Practical Tax People

Association of Taxation Technicians

May 2015 Examination

PAPER 4

Corporate Taxation

Part II Suggested Solutions

Question 1

	Marks
1)	
<u>Repurchase of shares</u>	
As Stephen’s shares have been held for less than five years, the capital conditions	½
are not met and the repurchase will be treated as a distribution.	½
The difference between the repurchase price and the par value of £1 at which	½
Stephen subscribed will be grossed up at 100/90 and taxed at the dividend rates	½
with a corresponding 10% tax credit.	½
For Krystal Ltd, the repurchase is a distribution and therefore not deductible for	1
corporation tax purposes. In addition, the legal fees of £1,200 are not deductible as they relate to a distribution.	½
(4)	
<u>2)</u>	
<u>Write-off of loans</u>	
As Alex is an employee, the amount of the write-off will be treated as employment income. Although Krystal Ltd is a close company, the write–off is not treated as a distribution, due to the amount being treated as employment income.	½
The write off will be treated as a debit on a non-trading loan relationship for	½
corporation tax purposes. The deduction will set against credits on non-trading loan relationships, such as interest receivable.	½
When the loan to Stephen was made in April 2012, a tax charge equal to 25% of the amount of the loan will have been paid by Krystal Ltd, as if it were corporation tax, as the company is close.	½
When the loan is written off, this tax charge will be repaid to Krystal Ltd.	½
The write-off will be treated as a distribution for Stephen and no corporation tax deduction is available for this amount for Krystal Ltd.	½
(3)	
3)	
Statutory redundancy pay is specifically deductible as a trading expense for Krystal Ltd.	½
With regard to the ex gratia payment, as it is non-contractual it is only deductible if it meets the wholly and exclusively test.	½
(1)	
4)	
Relevant accounts must be prepared to determine whether there are available profits to fund the repurchase.	½
A directors’ statement must be issued that Krystal Ltd will remain solvent and carry	½
on business for at least a year. The statement should also specify the amount of the permissible capital payment (PCP).	½
An auditor’s report must support the directors’ statement stating that:	½
- It has inquired into the company’s state of affairs	½
- The PCP is properly determined, in its opinion	½
- The auditor is not aware of any circumstances to indicate the directors’ opinion is unreasonable.	½

A special resolution must be passed not later than one week after the directors' statement.	½
The notice of the statement must be published in the Gazette or a national newspaper within one week of the resolution.	½
The PCP must be made by Krystal Ltd not less than five nor more than seven weeks after the special resolution is passed.	½

(Max 4)

5)

The double entry required is:

	£	
Dr Bank	120,000	1
Cr Share capital	5,000	1
Cr Share premium account	115,000	1

(15)

Question 2

1)

Marks

Our address
Date

Your address 1

Dear Dilys

I have set out below a response to your email outlining various issues concerning Walling plc.

1. <u>Goodwill</u>

As the goodwill that you plan to sell was purchased in August 2011, any gain will be treated as a trading profit, subject to corporation tax. This will normally be the accounting gain, unless a different basis of claiming writing down allowances has been elected.	½ ½
If another intangible fixed asset (IFA) is purchased within 12 months before and 36 months after the sale of the original goodwill, rollover relief will be available.	½ ½
Assuming all of the sale proceeds are reinvested, the amount rolled over is the amount by which the proceeds of realisation exceed the cost of the original asset purchase.	½ ½
The difference between the gain on disposal and the amount rolled over is taxed as a trading credit in the corporation tax computation.	½
The cost of the new IFA, for tax purposes, is reduced by the amount of the gain rolled over.	½

(Max 4 including presentation)

2. <u>Purchase of goods from King Inc</u>

As Walling plc controls King Inc and is not an small or medium sized enterprise for tax ½
purposes, transfer pricing rules apply to the transactions between Walling plc and King ½
Inc.

Walling plc has gained an advantage as a result of the non-arm's length price charged. ½
An adjustment should be made in the tax computation of Walling plc. The adjustment
cannot be avoided because the companies are in a group. The adjustment should be ½
made on Walling plc's corporation tax return and records kept regarding the arm's ½
length price.

(Max 2)

3. <u>Royalties and donations</u>

The royalties are a source of overseas income and will be subject to corporation tax as ½
part of Walling plc's taxable total profits.
Double tax relief will be available on the lower of the overseas tax paid at 17% and the ½
UK corporation tax payable on the overseas profits at 21%. ½

The qualifying charitable donations made by Walling plc should be offset against its UK
income, in preference to the overseas income from Saturnalia. This will preserve the ½
maximum amount of double tax relief on the overseas income. ½

(Max 2)

4. <u>Rocky Ltd</u>

Rocky Ltd's estimated taxable total profits are £652,600, as shown in Appendix 1, and I have included notes as to the tax treatment of the various items. This results in a corporation tax liability of £137,046.

Please feel free to contact me if you have any further questions.

Yours sincerely

Mikael Khan

Appendix 1

	£	£	
Bank interest		3,450	½
Rental income	810,700		
Service fee	(48,000)		½
		762,700	
Chargeable gain		10,000	½
Less: management expenses			
Rent on office space		(55,750)	½
Staff costs		(65,800)	½
Capital allowances on the new computer (AIA)		(2,000)	½
Taxable total profits		652,600	
Corporation tax on £652,600 x 21% (2 associates)		£137,046	½

Notes:

The service fee relates directly to the rental activities and is therefore deductible against that source of income.	½
The rent and staff costs are management expenses relating to the business as a whole and are therefore deductible against total profits.	½
The capital allowances are also management expenses, assuming that the office manager's job is not solely related to the rental business.	½

(5)

2)

Ethical issues:

The senior should raise the issue of Dilys not agreeing to make the transfer pricing adjustment which may constitute tax evasion.	½
The firm may have to consider resignation.	½
In addition an incorrect return may constitute money laundering, in which case the MLRO	½
should be informed and further procedures considered.	½

(Max 2 – credit will be given for any other suitable comments)

(15)

Question 3

1)

Cost of employing Marina	£	£	Marks
Allowable costs:			
Salary		90,000	½
Provision of the car - 85% x £14,000		11,900	½
Cost of fuel		13,800	½
Class 1 secondary NICs			
£(90,000 – 7,956) x 13.8%		11,322	1
Class 1A NICs			
£(4,160 + 5,642) x 13.8%		1,353	1
Total allowable cost		128,375	
Less: corporation tax relief		(25,675)	½
£128,375 x 20%			
Add: disallowable lease costs			
Marina's car			
15% x £14,000		2,100	1
Total cost of employing Marina		104,800	

Notes on National Insurance contributions:

Class 1 secondary contributions are payable on Marina's salary, but not benefits.	½
Class 1A contributions are payable on the taxable amount of her car and fuel benefit.	½

(6)

2)

As Cerimon Ltd is centrally managed and controlled from the UK, despite being	½
incorporated overseas, it is a UK resident company. Therefore, any dividends received by	½
Pericles Ltd are from a UK company and therefore exempt.	½
In addition, the purchase of Cerimon Ltd creates an additional associate for Pericles Ltd in the determination of its applicable corporation tax rate.	½
As Cerimon Ltd is a UK resident company for tax purposes and Pericles Ltd owns at least 75% of the share capital, group relief surrenders may be made between the two companies.	1
The sale of the Cerimon Ltd shares may benefit from the substantial shareholding	½
exemption, meaning that any gain or loss will be exempt from corporation tax. Whilst the	½
10% shareholding and 12 month holding period is met, the exemption will only apply if	½ + ½
Cerimon Ltd is a trading company. Otherwise, any gain on disposal will be subject to corporation tax.	½

(Max 4)

(10)

Question 4

1)

Trading loss for the nine month period ended 31 December 2014:

	£	Marks
Trading loss per the question	(78,600)	
Less: capital allowances (W1)	(1,600)	½
Trading loss	(80,200)	

W1 – Capital allowances

	Main pool	Special rate pool	Allowances	
	£	£		
TWDV b/f	6,200	1,000		
Disposals				
Plant - £(500 + 2,900)	(3,400)			2 x ½
Car		(2,200)		½
Balancing allowance	2,800		2,800	½
Balancing charge		(1,200)	(1,200)	1
Total capital allowances			1,600	
No WDAs				½

(4)

2)

	Y/E 31 March 2012	Y/E 31 March 2013	Y/E 31 March 2014	Period ended 31 December 2014	
	£	£	£	£	
Trading profit	20,000	16,600	16,000	nil	½
Bank interest	2,000	1,700	650	700	½
Property income	1,000	4,400	2,000	-	½
Chargeable gains (W1)	-	-	-	32,919	½
Total profits	23,000	22,700	18,650	33,619	
Rental income loss				(300)	1
Less: terminal loss relief	(5,531)	(22,700)	(18,650)	(33,319)	4 x ½
Qualifying charitable donations	(1,000)	(wasted)	(wasted)	nil	1
Taxable total profits	16,469	nil	nil	nil	½

W1 – chargeable gains

	£	£	£	
Coriander House				
Sales proceeds		900,000		½
Less: cost		(497,000)		½
Less: indexation		(259,434)		1
258.9 – 170.1/170.1 = 0.522 x £497,000				
Gain before group rollover relief		143,566		
Rollover relief		(133,566)		½
Proceeds not reinvested £(900,000 – 890,000)			10,000	1
Shares in Cumin Ltd				
Sales proceeds		45,000		½
Less: Indexed cost (W2)		(22,081)		
Chargeable gain			22,919	
Total			32,919	

W2 – Cumin Ltd share pool

	Number	Cost	Indexed cost	
May 2000 - purchase	1,000	12,000	12,000	½
Indexation to June 2004 186.8 – 170.7/170.7 x £12,000			1,132	1
Rights issue @ £14	200	2,800	2,800	1
Total			15,932	
Indexation to November 2014 258.9 – 186.8/186.8 x £15,932			6,149	1
Total indexed cost			22,081	

(14)

3)

On cessation of trade, Poppy Ltd must deregister for VAT purposes within 30 days. ½

In addition, if there is any stock or other assets on hand on cessation upon which input tax has been claimed, then output tax must be accounted for on the replacement value, unless the total amount of output tax is no more than £1,000. 3 x ½

(2)

(20)