



## **November 2017 Examination**

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**PAPER 4**

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**Corporate Taxation**

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Part I Suggested Answers

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1.

Late filing penalties

There will be an initial late filing penalty of £100 as the return was not filed by the filing date of 31 March 2017. (1/2)

Furthermore, as the return was not filed within 3 months of the filing date, then a daily penalty of £10 per day (1/2) can be imposed up to the filing date of 15 July (15 x 10 = £150). (1/2)

Late payment penalties

A penalty is due of 5% of the outstanding tax at the filing date therefore £600 (5% of £12,000). (1)

A further late payment penalty is due as the liability has not been fully settled within 3 months of the filing date. (1/2) This is 5% of the tax outstanding 3 months after the filing date which is £300 (5% of (£12,000 - £6,000)). (1)

4 marks

2

A non-UK resident company is chargeable to UK corporation tax if they carry on a trade in the UK through a permanent establishment. (1/2)

The non-UK resident company will be subject to UK Corporation Tax on the trading profits, UK property income and capital gains which are attributable to the permanent establishment. (1/2)

A company incorporated outside of the UK may be considered UK resident if it is centrally managed and controlled in the UK. (1/2)

If a company is UK resident it will be taxable on its worldwide income (1/2), unless an election is made to exempt profits of overseas permanent establishments. (1/2)

Double tax relief is available in the form of unilateral relief. (1/2)

The relief available is the lower of the UK corporation tax due on that source of income (1/2) and the foreign tax suffered. (1/2).

4 marks

3

	FYA £	AIA £	General Pool £	Allowances £
WDV b/fwd			75,000	
Additions				
Energy saving boiler	50,000			(1/2)
Production line		125,000	25,000	(1)
Electrical wiring		25,000		(1/2)
	<hr/>	<hr/>	<hr/>	
	50,000	150,000	100,000	
FYA @ 100%	(50,000)			50,000 (1/2)
AIA @100%		(150,000)		150,000 (1/2)
WDA @ 18% x 9/12			(13,500)	13,500 (1/2)
WDV c/fwd			<hr/>	<hr/>
			86,500	213,500

Maximum annual investment allowance = £150,000 (200,000 x 9/12) (1/2)

4 marks

4.

Share issue

Dr: Bank account (50,000 x £1) £50,000 (1/2)

Cr: Share Capital (50,000 x £0.50) £25,000 (1/2)

Cr: Share Premium (50,000 x £0.50) £25,000 (1/2)

Bonus Issue

On 30 June, there were 200,000 50p Ordinary shares in issue. Therefore the bonus issue will be  $\frac{1}{2} \times 200,000 = 100,000$  shares. (1/2)

Dr Profit and loss reserves (100,000 x £0.50) £50,000 (1/2)

Cr Share capital (100,000 x £0.50) £50,000 (1/2)

3 marks

5.

Each member will be subject to income tax on their share of the profits. (1/2)

Therefore, for 2016/17, Freddie will be taxed on £35,000, Liam will be taxed on £35,000 and Paul will be taxed on £30,000. (1/2)

Each member will also be liable to Class 4 (1/2) as well as Class 2 National Insurance contributions. (1/2)

2 marks

6.

Section 104 pool

		Number of shares	Cost £	Indexed cost £	
1 January 2000		5,000	10,000	10,000	(1/2)
31 December 2005	Indexation			1,651	(1/2)
31 December 2005	Acquisition	7,500	30,000	30,000	(1/2)
		<hr/>	<hr/>	<hr/>	
		12,500	40,000	41,651	
31 March 2017	Indexation			<hr/>	(1/2)
				15,751	
31 March 2017	Disposal	(2,500)	(8,000)	57,402	(1)
				(11,480)	
	c/fwd	<hr/>	<hr/>	<hr/>	
		10,000	32,000	45,922	

Proceeds	£	25,000
Less cost		(8,000)
		<hr/>
		17,000
Less indexation allowance (11,480 – 8,000)		(3,480)
		<hr/>
Chargeable gain		<u>13,520</u> (1)

4 marks

7.

A trading loss can be relieved as follows

1. Against total profits (before qualifying charitable donations) in the current chargeable accounting period. (1/2)
2. Carry back and set against total profits (before qualifying charitable donations) in the preceding 12 months (providing a current year claim has been made). (1/2)
3. Carry forward and set against the next available future profits from the same trade. (1/2)

The rental loss is set against total profits of the current chargeable period and is given priority to trading losses. (1/2)

Any excess property losses are carried forward against future income and gains of any description. (1/2)

The rental losses of £5,000 will be set against the gain in the year. (1/2)

Trading losses of £3,000 will be carried forward (1/2), after carrying back £6,000 to the previous year. (1/2)

4 marks

8.

The interest of £5,000 to the director should be paid net of basic rate tax (1/2). Therefore Longham Ltd will pay the director £4,000 and will pay HM Revenue and Customs £1,000. (1/2)

Patent royalties also need to be paid net of basic rate tax. (1/2) Therefore Longham Ltd will pay Peter £4,000 and will pay HM Revenue and Customs £1,000. (1/2)

Interest paid to Eastham Ltd will be paid without the deduction of tax. (1/2) Therefore Longham Ltd will pay £5,000 to Eastham Ltd. (1/2)

3 marks

9.

All of the amounts paid to Ross are deductible for CT purposes in the accounting period in which they are paid. (1)

Income Tax:

The statutory redundancy payment of £2,800 is taxable, (1/2) but covered by the £30,000 exemption (1/2).

The amounts in lieu of contractual holiday pay are taxable as earnings. (1/2)

The ex gratia termination payment of £35,000 is exempt up to £30,000, (1/2) but the statutory redundancy payment has used up part of that amount. Therefore £35,000 - (30,000 - 2,800) = £7,800 is taxable. (1)

4 marks

10.

	£	
Profit per accounts	37,500	
Add		
Accrued wages not paid within 9 months	5,000	(1/2)
Pension costs paid post 31 October 2016	500	(1/2)
Business entertaining	400	(1/2)
Taxable trading profit	<u>43,400</u>	

Notes

Stationery costs allowed as pre trading expenditure. (1/2)

Staff entertaining is allowable (1/2)

Warranty provision allowed as calculated in accordance with generally accepted accounting principles. (1/2)

3 marks

11.

1 August 2014 – 31 August 2014 (1/2)

1 September 2014 – 31 August 2015 (1/2)

1 September 2015 – 31 October 2015 (1/2)

1 November 2015 – 31 October 2016 (1/2)

1 November 2016 – 31 January 2017 (1/2)

1 February 2017 – 31 March 2017 (1/2)

3 marks

12.

Transfer pricing rules seek to stop companies from gaining a UK tax advantage (1/2) by entering into transactions with connected parties (1/2) using non-arm's length prices. (1/2)

The transfer pricing rules do not apply where the potentially advantaged person is a small or medium sized enterprise (1/2) or a dormant company (1/2).

Max 2 marks



## **November 2017 Examination**

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Part II Suggested Answers

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### Question 1

Part 1)	£	£	Marks
<u>Year ended 30 June 2017:</u>			
Profit per the accounts		543,500	
Add:			
Depreciation	20,000		½
R&D – computer hardware	7,500		½
Interest payable – Interest on loan to purchase shares	2,800		½
- Interest on underpaid CT	900		½
		31,200	
Less:			
Interest receivable	2,180		½
Profit on sale of 13 Pick Street	94,700		½
R&D			
£17,000 x 130%	22,100		½
£(3,200 x 40% x 130%)	1,664		1
		(120,644)	
Less: capital allowances		(13,900)	½
Tax adjusted trading profit		440,156	

Part 2)	£	£	Marks
<u>Year ended 30 June 2017</u>			
Trading profit (part 1)		440,156	½
Chargeable gain (W1)		210,131	
Taxable total profits		650,287	
Non-trading deficit (2,180 - (2,800 + 900))		(1,520)	1
		648,767	
Less: consortium relief			
Lower of: £180,000 and		(129,753)	½
£648,767 x 20%			1
Taxable total profits		519,014	
Corporation tax on £519,014 @ 20%		£103,803	½

W1 - Gain on 13 Pick Street			
Proceeds		235,000	
Less: Cost	140,300		½
Rollover relief claim	(120,000)		½
		(20,300)	
Less: Indexation allowance			
£20,300 x (265.5 – 242.1/242.1) = 0.097		(1,969)	1
		212,731	
Less: capital loss b/f		(2,600)	½
Chargeable gain		210,131	



Part 3)	<b>Marks</b>
Professional privilege is the confidentiality that tax advisers have with respect to communications with their clients.	1
Tax advisers are under no obligation to disclose details of their clients' affairs unless required to do so by due process of law, including any statutory requirement to disclose.	1 ½
Professional privilege extends to papers, documents and other communications in their possession as a result of a professional relationship with the client.	1 ½

## Question 2

	<b>Marks</b>
Part 1)	
The cost of the salary of £35,000 and the benefits provided of £4,500 is deductible for CT purposes.	½ ½
Class 1 secondary contributions are payable by Wave Ltd at 13.8% above the secondary threshold of £8,112.	1
Class 1A contributions are payable by Wave Ltd on the benefits of £2,700 at 13.8%	1
Part 2)	
The fee paid to Function Ltd will be deemed to have been paid as salary to Albert and therefore subject to PAYE Income Tax in Albert's hands and National Insurance for both Albert and Function Ltd.	½ 2 x ½ ½
The gross deemed payment is deductible in arriving at Function Ltd's trading profit.	½
<u>Annual net deemed payment</u>	£
Fees from relevant engagements	43,000
Less: 5% deduction	<u>(2,150)</u> ½
Gross payment	40,850
Class 1 secondary contributions on gross payment	
£40,850 x 13.8/113.8	<u>(4,954)</u> ½
Net deemed payment	<u>35,896</u> ½
Part 3)	
The fee of £1,500 per month is deductible for Wave Ltd for Corporation Tax purposes.	1
As Max is not an employee there will be no National Insurance consequences for Wave Ltd, in the absence of HMRC challenging his self-employment status.	2 x ½
Part 4)	
Max will be subject to Income Tax on the amounts received from Wave Ltd as trading profit.	½
He will be liable to Class 2 (fixed) and Class 4 contributions on £(1,500 x 12) = £18,000. Contributions are payable at 9% on £(18,000 – 8,060) = £895.	3 x ½
<i>Mention of risk of challenge to self-employment status with some rationale.</i>	1

Max 2

### Question 3

Marks

To: Manager@firm  
From: Consultant@firm  
Date: Today  
Subject: Mowbray Ltd

1

Dear Manager

Here is my reply to the issues raised in your earlier email.

#### 1) Sale of shares in Pistol Ltd

The transfer of the freehold building in May 2015 will have occurred at nil gain/nil loss.

½

The sale of 50% of the shares in Pistol Ltd in July 2017 means that Pistol Ltd leaves the gains group within 6 years of the nil gain/nil loss transfer and therefore a degrouping charge arises as follows:

½

½

	£	
Deemed proceeds (MV at May 2015)	290,700	½
Less: Cost (June 2014)	<u>(250,900)</u>	½
	39,800	
Less: Indexation allowance $258.5 - 256.3/256.3 = 0.009 \times \text{£}250,900$	<u>(2,258)</u>	1
Degrouping charge	<u>37,542</u>	

The sale of the shares in Pistol Ltd results in the following loss:

	£	
Proceeds (179,000 + 37,542)	216,542	½ + ½
Less: Cost $\text{£}520,000 \times \frac{1}{2}$	<u>(260,000)</u>	½
Loss	<u>(43,458)</u>	

However, the substantial shareholding requirements are met and therefore this is not an allowable loss.

½

½

In addition, the degrouping charge, is added to the proceeds, effectively making the degrouping charge also exempt from tax.

½

½

Max 7

#### 2) Sale of Hastings Ltd

The sale of the shares in Hastings Ltd represents a change in ownership of that company. If this is combined with a major change in the nature or conduct of the trade within three years before or three years after the change of ownership, the losses in Hastings Ltd will not be able to be carried forward and set against future trading profits.

1

½

½ + ½

½

Therefore, the circumstances as to the previous and future operations of Hastings Ltd will affect the price negotiation otherwise the losses may not be of the perceived value.

1

#### 3) VAT issue

The output tax on this invoice is  $\text{£}15,600 \times \frac{1}{6} = \text{£}2,600$ .

1

The tax point for the supply is 28 August 2016, the date the goods were made available to the customer.

1

The debt has been written off in the accounts but the debt has to be at least 6 months old. This is from the later of the tax point or the invoice date.

½

½ + ½

Therefore the output tax is not yet recoverable as a bad debt.

½

Max 3

#### 4) Purchase of UK companies

The purchase of >50% of the shares of the UK companies will result in additional related companies in the group.	½
The upper threshold of £1.5m is divided by the number of related companies for the purposes of deciding whether a company is "large" for the purposes of corporation tax payments.	½
A large company will pay corporation tax in quarterly instalments, starting on the 14 <sup>th</sup> day of the 7 <sup>th</sup> month of the accounting period and then every 3 months after that.	½ ½
Other companies pay corporation tax 9 months and 1 day after the end of the accounting period.	½
However, the number of related companies, when determining payment dates is examined at the end of the previous accounting period. Therefore any additional companies would only affect the corporation tax payable for the year ended 31 March 2019.	1 1
Hastings Ltd will be sold in December 2017, so will be a related company for the year ended 31 March 2018.	½
Pistol Ltd's shareholding dropped to 50% in July 2017, but it will still be a related company for the year ended 31 March 2018.	½

Max 5

Please let me know if you need anything else on your return.

Best regards

Consultant

#### Question 4

Part 1)	£	£	Marks
Gain on goodwill (cost = nil)		50,000	1
Loss on building			
Proceeds	285,000		
Less: Cost	(300,000)		
		(15,000)	1
Net gain on incorporation		35,000	
 Part 2)			
Net gain		35,000	
Less: incorporation relief:			
£35,000 x (345,000/355,000) (W1)		(34,014)	1
Gain		986	
Capital Gains Tax on £986 x 20%		197	½
 W1 - MV of assets transferred			
Goodwill		50,000	
Building		285,000	
Other assets		20,000	
		355,000	½
 The base cost of the shares is reduced by the incorporation relief.			
MV of shares		345,000	½
Less: incorporation relief		(34,014)	½
Base cost of the shares		310,986	
 Part 3)			
The transfer of the assets will be treated as a transfer of a going concern if:			½
<ul style="list-style-type: none"> <li>• The business is transferred as a going concern</li> <li>• There is no significant break in trading</li> <li>• The same business is carried on after the transfer</li> <li>• Mustard Ltd is or becomes VAT registered</li> </ul>			4 x ½
In which case the transfer is outside the scope of VAT and no VAT is chargeable.			½
If the conditions are not met, VAT at the standard rate of 20% on £355,000 = £71,000 will be chargeable on the transfer.			½

Max 3

Part 4)

**Marks**

Corporation Tax (CT)

Any salary or bonus will be deductible for CT purposes. However, the bonus will only be deductible if it is paid within 9 months of the end of the accounting period in which it is accrued.	1/2 1/2
In addition, the National Insurance payable by Mustard Ltd in respect of the salary and bonus will be deductible for CT purposes.	1/2
The costs of providing the company car will be deductible.	1/2
Although Phil will be a participator in a close company, as he is an employee the costs of providing the benefit are deductible.	1/2
The payment of a dividend is not deductible for CT purposes	1/2

Income Tax (IT)

The salary and bonus will be subject to IT on a receipts basis and the benefits on an arising basis.	1/2 1/2
Any dividend received by Phil will be subject to tax at 32.5%. However, the dividend allowance of £5,000 will be available.	1/2 1/2

Max 4

Part 5)

Client acceptance procedures should be conducted before Phil is accepted as a client and there should be an appropriate engagement letter to cover the services provided.	1/2 1/2
There is a potential conflict of interest in acting for both Phil and Helena, which may impair objectivity.	1/2 1/2
This must be resolved by looking at the potential conflict and considering whether it is appropriate to act for one or more of the clients immediately.	1/2 1/2
Any conflict resolution should be put in writing to the client including any agreement where the firm agrees to act for both parties.	1/2 1/2

Max 3

Total 15