PROFESSIONAL LEVEL

TUESDAY 7 DECEMBER 2021

2.5 HOURS

BUSINESS PLANNING: TAXATION

This exam consists of **three** questions (100 marks).

Marks breakdown

Question 1	40 marks
Question 2	30 marks
Question 3	30 marks

Assume that the Finance Act 2020 rates and allowances as set out in the ICAEW Learning Materials for exams in 2021 will continue to apply for 2020/21 and future years unless you are specifically instructed otherwise.

The link to the ICAEW bookshelf can be found in each question above the word processing area.

Important Information:

1. Please read the instructions carefully before you begin your exam.

Starting and ending the exam

2. Click on the **right arrow** in the header to begin the exam. The exam timer will begin to count down.

3. A warning is given five minutes before the exam ends. When the exam timer reaches zero, the exam will end. To end the exam earlier, navigate to the last question and click the right arrow button. Click the **Submit** button to close the exam.

Encountering issues during the exam

4. If you encounter any issues during the delivery of the exam you should alert the invigilator (or online chat support if you are sitting remotely). Neither the invigilator nor the online chat support can advise you on how to use the software.

Preparing your answers

5. Respond directly to the exam question requirements. Do not include any content of a personal nature, this includes your name or any other identifying content.

6. You may use a pen and paper for draft workings. Any information you write on paper will not be read or marked.

7. The examiner will take account of the way in which your answers are structured. You must make sure your answers and workings are clearly visible in the word processing area when you submit your exam. **Only your answer in the word processing area will be marked.** You must copy over any data from the spreadsheet area to the word processing area for marking. The examiner will **not** be able to expand rows or columns where content is not visible.

After the exam

8. If you are sitting in an exam centre and believe that your performance has been affected by any issues which occurred during the exam, you must inform your invigilator at the time of occurrence and follow up with

ICAEW directly after your exam. You will then need to submit a special consideration application to ICAEW if you wish us to consider such issues, as per our published policy. If you are sitting remotely please submit your special consideration application referring to anything of note which occurred and will have been recorded, for use as evidence to support your case.

9. A student survey is provided post-exam for feedback purposes.

Question 1

You are an ICAEW Chartered Accountant working in practice as a tax adviser. Your personal tax client, Joe Higgins, has written to you asking for some tax advice. An extract from the letter is in **Exhibit 1**.

Background information:

Joe is 59 years old. For the last three years he has been employed on a fixed term contract, as a senior manager in the IT department of Cowford University. Joe's fixed term contract ends on 31 December 2021.

Joe intends to have a few months off work in order to project manage some building work on his own home, before he starts his next contract in April 2022. He intends to sell some investments and use his redundancy pay to fund the building work. Details of the two contracts being offered to him from April 2022 are shown in **Exhibit 2**.

Joe rang your office two days ago asking for advice about a proposed tax-saving scheme. Notes of the telephone conversation are in **Exhibit 3**.

Requirements

1. Advise Joe how much net after-tax cash he will receive from his redundancy pay and the sales of investments in January 2022 (Exhibit 1).

2. Advise Joe on the tax consequences of undertaking each of the two contracts offered to him, starting in April 2022 (Exhibit 2).

   Your answer should include:

   - calculations of the net after-tax cash he would receive from each contract for the 2022/23 tax year, together with a recommendation about which contract should be accepted and;

   - notes of any assumptions you have made or any further information you would need to make a full recommendation.

   Assume that each contract will commence on 6 April 2022.
   Ignore the contents of Exhibit 3 in answering this part of the question.

3. Explain the tax and the ethical implications of the proposed tax-saving scheme and any actions you should take. (Exhibit 3).

Total: 40 marks

Exhibit 1: Extract from Joe Higgins' letter

As you are aware, I have been working for Cowford University as a fixed-term employee since 1 January 2019 and my three-year, fixed term, employment contract will end on 31 December 2021. My salary at Cowford University was £48,000 pa and I will receive statutory redundancy pay of £2,421; when my contract ends.

I intend to take time off from January to March 2022 and I'll start work again in early April 2022.

I intend to sell some investments I have made to provide funds for the first three months of 2022.

In January 2022 I will sell:

<u>10,000 shares in Tiger VCT plc</u>

Tiger VCT plc is a venture capital trust company. I subscribed for these shares in June 2019 at £2 per share. I receive annual dividends from Tiger VCT plc. In November 2021 I received a dividend of £1,000. I estimate that the shares will have a current market value of £10 each.

The money to buy these shares came from a cash gift of £20,000 from my aunt in June 2019. Sadly, she died in October 2021. I received nothing more from her estate on death because she gave away most of her £10 million estate to my cousins, just before she made the gift of £20,000 to me.

<u>4,000 shares in IT Management Ltd</u>

IT Management Ltd is a qualifying enterprise investment scheme company.

I subscribed for the shares when issued in July 2019, at £10 each. I receive annual dividends from these shares on 1 December. On 1 December 2021 I received a dividend of £1,500. I estimate that the shares will have a current market value of £30,000.

To purchase these shares, I sold a stamp collection inherited from my father many years ago. I sold the collection for £40,000 in January 2020. According to my father's probate papers, it was valued at £2,500 on his death.

<u>An apartment in Manchester</u>

I bought an apartment for £100,000 (plus stamp duty land tax and solicitor's fees of £850) when my daughter went to university in Manchester in 2018. I financed this with a £100,000, interest-only mortgage, which will need to be repaid on sale. My daughter has now left university, and I have agreed a sale of the apartment for £150,000.

Exhibit 2: Details of two alternative contracts offered to Joe Higgins

Joe registered with an IT recruitment consultant a few months ago and the consultant has offered him the choice of two contracts, both starting in April 2022. Details of each contract are as follows:

<u>Contract 1</u>

This contract is with Cowford University, his former employer, and will be for 12 months. Joe will manage an IT project that is expected to deliver a new IT service by the end of the 12-month contract.

Joe was offered this contract because of his unique skills and knowledge. Joe will be expected to work normal office hours, five days a week, and he will be eligible for holiday and sick pay.

The contract is worth £65,000 for the 12 months and he will be paid monthly.

Cowford University will pay 21% of the monthly contract fee into an occupational pension scheme, and Joe will also pay 8% into this scheme.

<u>Contract 2</u>

This contract is with Aioli plc, a technology consulting company, and will be for 12 months, to manage a single IT project.

This project is generic and so Joe has already agreed that his friend Mike can manage the project, if Joe needs time off sick.

The contract is worth £65,000 for the 12 months, but Joe will not be eligible for any holiday pay, sick pay, or pension contributions.

Aioli plc will not stipulate Joe's working hours and they will measure his success based on the progress he makes with the project.

Exhibit 3: Notes of a telephone conversation with Joe Higgins.

Joe's IT recruitment consultants are suggesting that, whichever contract he chooses, he should provide his services to the client through a managed service company, ITServices Ltd.

They also state that this company uses a tax-saving scheme which will reduce the tax and NICs payable by Joe and that this scheme is 'HMRC compliant'. Evidence of HMRC compliance is that the tax-saving scheme used by ITServices Ltd has a scheme reference number.

Under this tax-saving scheme, Joe would be paid a small salary every month by ITServices Ltd, net of PAYE.

The balance of Joe's contractual entitlement each month (a much larger payment) would then be paid to him by an overseas company, ITServices (Overseas) GmbH, in the form of a loan. No PAYE would be deducted from this loan.

A fee of 10% of Joe's gross contractual entitlement would be paid to ITServices Ltd for use of this scheme.

Question 2

You are an ICAEW Chartered Accountant acting as tax adviser to BD plc.

BD plc runs a successful chain of convenience stores in the UK.

BD plc is owned in equal shares by Samantha and Paula Green. Samantha and Paula are sisters and started BD plc with one convenience store in 1995. The company now operates 323 stores nationwide.

BD plc prepares accounts and VAT returns to 31 March annually and is registered for VAT, making a mixture of standard-rated, zero-rated, and exempt supplies of goods.

Proposed purchase of Alco plc

BD plc made a bid to purchase 100% of the issued share capital of Alco plc. Alco plc is well-established in the UK and operates both large supermarkets and convenience stores and is valued at £700 million.

In preparation for a meeting with the BD plc team, managing the purchase of Alco plc, your manager has asked you to prepare some notes, identifying the tax consequences of specific aspects of the proposed deal to buy Alco plc and the subsequent sale of Alco plc's convenience stores to BD plc.

The terms of the proposed purchase of Alco plc are set out in **Exhibit 1**

Tax advice for Samantha and Paula Green

Samantha Green has e-mailed you to ask for some tax advice. An extract from her email is reproduced in **Exhibit 2**. Samantha and Paula are planning to buy a private island and live there and want to understand the potential impact on their personal tax liabilities if they do so.

Requirements

1. Using the information in Exhibit 1, prepare notes for your manager to identify, explain and calculate the tax consequences of:

   (a) the sale and leaseback of BD plc's warehouse complex;

   (b) the sale of Alco plc's convenience stores to BD plc.

2. Following on from part 1 of your answer, evaluate the differences for tax purposes between financing the remainder of the purchase price through either debt or equity. You should recommend which method of financing would be preferable for tax purposes.

In each part of your answer to requirements 1 and 2, identify any further information you would need, in order to provide your advice to BD plc.

3. Advise Samantha and Paula about the capital gains tax and inheritance tax consequences of making lifetime or death gifts of their assets to their children, once they have relocated to live on the private island (Exhibit 2).

Total: 30 marks

Exhibit 1: Terms of the deal to purchase Alco plc

The proposed date of purchase of Alco plc is 1 March 2022.

To finance the purchase, BD plc will pay £100 million in cash and will finance the remaining £600 million as follows:

- BD plc will raise funds to help with the purchase by selling its freehold warehouse complex to Expedite plc, an unconnected company, for £95 million on 1 February 2022.

  The warehouse complex:

  - cost £75 million and was bought new from the developer on 1 March 2018;
  - is used 80% for taxable supplies and 20% for exempt supplies;
  - will have selling costs of £500,000;
  - will be the subject of an option to tax election, by BD plc on 1 January 2022;
  - is not a part of the BD plc business that is capable of separate operation;
  - will be leased back on a 25-year lease from Expedite plc for £5.7million pa. There will be no lease premium payable on the grant of the lease.

- The remaining part of the purchase price, will be financed by either:

  - A public offering of shares in BD plc; or
  - BD plc raising debt on public markets.

Alco plc makes consistent pre-tax profits of £50 million pa.

If the purchase of Alco plc is financed by equity, investors will expect a minimum annual dividend of 4p per £1 (nominal value) share.

If the purchase of Alco plc is financed by debt, the interest rate is predicted to be 3.5% pa at current rates.

After the purchase of Alco plc, it is intended that BD plc will concentrate on convenience stores and Alco plc on supermarkets. Therefore, immediately after the purchase of Alco plc on 1 March 2022, Alco plc’s existing convenience stores will be sold to BD plc for £75 million.

Exhibit 2: Extract from email from Samantha Green

Paula and I have seen a private island for sale, just off the coast of the island of Guernsey. As I am sure you already know, residents of Guernsey, and the surrounding islands, are not resident in the UK for tax purposes.

Given our ability to run our businesses remotely, using technology, we think that we could live and work from this island full-time, only visiting the UK mainland for 10 to 15 days a year. Paula and I are in our 50s and we are thinking about how much UK tax we would pay if we disposed of our businesses, or passed them on to our children, either now, or when we die.

You may recall that we each have two children, and they are all in their late twenties.

Please could you advise us about the capital gains tax and inheritance tax consequences of gifting our assets to our children now, or on death, assuming we have already moved to the island?

Question 3

You are an ICAEW Chartered Accountant working for a firm of tax advisers. Yi-Ling Zhao, a new client, is meeting you next week to discuss her tax affairs.

Yi-Ling recently graduated from university with a PhD in computer science. During her studies she developed a revolutionary app that uses artificial intelligence to monitor certain health conditions; the app provides early warning for medical practitioners of events such as strokes and heart attacks, allowing for early intervention with patients and has the potential to save lives.

Yi-Ling plans to set up her own business to sell the app to healthcare bodies. She requires advice about how to set up the business in the most tax efficient way.

In advance of the meeting Yi-Ling completes a new client questionnaire and provides you with some information about herself and the tax advice she requires (**Exhibit 1**). She also provides you with extracts from her business plan (**Exhibit 2**).

The financial investment needed to set up the business will be provided by a loan of £350,000 from Professor Thomas, Yi-Ling's PhD supervisor.

Requirement

Prepare for your meeting with Yi-Ling by:

(a) Identifying and explaining the tax payable by Yi-Ling and her business, for the first three years of trade, depending on whether she operates the business as either an unincorporated business or as a company.

Your answer should include calculations of the tax payable by Yi-Ling and the business, under each alternative business structure, for the first three years of trade.

In answering this part of the question, you should assume that the finance provided by Professor Thomas is in the form of a long-term loan to the business.

(b) Based on your answer to Part (a) above, recommend which business structure Yi-Ling should adopt.

(c) Assuming that Yi-Ling sets up a limited company and Professor Thomas invests £350,000 in the share capital of the company, advise Professor Thomas on the tax treatment of this investment.

Total: 30 marks

Exhibit 1: Completed new client questionnaire: Yi-Ling Zhao

Age: 27

Current employment/self-employment: None (PhD student)

Details of current taxable income: None – I have been in receipt of a tax-free scholarship to complete my PhD of £12,000 pa. The scholarship ends on 31 March 2022.

Details of savings and investments: None

Tax advice required: I want to start my own business.

I have developed a healthcare app. I have further research and development (R&D) to do before the app can be approved for medical use and before I can market it for sale.

I intend to start working full-time to develop and market the app in April 2022.

Extracts from my business plan (Exhibit 2) show the anticipated costs of R&D and the estimated revenue and expenses of the business for the first three years of operation from 1 April 2022 to 31 March 2025.

I am aware that I can either set up my business as an unincorporated business or as a company, but I don't know which option would be better for me from a tax perspective.

To finance the R&D costs I will need some external funding. My PhD supervisor, Professor Thomas, will lend me £350,000. He will charge interest of 8% pa on the loan. Professor Thomas is an additional rate taxpayer.

If I incorporate my business, I could consider issuing shares in the company to Professor Thomas in return for his investment of £350,000. It would be useful to understand the tax implications for Professor Thomas if I decide to do this.

Exhibit 2: Extract from Yi-Ling Zhao's business plan

The revenue and expenses for the first three years of trade, from 1 April 2022 to 31 March 2025, are estimated to be as follows:

	Year ending 31 March 2023 £'000	**Year ending 31 March 2024 £'000**	**Year ending 31 March 2025 £'000**
Revenue	Nil	500	750
Expenses			
R&D expenditure (Note 1)	300	Nil	Nil
Marketing costs	10	50	150
Rented premises costs	25	25	25

Notes:

1. R&D expenditure in the year ending 31 March 2023 is:

	£'000
Specialist computer hardware	150
Staff costs	100
Sub-contractor fees	50
	300

2. The finance costs relating to the £350,000 loan from Professor Thomas are not included in the figures above.

3. Yi-Ling intends to withdraw the following gross amounts from her business:

Year ending 31 March 2023 £'000	Year ending 31 March 2024 £'000	Year ending 31 March 2025 £'000
12	50	100

If she incorporates the business these amounts would be withdrawn as a dividend.