May 2022 Examination

PAPER 4

Corporate Taxation

Part I Suggested Answers

Candidates will be given credit for relevant points not on the mark scheme.

1.	FYA @100% £	FYA @50% £	General pool £	Special rate pool £	Allowances £	
WDV b/f			3,575,000	125,600		
Additions						
Car 45g/km			27,500			(½)
Electric car	30,000					(½)
Electric lighting system		250,000				(½)
Disposals:						
Equipment			(25,000)			(½)
			3,577,500	125,600		
Allowances						
FYA @ 100%	(30,000)				30,000	(½)
FYA @ 50%		(125,000)			125,000	(½)
WDA @18%			(643,950)		643,950	(½)
WDA @6%				(7,536)	7,536	(½)
Transferred to Special rate pool		(125,000)		125,000		(½)
WDV c/f			2,933,550	243,064		
Total allowances					806,486	

Max 4 marks

2. Calculation of input VAT credit for Greenham Ltd for the quarter ended 31 January 2022

	VAT £	
Accountancy fees – as the invoice is mislaid the company has no evidence available, without evidence this input VAT cannot be recovered. (½)	-	(½) ~~(1)~~
Home telephone bill -50% business element is recoverable. (½)	34	(½) ~~(1)~~
Purchase of motor car – input tax not recoverable as it is available for private use (½)	-	(½) ~~(1)~~
Purchase of plant and machinery - used in the business so there is a direct and immediate link with taxable supplies made by the business. (½)	3,000	(½) ~~(1)~~
VAT input credit	3,034	

4 marks

3. Courtfield Ltd

	£	£	
Accounting profit		752,131	
Add back:			
Depreciation	75,100		(½)
Entertaining customers (staff entertaining is allowable as for the purposes of the trade(½))	2,000		(½) ~~(1)~~
Loss on sale of fixed asset	4,500		(½)
Donation to a registered charity (relief as a QCD not as a trading deduction(½))	1,500		(½) ~~(1)~~
Directors' bonuses not paid within 9 months of year end	60,000		(½)
		143,100	
Tax-adjusted trading profit before capital allowances		895,231	(½)

4 marks

4.

	£	£	
Dr Directors' loan account (Balance sheet)	100,000		(½)
Cr Bank/Cash (Balance sheet)		100,000	(½)
Dr Salaries (P&L expense)	75,000		(½)
Cr Directors' loan account (Balance sheet)		75,000	(½)

2 marks

5. As Fleming Ltd is a small company for the purposes of off-payroll working, it is Steve (the worker) that is responsible for determining whether or not the rules apply. (½)

If Arnott Ltd is subject to personal service company rules, a deemed salary payment will need to be calculated.(½) The deemed salary payment is calculated by taking the income received by the company (½) and deducting 5% of turnover from this amount. (½) Expenses paid by Arnott Ltd which would be deductible from taxable earnings if met by Steve are also deductible, (½) as are actual salaries and benefits paid to Steve. (½)

The resulting gross deemed payment will be subject to Employers' National Insurance at the rate of 13.8% / 113.8%.(½) Steve will be subject to PAYE and Class 1 NIC on the resulting net deemed payment, as if had been paid as salary. (½)The payment will be deemed paid to Steve on 5 April. (½)

Max 4 marks

6.

	£		
Bonus	10,000	Classed as earnings so Class 1 NIC payable	(½)
Pension contributions	5,000	Not subject to NIC	(1)
Medical insurance	750	Non cash benefit (½) subject to Class 1A NIC	(½~~1~~)
High Street store voucher	100	Classed as earnings (½) so Class 1 NIC payable	(½)

Max 3 marks

7. Augmented profits for the year are calculated by adding taxable total profits (TTP) and dividends received from companies which Dorothea Ltd owns less than 50%.(½) Dorothea Ltd therefore has augmented profits of over £20 million (£19,500,000 + £1,500,000 = £21,000,000) (½) and therefore is a very large company. (½)

   Very large companies must make their instalment payments as follows:

   1. 14th day of month three from the start of the accounting period, 14th March 2021. (½)
   2. Subsequent payments are due in three months intervals after the previous instalment, 14 June 2021 (½) and 14 September 2021. (½)
   3. Final payment is due on 14th day of the final month of the accounting period, 14 December 2021. (1)

   4 marks

8. Since 5 April 2019 disposals of interests in UK land (½) by a non UK resident company (½) are subject to corporation tax (½) on the chargeable gain that arises on the disposal of that land (½). Musikanten Ltd will therefore have to complete a corporation tax return to show the gain that is made if it does dispose of the land (½) and pay corporation tax on any liability that arises. (½).

   3 marks

9. As Colossus Ltd has not fully reinvested the proceeds from the sale, full rollover relief will not be available.

	£	
Proceeds	1,500,000	(½)
Less: cost	(900,000)	(½)
	600,000	
Less: indexation((278.1 – 261.1)/261.1) = 0.065 x 900,000	(58,500)	(1)
	541,500	
Less: Rollover relief (restricted by the amount not reinvested)	(341,500)	(½)
Gain (1,500,000-1,300,000)	200,000	(½)

The £341,500 will be rolled over and reduce the base cost of the new building:

	£	
Cost	1,300,000	(½)
Less: rolled over gain	(341,500)	(½)
Base cost of new asset	958,500	

4 marks

10. Rachel is associated with Paul as he is Rachel's spouse (½) and Robert as he is her brother (½). She is not associated with Sally, as Sally is only her sister-in-law. (1)

The company is close (½) as it is under the control (>50% of share capital etc. (½)) of five or fewer participators (½) being:

Rachel (and associates)	38%		(½)
Sally	5%	}	
Any other shareholder	5%	}	(½)
Any other shareholder	5%	}	
	53%		

Max 4 marks

11. Interest is generally taxable and deductible on an accruals basis. (½)

However, interest is deductible when it is paid if:

- it is payable to a participator (or their associate) in a close company and (½)
- it has not been paid within 12 months of the end of the accounting period and (½)
- it has not been taxed under the loan relationship rules in the hands of the recipient. (½)

As Thorne Ltd is a close company having only one shareholder, (½) the interest payable to Laura is not deductible in Thorne Ltd during the year ended 30 June 2021(½) but will be deductible in the year ended 30 June 2023 (½) which is the year in which it was paid to Laura. (½)

4 marks

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Candidates will be given credit for relevant points not on the mark scheme.

12.

1) The loss arising in the year to 31 December 2021 is relieved as follows –

	£	
Chargeable gain	250,000	
NTLR	20,100	
Profit	270,100	(½)
Less		
Current year offset	(270,100)	(½)
Total	NIL	(½)
Donation to charity unrelieved	0	

A claim for carry back of loss can be made as follows:

Six-month period to 31 December 2020

	£	
Trade profit	1,600,000	
Chargeable gain	100,600	
Total	1,700,600	(½)
Normal loss carried back from 2021	(1,700,600)	(½)
Donation to charity (unrelieved)	nil	(½)
TTP	nil	(½)

Loss carried back to year ended 30 June 2020

	£	
Trade profit	4,400,900	(½)
Loss carried back from 2021 Normal relief (6/12)	(2,200,450)	(½)
Temporary loss carried back extension from 2021 with £2m cap (½)	(2,000,000)	(½)
Donation to charity	(750)	(½)
TTP	199,700	(½)

Loss memorandum

	£	
Loss incurred in 2021	6,680,000	
Current year offset	(270,100)	

Offset against profits in period to 31 Dec 2020	(1,700,600)	
Offset in year to 30 June 2020	(4,200,450)	
Loss carried forward	508,850	(½)

The repayment of tax for the 6 months to 31 December 2020 will be 19% x £(1,700,600 - 750) = £322,972 (½)

The repayment of tax for the year to 30 June 2020 will be 19% x £4,200,450= £798,086 (½)

8 Marks

2) The claims for current year and extended carry back (½) offset must be made by notifying HMRC within two years of the end of the accounting period in which the loss arose. (½)
As the loss to be offset arose in the year to 31 December 2021(½), the claim must be made by 31 December 2023. (½)

2 Marks

(Total 10 Marks)

13.

1) The structures to be considered are either a company resident in the overseas jurisdictions (½) or a branch of Northey Ltd. (½)

A company resident overseas will be taxed(½) in that overseas country so generally it would be more tax efficient to use the company structure in a country with a lower tax rate than in the UK (½) if it is likely that profits will arise (½) in that business. Also to be considered is what deductions can be obtained in the overseas country – for example for capital allowances and loan interest deductions as the business will be subject to the overseas tax regime. (½) A further consideration (as cash flow is an issue for the company) is the timing of tax payments in the overseas jurisdiction. (½)

If a loss arose in this business, it could not be offset against the UK profits (½) and would be subject to the loss offset regime of the overseas country. (½)

Also to be considered is the UK tax on any income remitted by the overseas company. (½) If this is in the form of a dividend they are usually exempt from UK tax. (½)

Also an overseas subsidiary will be a group company for determining if Northey Limited is subject to the QIPS regime, (½) which might be a cash flow consideration.

Capital allowances are available for expenditure on plant and machinery used in an overseas branch. (½)

If it is likely that losses will arise in the overseas business (½) then it would be more efficient to operate as a branch of the UK company (½) as losses could be offset against UK profits. (½)

It may also be tax efficient to operate as a branch if the overseas jurisdiction has a higher tax rate than the UK – however the branch's profit may also be taxed in the overseas country (½) so consideration should be given to the availability of double tax relief in the UK. (½)

It is possible to elect (½) to have foreign branch profits exempt from UK corporation tax. (½) However if the branch is loss making, they cannot be offset against the UK profits. (½) Such an election applies to all branches of the UK company (½) and once made is irrevocable. (½) It is effective from the first accounting period after the period in which the election is made. (½)

Maximum 10 Marks

2) Northey Ltd UK CT

	£	£	
UK income		1,000,000	
Overseas Income	200,000 x 100/75(½)	266,667	(½)
Total taxable		1,266,667	
UK tax @ 19 %		240,667	(½)
Double Tax relief			
Lower of (½)			
266,667 @19%(½)	50,667(½)	(50,667)	
And			
Overseas tax paid	66,667(½)		
Tax payable		190,000	(½)

The dividend received will be exempt from UK tax (½) and no credit will be given for the overseas tax suffered. (½)

5 Marks

(Total 15 Marks)

14.

To Adam Simons, Business Development
From A Tax Advisor
Date 4 May 2022

Subject Your email re R&D

Presentation (1)

Adam

Thanks for the email. It is great that the seminar provoked so much interest.
I can answer the specific queries as follows-

1) AP Developments Ltd – the following expenditure is qualifying for the purposes of R&D (and it must be revenue in nature (½) and related to a trade (½) carried on by the company)

- Staff costs directly related(½) to the R&D project. Support staff costs (i.e., not directly related) are not eligible (½)
- Software expenditure – if the software is directly used in the R&D project (½)
- Costs of subcontractors or external workers (½) directly related to the project
- Costs of consumables (½)

The size of company is relevant to the amount of R&D relief and the way in which it is given, (½) as follows

- For a small or medium size company(½) (being one which has fewer than 500 employees (½)and either turnover not exceeding €100m or annual balance sheet not exceeding €86m(½)) the relief is given as an additional deduction(½) from taxable profits, being an extra 130% of qualifying expenditure(½). The SME limits are divided amongst all linked companies in a group. (½)
- For large companies (i.e. those that do not meet the definition of SME) the relief is given by means of an R&D expenditure credit (RDEC) (½). The RDEC is a taxable receipt in calculating profits for an accounting period (½) equal to 13% of the qualifying expenditure. (½) As the RDEC is taxable, it provides an effective benefit of 10.53% based on the current tax rate of 19% ((1-0.19) x 13%). (½). The relief is paid as a reduction in the company's tax liability. If the RDEC is greater than the tax liability for a period a cash repayment may be made subject to certain conditions. (½)

Also there is a 100% capital allowance(½) for capital expenditure (½) on assets used in qualifying activities. .

Max 10 Marks

2) Swinbrook Ltd – it is possible for a loss making company which is an SME to obtain a cash refund from HMRC (known as an R&D Tax credit) (½)
This is obtained by surrendering part of the tax losses. For Swinbrook Ltd this is calculated as follows –

	£	
The surrenderable amount is the lower(½) of		
The trading loss	1,500,000	(½)
and		
230% (½) of the qualifying R&D expenditure		
£58,000 x 230%	133,400	(½)
Amount surrendered	**133,400**	
Tax credit given (i.e. cash refund) (½)	**19,343**	(½)
14.5% (½) £133,400		

As the tax credit is less than £20,000 there is no need to consider the PAYE cap(½)
Trading loss carried forward in Swinbrook Ltd will be £1,500,000 - £133,400 (½)**= £1,366,600**(½)

Max 5 Marks

3) CN Group Ltd. I note that you have requested that we undertake the review of CN Group Ltd without an engagement letter. Although it isn't compulsory for an engagement letter to be issued, (½) it is recommended. (½)
The status of the engagement letter is

- It defines the terms (and limitations) of the work we will (½) do and asks the client to agree these; (½) (i.e. for CN – a review of their R&D)
- We can use it to manage the client's expectations as to what the work will achieve(½) (i.e. – within CN Group, we are reviewing the R&D expenditure for tax deductions)
- Our insurers normally require an engagement letter, as the lack of one is seen as a litigation risk (½)
- The engagement letter protects us in the event of a professional negligence claim(½)
- It records the terms of our engagement (i.e., for CN, what they have asked us to do, the fee involved, which staff member will do the work) (½)
- We use it to advise the client of our standard terms of business(½) and also our privacy notice. (½)

5 Marks

(Total 20 Marks)

I hope these notes prove useful and that your forthcoming meetings are successful

Regards

A. Tax Advisor

15.

1) The parent of a chargeable gains group is referred to as the principal company. The general rule is that companies form a chargeable gains group where there is 75% direct ownership (½) and not less than 51% effective ownership by the principal company. (½) Ashburton Ltd is the principal company in this scenario. It owns at least 75% (½) of Burn Ltd and Cactus Ltd (½) and so they are in a corporate gains group. (½)

   Companies that are at least a 75% subsidiary of another company cannot generally be the principal company of a group so that companies can only be a member of one chargeable gains group. (½)

   Devonian Ltd is an indirect sub – subsidiary of Ashburton Ltd (72% indirect ownership) (½) and so forms a group with Ashburton Ltd. Also, Elderwood Ltd is a sub-subsidiary of Ashburton (67.5% ownership). (½)

   However Fairy Ltd is not in the group with Ashburton Ltd as there is less than a 51% indirect ownership (it is 47%) . Fairy cannot be in a gains group with Elderwood Ltd as Elderwood Ltd is a 75% (½) subsidiary.

The gains group is therefore Ashburton Ltd, Burn Ltd, Cactus Ltd, Devonian Ltd, Elderwood Ltd but not Fairy Ltd. (½)

Max 4 Marks

2) The brought forward loss in Burn Ltd cannot be transferred to Ashburton Ltd as it is out of time to make the election to transfer. (½) This must be done within 2 years of the end of the accounting period in which the loss arose. (½)
Ashburton Ltd should therefore elect to transfer part of its gain to Burn Ltd to use the brought forward loss and the current year loss.
Maximum loss offset for full relief is £2,500,000 (due to the sharing of the group deductions allowance) (½)

Burn Ltd

	£	
Brought forward capital losses	1,500,000	
Current capital year losses	300,000	
Total losses	**1,800,000**	(½)

Ashburton Ltd should therefore elect to transfer £1,800,000 of its gain to Burn Ltd, and result in Burn Ltd having a taxable total profit of £nil. This will leave (£3,000,000 - £1,800,000) £1,200,000 of the gain chargeable in Ashburton Ltd. (½)
This can be partially offset by the trading loss as follows –

	£	
Gain	1,200,000	
Less current year trading loss	(250,000)	(½)
Total Taxable profits	950,000	(½)

Tutorial note: More of the gain could have been transferred to Burn Ltd giving a positive taxable total profit in Burn Ltd and a smaller taxable total profit in Ashburton Ltd.

3 Marks

3) Cactus Ltd Total taxable profits

	£	**£**	
Trade profit		15,000,000	
Chargeable gains	£5,000,000		
Offset – current year loss transferred from Elderwood Ltd	(450,000)		
Gain		4,550,000	(½)
Total taxable profits		19,550,000	(½)

The brought forward loss cannot be offset as it is a realised pre-entry loss. **(½)**

Elderwood Ltd

	£	**£**	
Gain	50,000		
Less brought forward loss	(50,000)		(½)
(property bought for use in the trade)			
Gain brought into charge to CT	-		(½)
Capital Loss Memo			

Carried forward loss	£600,000		
Less loss utilised	(50,000)		(½)
Carried forward loss	£550,000		(½)

3 Marks

4) A warranty is given by the seller of the company to the buyer. (½) A warranty is a specific statement of facts about the affairs of the company (½), or that the affairs are as otherwise disclosed. (½)
An example of a tax warranty is that all VAT liabilities have been paid and all returns have been submitted. (½) An example of a disclosure is that the company had submitted a corporation tax return after the due date. (½)
A breach of a warranty can lead to a claim by the buyer against the seller if the buyer can show that they have suffered a loss. (½)
An indemnity is an undertaking made by the seller that they will pay to the company or to the purchaser (½) a tax liability arising. (½) . A loss does not have to be proven (½) An example of an indemnity is a promise to pay a corporation tax liability that has arisen for an accounting period prior to the sale of the company. (½)

5 Marks

(Total 15 marks)