May 2018 Examination

PAPER 4

Corporate Taxation

Part I Suggested Answers

Question 1

Capital Allowances computation for Louth Ltd

	FYA	AIA	General pool	Special rate pool	Allowances	
	£	£	£	£	£	
WDV b/f			595,000	227,500		
Additions						
- Machinery		177,500	57,750			(1)
- Solar panels		22,500				(1/2)
- Heating equipment	53,000					(1/2)
	53,000	200,000	652,750	227,500		
Allowances						
AIA @ 100%		(200,000)			200,000	(1/2)
FYA @ 100%	(53,000)				53,000	(1/2)
WDA @ 18%			(117,495)		117,495	(1/2)
WDA @ 8%				(18,200)	18,200	(1/2)
WDV c/f			535,255	209,300		
Total allowances					388,695	

Note – the AIA has been allocated to the solar panels first as they qualify for inclusion in the special rate pool.

4 Marks

Question 2

The time of supply (tax point) rules determine the date upon which items are bought or sold, (½) and hence when both input and output VAT should be accounted for. (½)

However the basic tax point can be overridden in the following situations:

1. If payment is received before the basic tax point, or if the invoice is issued before the basic tax point, then the actual tax point becomes the earlier date. (1)

2. If the VAT invoice is raised within 14 days after the basic tax point, then the invoice date will be the tax point. (1)

3 Marks

Question 3

The losses that can be surrendered from JM (JV) Ltd to the consortium members are:

Company	Loss to be surrendered	
Jasper Ltd	£7,500 (= all of taxable profits)	(1)
Maypole Ltd	£100,575 (= member's interest x consortium company's loss)	(1)
Gardenia SA	Nil (as company not UK resident although taken into account when establishing the consortium)	(1)
Lobelia Ltd	Nil (as does not own at least 5% of the shares)	(1)

4 Marks

Question 4

Jolyon Ltd – Trading Profit

	£	
Profits per the accounts	470,250	
Add:		
Depreciation	11,350	½
R&D expenditure	27,650	½
Directors' bonuses not paid within 9 months of year end	100,000	½
Donation to political party	5,000	½
Less:		
Enhanced R&D (£27,650 x 230%)	(63,595)	½
Profit on the sale of a fixed asset	(14,000)	½
Trading profit	536,655	½

Note – the cost of the gifts is allowable they do not exceed £50 per customer and bear an advertisement for Jolyon Ltd. (½)

(Candidates who simply deduct the additional 130% of R&D relief will receive equal credit.)

4 Marks

Question 5

1) On the incorporation of his business, in the absence of any reliefs Cyril would be subject to capital gains tax on the transfer of any chargeable assets, (½) the gain(s) being calculated using open market value at the date of transfer, less allowable costs. (½)

2) As this is the transfer of an ongoing trading business (½), incorporation relief is available if all of the assets of the business (which can exclude cash balances) (½) are being transferred into the company in exchange for shares. (½)

This has the effect of deferring the potential tax charges and is achieved by reducing the base cost of the shares by the gain arising (½). There is no election necessary for incorporation relief. (½)

Alternatively, if Cyril gifts his business assets to the new company, (½) gift relief may be claimed. Unlike incorporation relief this does not require all of the assets to be transferred into the new company (½). Any gains arising are held over and reduce the base cost of the relevant assets transferred into the business. (½)

Max 4 Marks

Question 6

1) The accounting profits of the LLP are adjusted under normal tax rules to arrive at the taxable profits. (½) An LLP is not taxed on its profits; instead, the profits are allocated to the members in the accordance with their profit sharing ratio. (½)

The allocated profits are subject to income tax on each individual member and must be entered on their tax return. (½) The members are treated as self-employed and are therefore subject to Class 2 and 4 NIC on the profits. (½)

Gains in an LLP will be allocated to the members in proportion to the capital ratio. (½) They are then aggregated with any other gains or losses of the members. (½)

Max 2 marks

2) The profit share can be deemed disguised salary if it is fixed (½) or only variable based on the individual's performance (and not of the LLP) (½) and is not affected by the overall profits of the LLP. (½)

Max 1 mark

Max 3 Marks

Question 7

1) If POK Ltd is subject to IR35, then all income received by POK Ltd will be treated as income received by Peter (½), after the deduction of allowable expenses. (½) It will be subject to PAYE and Class 1 NIC (½) and deemed paid on 5 April. (½)

2 Marks

2) Net deemed payment

	£	
Income	80,000	½
Less 5% deduction	(4,000)	½
	76,000	
Employers NIC on gross payment (76,000 x 13.8/113.8)	(9,216)	½
Net deemed payment	66,784	½

2 Marks

4 Marks

Question 8

Payment of school fees – as this amount is reimbursed to the director the cost is subject to Class 1 NIC (both employer and employee). (1)

Private medical insurance - Class 1A NIC at 13.8% of the amount of the benefit will be payable by the company (½).

Christmas party – Reported under the PAYE Settlement Agreement rules and so is subject to Class 1B NIC at 13.8% (½)

2 Marks

Question 9

	£	£	
Dr Corporation Tax P&L charge	15,000		(½)
Cr Corporation Tax creditor		15,000	(½)
Dr Corporation Tax creditor	80,000		(½)
Cr Cash		80,000	(½)

2 Marks

Question 10

Ernest must have held at least 5% of the share capital in Field Ltd (½) and be able to exercise at least 5% of the voting rights (½).Ernest must also be a director or employee of the company. (½)

Field Ltd must be a trading company or the holding company of a trading company. (½).

The conditions must be met for the twelve month period leading up to the disposal of the shares (½).

There is a lifetime cap on the amount of gain that can benefit from ER, being £10m (½).

3 marks

Question 11

Chargeable Gain in Waggon Ltd

	£	£	
Sale of shares in Zane Limited -			
Proceeds		2,630,500	
Less			
Purchase Price	1,500,000		½
Legal fees	25,000		½
Stamp Duty	7,500		½
	1,532,500		
Indexation Allowance			
276.5-267.1/267.1 x £1,532,500	53,933		1
		(1,586,433)	
Chargeable Gain		1,044,067	

Note – The restriction of indexation to December 2017 is not yet examinable. However, candidates who have restricted to this date will receive equal credit.

The gain arising could be reduced to nil if the substantial shareholding exemption is available – the main conditions being that Waggon Ltd holds at least 10% of the shares (½) for a twelve month period in the two years prior to sale (½), and that both companies are trading companies or members of a trading group. (½)

4 Marks

Question 12

Large companies are required to pay their Corporation Tax liabilities in quarterly instalments. The instalment payments are due as follows:

1. The first payment is due on the 14th day of month 7 counting from the start of the accounting period;
2. Subsequent payments are each due 3 months after the previous instalment;
3. The final payment is due 3 months plus 14 days from the end of the accounting period.(1)

Each instalment is required to be 25% of the total tax payable for a 12 month period (½) or 3/n x corporation tax liability if not (where n is the number of months in the accounting period).(½).
As instalments are made during the year when the total tax may not be known, the company will be required to estimate the tax payable. (½)
Interest will be charged, or credited, on the difference between the amounts paid and the final liability. (½) If a company has underpaid tax it can stop interest accruing by making payments at any time. (½)

Max 3 Marks

May 2018 Examination

PAPER 4

Corporate Taxation

Part II Suggested Answers

Question 1

1) **Marks**

		Number	Cost	Indexed Cost	
12 July 2017	Acquisition	2,000	27,000	27,000	½
1 August 2017	Bonus issue (1:5)	400		-	½
Indexation					
275 - 271.5/271.5 x £27,000				348	½ ½
17 February 2018	Rights issue (1:2)	1,200	12,000	12,000	½
				39,348	
Indexation					
276 – 275/275 x £39,348				143	½ ½
		3,600	39,000	39,491	
3 April 2018	Sale of 1,000 shares	(1,000)	(10,833)	(10,970)	½

	£	
Sales proceeds	17,500	½
Less: Cost	(10,833)	
	6,667	
Less: indexation	(137)	
Chargeable gain	6,530	½

5 marks

2) **Marks**

World Ltd would be UK resident were it to be incorporated in the UK, but it is not. ½
The central management and control of World Ltd is overseas, given the activities ½
of Owen Ball and his team in the overseas jurisdiction and therefore the company ½
is non-UK resident for tax purposes.

As a result World Ltd will be taxed on its profits overseas according to the rules of ½
that jurisdiction and only amounts remitted to the UK in certain circumstances will be subject to UK Corporation Tax.

2 marks

3)

Amounts remitted to the UK

	£	
Trading profits – not taxable in the UK	-	½
Interest from World Ltd (gross)	2,100	½
Dividends from World Ltd - exempt	-	½
	2,100	
Corporation Tax on £2,100 x 19%	399	½
Less: DTR, lower of		
- UK tax = £399		½
- Overseas tax = £2,100 x 5% = £105	(105)	½
Corporation Tax payable	294	

3 marks

4)	**Marks**
The input VAT of £800 on the legal fees on set up is irrecoverable as it was incurred more than six months prior to registration.	½ ½
The input VAT of £200 on the legal fees regarding an employee's dismissal is recoverable as it was incurred within six months prior to registration and relates to the making of taxable supplies.	½ ½
The input VAT of £1,100 on the purchase of plant and machinery is recoverable as it was incurred within four years prior to registration. However, the items must still be owned by New Ltd on registration.	½ ½ ½
The input VAT of £300 on the fees in relation to the lease is recoverable, relating to the making of taxable supplies.	½
The input VAT of £150 in relation to the tax advice will be recoverable unless it is wholly related to the private affairs of the MD in which case it is irrecoverable. Further information is required.	½ ½ ½

Max 5 marks

Question 2

Part 1	**Marks**
Drake Ltd is a company with investment business	½
which is defined as a "company whose business consists wholly or partly of making investments".	½
The Corporation Tax computation lists the various types of taxable investment income.	½
From each individual type of income there may be specific expenses directly deducted from that source e.g. against rental income.	½
Management expenses i.e. costs related to the whole business are deducted from	½
total profits, as are capital allowances.	½
Capital expenses are not deductible.	½

Max 3 marks

Part 2 Year ended 30 September 2017	£	£	**Marks**
UK rental income	202,000		½
Less: expenses			
Repairs	(5,000)		½
Repainting	(4,800)		½
		192,200	
Overseas rental income		70,000	½
Interest receivable	7,100		½
Interest payable – rental property	(5,200)		½
Overdraft interest	(900)		1
Non-trading loan interest		1,000	
UK dividends - exempt		-	½
Total profits		263,200	
Less: management expenses			
Head office staff costs	36,900		½
Rent payable	21,000		½
General overheads	12,500		½
		(70,400)	
Capital allowances:			
Computer equipment (AIA)		(3,000)	1
Less: QCDs		(2,600)	½
Taxable total profits		187,200	
Corporation tax:			
£187,200 x 6/12 x 20%		18,720	½ ½
£187,200 x 6/12 x 19%		17,784	½
		36,504	

9 marks

Part 3	**Marks**
As the expenses and capital allowances will exceed the investment income they are treated as excess management expenses.	1
These may be carried forward and set against future total profits in Drake Ltd.	½ ½

2 marks

Question 3

Part 1 **Marks**

To: Eva Aspen E mail presentation 1
From: Adviser
Date: Today
Subject: Tax advice

Dear Eva

Thank you for your email, here are my responses to your concerns.

Loan from Viper Ltd

Viper Ltd is a close company as it is controlled by five participators or fewer and ½ ½
therefore when the loan was advanced to you there will have been a tax charge payable by the company.
The tax charge is calculated as 32.5% of the amount of the loan, so £10,000 x ½
32.5% = £3,250.

When the loan is written off, this tax charge is repayable to Viper Ltd. ½

There will have been an Income Tax benefit for you on the tax free loan each ½
year, based on the official rate of interest and the amount outstanding, which has remained the same.

As you are a participator (shareholder) in a close company, the loan write off will 1
result in you being deemed to receive a dividend equal to the amount written off i.e. £10,000.
The first £5,000 of the dividend will be covered by your tax free dividend 1
allowance (assuming you have received no other dividends) and the remainder
will be subject to Income Tax at your marginal rate of tax which is 38.1% i.e. 1
£5,000 x 38.1% = £1,905.

The £10,000 write off will not be deductible for Corporation Tax purposes for Viper ½
Ltd.

Max 6 marks

Purchase of your shares

You are correct in identifying the two different treatments and I have summarised the tax effects for you below.

Income treatment:
If the income treatment applies, you will be treated as having received a dividend, ½
calculated as the difference between the repurchase price paid and the original subscription price.
This will be:
£(25 – 1) = £24 x 4,000 = £96,000 1

As you are an additional rate taxpayer this amount will be subject to income tax at ½
the top dividend rate which is 38.1%.

In addition, there is capital gain arising under the income treatment which is
calculated as the difference between the original subscription price for the shares 2 x ½
and the price paid by you. As both of these figures are £1 there are no additional capital gains tax issues.

Capital treatment:

If the capital treatment applies, then you will be subject to capital gains tax on the following:

	£	
Repurchase price £25 x 4,000	100,000	½
Less: Cost £1 x 4,000	(4,000)	½
Gain	96,000	
Less: Annual exempt amount	(11,300)	½
	84,700	

Therefore estimated capital gains tax payable by you is:
£84,700 x 20% = £16,940 ½

Please contact me with any other queries regarding these transactions.

Best regards

Advisor

Max 10 marks

Part 2	Marks
Eva is asking for an inflated amount to be charged for the work performed and that is not an arrangement to which the firm should agree.	½
In addition she has asked for the bill to be back dated, which is also not an arrangement to which the firm should agree.	½
Eva plans to deduct the back dated inflated invoice for Income Tax purposes for 2017/18 and that constitutes tax evasion which is illegal.	½ ½
The firm should advise Eva, ultimately in writing that it will not back date and inflate her invoice.	1
If Eva does not agree then the firm should consider ceasing to act for her. Notification of ceasing to act should be given to HMRC without reasons.	½ ½

Max 3 marks

Question 4

Part 1	**Marks**
Astral Ltd will be required to make quarterly instalment payments of Corporation Tax if its augmented profits exceed £1.5m.	½
Augmented profits are defined as taxable total profits plus dividends from non-group companies i.e. companies where the shareholding is not greater than 50%.	½ ½
Therefore the dividends from Ursa Ltd are not included when calculating augmented profits.	½
However the £1.5m limit is divided by the number of companies related to Astral Ltd at the end of the previous period i.e. at 31 March 2017.	½ ½
A related company is defined as one where the ownership by Astral Ltd is more than 50%.	½
Therefore, Canis Ltd is not a related company as the shareholding held by Astral Ltd at 31 March 2017 is 45%.	½
Both Hydra Ltd and Orion Ltd are related companies as the more than 50% shareholding requirement is met.	½ ½
Ursa Ltd is a related company as Astral Ltd's shareholding is more than 50% for the year ended 31 March 2017.	½
Vega Ltd is a related company at the end of 31 March 2017 and therefore included when dividing the £1.5m limit, despite being sold in the year ended 31 March 2018.	½ ½

Max 6 marks

Part 2	**Marks**
Within Canis Ltd:	
A current year claim may be made to offset its trading loss against total profits of the year ended 31 March 2018.	½
Following the current year claim, any remaining loss may be carried back against total profits of the year ended 31 March 2017, saving tax at a higher rate of 20%.	½ 1
Alternatively the loss can be carried forward and set off against future trading profits arising from the same trade. However, this involves a cash flow delay *[and tax rates are falling].*	½ ½
Group relief:	
Canis Ltd can surrender its trading loss to Astral Ltd to be offset against taxable total profits (TTP). However a 75% shareholding is required and that is only achieved from 1 July 2017.	½ ½ ½
Therefore the amount of loss offset is limited to 9/12 x £84,000 = £63,000 or 9/12 x Astral Ltd's TTP, whichever is the lower.	½ ½
The same principle applies to a surrender of the trading loss to Hydra Ltd.	½
No surrender can be made to Orion Ltd as the indirect shareholding is less than 75% or Ursa Ltd as the direct shareholding is only 70%.	½ ½

Max 5 marks

Part 3 **Marks**

Canis Ltd is in a gains group with Astral Ltd from 1 July 2017 as Astral Ltd then has a 75% shareholding in that company. ½ ½

Both Hydra Ltd and Orion Ltd are in a gains group with Astral Ltd (and Canis Ltd) as there is a direct 75% shareholding between the companies and there is a >50% indirect shareholding from Astral Ltd to Orion Ltd. ½ ½ ½

Neither Ursa Ltd nor Vega Ltd is in a gains group with Astral Ltd as the 75% shareholding does not exist. ½

However, until 31 January 2018, Ursa Ltd and Vega Ltd are in a gains group as a result of the 100% shareholding between these two companies. ½

The capital loss in Vega Ltd for the year ended 31 March 2018 may be used against chargeable gains within that company. Any remaining loss will be carried forward to be set against Vega Ltd's chargeable gains in future accounting periods. ½ ½

The capital loss can be surrendered to Ursa Ltd or that company's gains can be allocated to Vega Ltd to absorb the capital loss, prior to 1 February 2018. ½

The capital loss will be a pre-entry loss for the new purchaser and therefore restricted in its use. ½

Max 4 marks

Part 4 **Marks**

Astral Ltd is a private company and therefore the following procedures should be followed:

- An application to buy shares must be made to the directors directly ½
- Shares are allotted and issued subject to the formal resolution of the directors and the fulfilment of any condition e.g. subscription money ½ ½
- Brian Weeks is entered into the register of members. The allotment must be recorded in the register within two months ½ ½
- A return of allotment is made to the Registrar containing prescribed particulars and a statement of capital within one month ½ ½

Max 3 marks