May 2017. (4)

3) Explain the actions that should be taken by your firm in light of the information contained within the 5 May 2017 email. (4)

Total (15)