Practical Tax People

Association of Taxation Technicians

May 2015 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. You are not permitted to write in the answer folders. The Presiding Officer will inform you when you can start writing. Calculators may not be used during this time.

- You are provided with two answer folders (one for each part of the paper). You must put your candidate number on the front cover of both folders.

- You must write your answers on the paper provided. Please start each answer on a new sheet of paper and write on one side of the paper only. Put your candidate number at the top of each page and make sure you place your answers in the correct answer folder.

- All workings should be shown and made to the nearest month and pound unless the question requires otherwise.

Part I

You must use the Part I answer folder.

1. Schemmel Ltd incurred the following expenditure in the eight month accounting period ended 31 March 2015.

	£
New shelving	15,000
Drinks machine	5,000

The drinks machine replaced an older model on which the company received £500 on disposal.

At 1 August 2014 the tax written down value on the general pool amounted to £8,000 and the tax written down value on the special rate pool was £15,000.

Calculate the maximum capital allowance claim for the period ending 31 March 2015. (4)

2. Edgar provides services through his company, Raiders Ltd, in which he owns 100% of the share capital. Although Raiders Ltd provides services to several clients, it is caught by the IR35 rules relating to personal service companies.

In the tax year 2014/15, Raiders Ltd invoiced clients £50,000 in respect of relevant engagements and £30,000 in respect of non-relevant engagements. The company also paid Edgar qualifying travel expenses of £1,800, non-qualifying travel expenses of £700 and made a pension contribution of £5,700.

1) **Briefly explain the tax implications of operating as a personal service company.** (1)

2) **Calculate the deemed employment payment for 2014/15.** (3)

3. Entrepreneurs' relief may be available to individuals when they dispose of their shares in a company.

State the conditions that must be met by an individual to qualify for entrepreneurs' relief on the disposal of shares. (3)

4. Companies within a group may form a loss relief group and/or a chargeable gains group.

State the conditions necessary to form a loss relief group and/or a chargeable gains group.
(3)

5. Horace is considering transferring his sole trade business to a limited company. It is anticipated the business will have the following net assets (market values) at the date of transfer.

	£
Freehold premises (cost £135,000)	235,000
Goodwill (cost £nil)	150,000
Net current assets (excluding cash)	125,000
Cash at bank	90,000
Total assets	£600,000

Horace has heard that incorporation relief is available to an individual transferring his business to a limited company.

1) **Explain how incorporation relief operates and the conditions that need to be met for incorporation relief to be claimed.** (2)

2) **Calculate the base cost of the shares in the company assuming Horace retained the cash and received 50,000 shares with a nominal value of £1 each.** (2)

6. Limited Liability Partnerships (LLPs) have increased in popularity in recent years.

Explain the fundamental features of an LLP and how profits arising from an LLP are taxed. (3)

7. Arnold and William Brody are the shareholders of Ark Ltd, which was incorporated in April 2001 with Arnold holding 60% of the share capital and William holding 40%. They have now decided to transfer the business back to individual ownership and wish to claim disincorporation relief.

At the time of incorporation, the value of goodwill was £35,000. Goodwill now has a value of £50,000. The company also owns land which has a value of £60,000, including land held as trading stock of £25,000. This land had a value of £30,000 at incorporation, of which £5,000 related to the land held as trading stock.

1) **Show how Ark Ltd's chargeable gains will be calculated, assuming a claim for disincorporation relief is made.** (2)

2) **Calculate the base cost of these assets for Arnold and William for any future disposal by them.** (2)

8. Jones Ltd prepares accounts to 31 January every year. Its Corporation Tax liability for the year to 31 January 2014 was £12,000. The Corporation Tax return for the year is still to be filed but the liability was paid on 21 February 2015.

Determine the penalties that will be due if the Corporation Tax return is filed on 14 August 2015 and any penalties that may relate to the payment of the liability, assuming the common penalty regime introduced by Finance Act 2009 applies. (4)

9. A company which is not a member of a group is able to gain relief for trading losses in three ways.

Describe the three options that are available. (3)

10. Icarus Ltd, a company with no associates, makes up its accounts to 31 March every year. A summary of the profit, depreciation charge and capital allowance claim for the year ended 31 March 2015 is set out below.

	£
Profit before depreciation	55,000
Depreciation charge	9,000
Capital allowance claim	20,000

Calculate the deferred tax adjustment for the year to 31 March 2015 and show the double entry required to record it. (2)

11. An engagement letter should be issued to a new client once instructions have been accepted.

Explain the purpose of an engagement letter. (3)

12. Enhanced relief is available for companies which incur qualifying Research and Development expenditure.

State the conditions that the expenditure needs to meet in order to qualify for enhanced relief. (3)

Place your answers for Part I in the Part I answer folder.

Part II

You must use the Part II answer folder.

Marks are specifically allocated for appropriate presentation.

1. Krystal Ltd is a trading company which was incorporated on 1 May 2011 and its shareholders subscribed for 10,000 ordinary shares at par for £1 per share. Krystal Ltd is a close company.

   Stephen Black is both a shareholder and an employee and has decided to sell his shares in Krystal Ltd. He disagrees with plans for the expansion of Krystal Ltd's operations and all of the shareholders have agreed that the company should buy back his shares. Stephen's shares will be purchased for £29 per share in June 2015, with associated legal costs incurred by Krystal Ltd of £1,200. The directors have decided that the repurchase will be from capital, as permitted by Krystal Ltd's Articles of Association.

   At the same time as the repurchase of his shares, Krystal Ltd will write off a loan of £4,000 which was made to Stephen and a loan of £1,000 that was made to Alex, who works for Krystal Ltd and is being made redundant at the same time. Both loans were made in April 2012. Alex will also receive statutory redundancy pay and an ex gratia payment as a gesture of goodwill as he is part of the Black family. Alex has been made redundant before and therefore he understands the Income Tax implications of the redundancy payments.

   Following Stephen's departure, Krystal Ltd plans to raise funds for the planned expansion via a rights issue. The rights issue offered will be 5,000 £1 shares at £24 each.

   You are required to:

   1) **Describe the tax treatment for Stephen and Krystal Ltd of the repurchase of Stephen's shares.** (4)

   2) **Explain the Corporation Tax treatment of the write-off of the loans made to Alex and Stephen.** (3)

   3) **Explain the Corporation Tax treatment of the statutory redundancy pay and the ex gratia payment made to Alex.** (1)

   4) **Explain the legal requirements for the repurchase of Stephen's shares.** (4)

   5) **State the double entry accounting entries required by Krystal Ltd to record the rights issue.** (3)

   Total (15)

2. You have just received the following email from your manager.

To: Tax senior
From: Mikael Khan
Subject: Response to Walling plc

I am out of the office today but have been contacted by the new tax controller of Walling plc, Dilys Ward, and she needs information about various tax issues.

I have outlined below the four issues that I would like you to research and produce a draft letter suitable for me to send to Dilys on my return. Please remember that Walling plc is a trading company, pays Corporation Tax at the main rate and prepares accounts to 30 June. Assume it is not a small or medium-sized enterprise for any tax purposes.

(a) In August 2011, Walling plc purchased goodwill used in its trade which it plans to sell in June 2015 at a profit. Please explain to Dilys how this profit will be treated for Corporation Tax purposes and whether any actions can be taken to mitigate any taxable amount arising as it intends to re-invest all the proceeds in other intangible fixed assets.

(b) King Inc is a trading company resident in Saturnalia and a 100% subsidiary of Walling plc. Saturnalia charges Corporation Tax at 17% and has no tax treaty with the UK. Walling plc purchases components from King Inc for twice the price that King Inc would normally charge to other customers. Dilys does not intend to make any adjustment in Walling plc's Corporation Tax return for the prices charged as the two companies are in a group.

(c) In March 2015, Walling plc received royalties on one of its patents from an unconnected company resident in Saturnalia. This was after withholding tax, which was charged at the rate of 15%. Please explain the Corporation Tax treatment of these royalties.

Dilys has also told me that Walling plc made significant qualifying charitable donations during the year and she is unsure as to how these will be offset in Walling plc's Corporation Tax computation.

(d) Rocky Ltd is a 95% subsidiary of Walling plc and owns a number of investment properties and shares. Dilys needs to estimate Rocky Ltd's Corporation Tax liability for the year ended 31 March 2015 and has provided you with the following information. Please prepare a draft computation of taxable total profits, and the estimated Corporation Tax payable, with brief notes as to your treatment of the various expenses.

Information from Dilys:	Expenses	Income
	£	£
Total rental income from the investments		810,700
Dividends from UK shareholdings		nil
Bank interest		3,450
Gain on the disposal of the whole of Rocky Ltd's 2% holding in a UK company		10,000
Rent paid on Rocky Ltd's office space	55,750	
Staff costs	65,800	
Service fees to the property management company that manages the investment properties	48,000	
New computer to be used by the office manager	2,000	

Continued

2. *Continuation*

You are required to:

1) **Prepare the draft letter requested by Mikael Khan. Marks will be awarded as follows:**

   (a) **Treatment of goodwill.** (4)

   (b) **Purchase of goods from King Inc.** (2)

   (c) **Royalties and donations.** (2)

   (d) **Rocky Ltd.** (5)

2) **Identify any ethical issues arising from the above scenario and outline how the firm should deal with them.** (2)

Total (15)

3. Pericles Ltd is a UK resident company that sells safety equipment and is looking to expand in both the UK and overseas markets. Pericles Ltd prepares accounts to 31 March each year and pays tax at the small profits rate.

On 1 April 2014, Pericles Ltd purchased the entire share capital of Cerimon Ltd, a company incorporated overseas, but centrally managed and controlled by the UK head office of Pericles Ltd. Cerimon Ltd is a profitable company and Pericles Ltd anticipates dividends to be received in the UK each year.

On 1 April 2014, Pericles Ltd also appointed Marina Gower, a UK resident, as their new operations director, with special responsibility for the overseas expansion.

Marina's employment package is as follows:

(a) An annual salary of £90,000.

(b) A company car for business and private purposes. The car has a list price of £16,000 and CO_2 emissions of 167 g/km. Pericles Ltd pays £14,000 per year under the terms of an operating lease for Marina's car. The car benefit assessable on Marina is £4,160.

(c) All private and business fuel which cost £13,800 for the year. The car fuel benefit assessable on Marina is £5,642.

You are required to:

1) **Calculate the annual after tax cost to Pericles Ltd of employing Marina Gower, with a brief explanation of the National Insurance contributions included in your calculations.** (6)

2) **Explain the Corporation Tax implications for Pericles Ltd of the purchase of Cerimon Ltd and the consequences of any future sale of these shares.** (4)

Total (10)

4. Poppy Ltd ceased trading on 31 December 2014 having previously prepared accounts to 31 March each year. Poppy Ltd was a company selling ceramics and glassware, wholly owned by Sesame Ltd, and its results for the previous three years are as follows:

	Year ended 31 March 2012	Year ended 31 March 2013	Year ended 31 March 2014
	£	£	£
Trading profit	20,000	16,600	16,000
Bank interest	2,000	1,700	650
Property income	1,000	4,400	2,000
Qualifying charitable donations	1,000	1,000	500

Isobel Robertson, the financial controller of Poppy Ltd, has informed you that the trading loss (before capital allowances) for the nine month period ended 31 December 2014 was £78,600. She has also provided the following information:

	£
Tax written down value of the main pool at 1 April 2014	6,200
Tax written down value of the special rate pool (one car) at 1 April 2014	1,000
Disposal proceeds in December 2014:	
Office furniture	500
Machinery	2,900
Car in the special rate pool (used 70% for private purposes)	2,200
Bank interest	700
Property income loss	(300)

Poppy Ltd also made the following disposals in November 2014:

(a) Sale of the freehold of Coriander House for £900,000. The property was purchased in April 2000 for £497,000.

(b) Sale of its 6% shareholding in Cumin Ltd for £45,000. Poppy Ltd purchased 1,000 shares in Cumin Ltd in May 2000 for £12 per share. A one for five rights issue at £14 per share was declared in June 2004 and Poppy Ltd took up all of its rights.

Poppy Ltd was incorporated on 1 April 2004 and Sesame Ltd subscribed for 100% of the shares at that date. Sesame Ltd purchased a warehouse in January 2014 for £890,000, partly financed by a mortgage of £40,000.

You are required to:

1) Calculate Poppy Ltd's trading loss for the period ended 31 December 2014. (4)

2) Calculate Poppy Ltd's taxable total profits for each accounting period up to and including 31 December 2014, assuming maximum loss relief and all claims for rollover relief are made. (14)

3) Explain the VAT consequences of the cessation of Poppy Ltd's trade. (2)

Total (20)

Place your answers for Part II in the Part II answer folder.