MARK PLAN AND EXAMINER'S COMMENTARY

The marking plan set out below was that used to mark this question. Markers were encouraged to use discretion and to award partial marks where a point was either not explained fully or made by implication. More marks were available than could be awarded for each requirement. This allowed credit to be given for a variety of valid points which were made by candidates.

Question 1

Total Marks: 40 marks

General comments

Question 1 was a multi tax case study scenario. The requirements were:

1. Explain the tax implications for Russell of the sale of his Sprinter Ltd shares to Mully Ltd (Exhibit 1). You should include supporting calculations and consider any beneficial elections, claims or reliefs.

2. Draft a response to Russell Sprinter's email (Exhibit 2).

3. Explain the actions you and your firm should take in response to the information you have been given by Sprinter Ltd's bookkeeper.

1.

Tax implications for Russell of the sale of the Sprinter Ltd shares to Mully Ltd

On the sale of shares to Mully Ltd, the share for share exchange rules (paper for paper provisions) apply automatically to the proportion of the consideration received as shares. Russell can elect to disapply the paper for paper provisions. This is because where the paper for paper provisions apply, there is no disposal for CGT purposes. This would be a worthwhile consideration, given that currently, the disposal of shares in Sprinter Ltd would qualify for Business Asset Disposal relief (BADR) as Sprinter Ltd is a trading company, Russell works for the company, owns more than 5% of the shares and has met these conditions for more than 2 years. A future disposal of Russell's Mully Ltd shares would not qualify for BADR as Russell does not own at least 5% of the share capital.

If Russell disapplies the paper for paper provisions, the first £1 million of any gain will be subject to CGT at 10% in 2021/22 rather than at 20% on a future disposal.

In terms of the consideration received, for CGT purposes, the following rules apply:

In respect of the £250,000 cash payable in November 2023, as the amount is known at the date of sale, the full amount is included in total proceeds at the time of sale. If the sales target is not met, the computation may subsequently be amended.

In respect of the earn out at the time of sale of the original asset a gain is calculated using an estimated present value of the chose in action. The receipt of the future consideration is treated as a disposal of the chose in action and will give rise to a second gain or loss. Russell can either use the loss in usual way against current year gains in 2023/24 with any excess carried forward, or he can elect to carry the loss back and set it against 2021/22 CGT to generate a maximum repayment of £10,000.

	Without disapplying paper for paper provisions	If paper for paper provisions are disapplied
Proceeds:	£	£
Shares		300,000
Conditional payment	250,000	250,000
Earn Out	100,000	100,000
	350,000	650,000
Cost:		
350/650 x £10,000	(5,385)	

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		(10,000)
Gain	344,615	640,000
AEA	(12,300)	(12,300)
Chargeable gain	332,315	627,700
CGT @ 10%	33,232	62,770

An additional £29,538 of CGT will be due for 2021/22 if Russell disapplies the paper for paper rules. However, the base cost of the shares will be higher by £295,385 at £300,000 rather than £4,615 (10,000 - 5,385), potentially saving £59,077 (20% x £295,385) on a future disposal.

Examiner's comments:

Some candidates failed to consider the share for share exchange rules in part 1 and instead focussed on the availability of incorporation relief on the initial set up of Sprinter Ltd. A lot of time was wasted discussing irrelevant points and producing "practiced" answers instead of focussing on the scenario in the question. Those that did produce answers specific to the scenario did very well and produced accurate calculations on the base cost of the new shares and the allocation of the original costs. The higher scoring answers recognised that there was an option to disapply the share for share exchange rules given the current holding in Sprinter Ltd would qualify for BADR, whereas in the future, Russell's shareholding in Mully Ltd would not. This showed excellent application and planning skills. There are still a number of candidates who get confused between BADR and the substantial shareholding exemption for corporate entities. At this level, that is quite concerning and is a misunderstanding of basic rules.

Total possible marks	**18**
Maximum full marks	**14**

2.

A gift of either the workshop or shares to Steven has potential Capital Gains, Inheritance Tax and Stamp Duty consequences. As the aim is to increase Steven's family income, the taxation of the income arising after the gift has been made also needs to be considered.

Capital Gains Tax

As you and Steven are 'connected' for CGT purposes a gift to Steven will be deemed to take place at market value. You will be chargeable to CGT on the deemed consideration, subject to any reliefs which are available. You are also deemed to be connected in the same way to Steven's wife Claire, if a transfer is made to her.

Workshop

The workshop currently stands at a gain of £180,000. A transfer would not qualify for gift relief as Sprinter Ltd is no longer your personal trading company.

As the workshop has been let to Sprinter Ltd at market value, it does not qualify for BADR as an associated disposal.

Shares in Mully Ltd

The transfer of shares would qualify for gift relief as it is a gift of shares or securities in an unquoted trading company. If gift relief is claimed no CGT would be due on the transfer from you to Steven or Claire. Gift relief needs to be claimed jointly by both the donor and the recipient.

In the earlier sale of your Sprinter Ltd shares, not disapplying the paper for paper provisions will save £29,538 of CGT in 2021/22 in comparison to if they are disapplied.
The drawback of not disapplying the paper for paper provisions and then claiming gift relief on a transfer to Steven, is that Steven would then hold the shares with a base cost of just £4,615, and should he dispose of them in future any gain would be subject to CGT at 20% on amounts above the basic rate band.

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Steven's projected income if he holds the shares, of £40,270 plus £20,000 of dividends, means that any gain on disposal would be taxed at 20%.

However, if you were to transfer the shares to Claire, she would have her basic rate band available, as she has no other income. If she were to dispose of the shares in future, she could obtain the same 10% tax rate by making the disposal over a number of years to keep gains within the basic rate tax band.

Summary of CGT due on transfer of either the workshop or shares:

	Workshop	**Shares**
	£	**£**
Market value	400,000	300,000
Cost	(220,000)	(4,615)
Gain	180,000	295,385
Less: gift relief	-	(295,385)
Less: AE	(12,300)	
Chargeable Gain	167,700	-
CGT@20%	33,540	

Inheritance Tax

A transfer of either the workshop or shares in Mully Ltd from you to Steven or Claire would represent a 'potentially exempt transfer' (PET) for IHT purposes. Provided you survive for seven years following the transfer, no IHT liability arises on either transfer.

Workshop

If you were to die within seven years, the recipient would be liable to IHT on £69,000 (£400,000 - £325,000 - £3,000 - £3,000) of the value of the workshop. The rate of tax reduces from 40% of £69,000 up to 3 years after the transfer, down to zero seven years after the transfer depending when the PET becomes chargeable. We would need further information on whether your NRB is still available and any previous gifts you have made.

Shares

As an unquoted trading company, the shares in Mully Ltd qualify for Business Property Relief (BPR), which gives 100% relief against IHT. This is restricted only if Mully Ltd holds assets which are not used for business purposes throughout the two years preceding the transfer, or are not required for future business use. It appears that this is not the case as all assets held are for the trade.

To obtain BPR, generally the donor must have owned the shares for two years before the transfer. However, as the shares replaced those you held in Sprinter Ltd, the ownership period is aggregated with the previous ownership of those shares.

Provided you survived seven years after the transfer, gifting the workshop to Steven would reduce the value of your estate chargeable to IHT when you die by £366,460 (£400,000 less CGT on transfer), potentially saving £146,584 of IHT (£366,460 x 40%)

Provided the shares continue to qualify for BPR they will not be chargeable to IHT if they are still held by you at your death, and no IHT saving is made by transferring them now.

Stamp Duty

No stamp duty would arise on either gift, as in both cases there is no consideration.

Income Tax

The expected income from either the rental of the warehouse, or dividends from the shares, is the same at £20,000 per year. However, the tax treatment of dividends and rental income is different.

In your hands, dividends will be taxed at 32.5% and rental income at 40%.

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Steven has £10,000 of his basic rate tax band unused by his employment income. If Steven has no other dividends the first £2,000 of dividends will be taxed at 0%, then the remaining £8,000 within his basic rate band at 7.5%. Rental income within Steven's basic rate band will be taxed at 20%. After the basic rate band is used, the remainder of either dividends or rental income will be taxed at the same rate as you are taxed.

Steven and Claire will lose the entire child benefit of £2,556per year if Steven's income increases in excess of £60,000.

The loss of the child benefit can be avoided if you transfer the warehouse or the shares to Claire, rather than to Steven.

Annual tax on the income for each of you, Steven and Claire would be as follows:

	Tax payable by Russell	Tax payable by Steven (including loss of child benefit)	Tax payable by Claire (after Personal Allowance of £12,570 and dividend allowance of £2,000)	Potential annual saving if transferred to Claire
	£	**£**	**£**	**£**
£20,000 Dividends	6,500	6,406 *	407	6,093
£20,000 Rental profit	8,000	8,556**	1,486	6,514

*first £2,000 x 0%, (£8,000 x 7.5%)+(£10,000 x 32.5%) + £2,556 loss of child benefit.
** £2,000+ £4,000+ £2,556 loss of child benefit

It can be seen that there would be little saving of income tax if either asset is transferred to Steven, but if the asset is held and income received by Claire rather than Steven, the family can make significant tax savings and would receive a net income of £19,593 from the dividends, or £18,514 from the rental income.

Conclusion

In order to gain the maximum benefit, the transfer should be to Claire rather than to Steven. This will generate additional post-tax income of up to £6,514 per year for the family, depending which asset is transferred.
If you transfer shares, there will be no CGT due on the transfer as gift relief can be claimed. If you transfer the workshop, CGT of £33,540 will be payable.

Transferring the workshop would potentially save £146,584 in future IHT. This saving clearly outweighs the CGT saving of £33,540 from transferring the shares rather than warehouse.

However, the IHT advantage will only be realised when you die, which is likely to be a long way ahead (and assumes that your estate remains chargeable when you die – once you have retired, the value of your estate may fall over the years, or IHT thresholds may rise). The loss of business asset disposal relief on the workshop is only an issue if a future transfer is envisaged, which it currently isn't.

You can transfer the shares to Claire with no CGT due now. Additionally, as mentioned above, she could potentially obtain the same 10% CGT rate on gains on a future disposal as you would if you paid the CGT now and claim BADR. This means there is less need for you to disapply the paper for paper provisions and pay additional tax now.

Therefore, it is recommended you do the following:

1. Do not disapply the paper for paper provisions on the disposal of the Sprinter Ltd shares.
2. Transfer the shares in Mully Ltd to Claire and make a claim for gift relief. There will be no tax payable on this transfer. Claire will hold the shares in Mully Ltd with a base cost of £4,615.
3. Your home should be left to Steven in your will, in order to take advantage of the residence nil rate band, which will increase the amount you can bequeath free of IHT by £175,000 to £500,000.

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Examiner's comments

Part 2 of the question was generally done well with candidates recognising there were income tax, capital gains tax and inheritance tax implications of the gifts. Again, it is really important that candidates fully assimilate and familiarise themselves with the information in the question. There is a tendency where there is a "gift" to discuss gift relief and the interaction with BADR, even though it may not be relevant, which it was not in the context of the workshop. Candidates are familiar with the IHT consequences and were able to pick up marks on this section. There were also some high scoring answers in relation to income tax, with candidates recognising the difference between rental income and dividends, with some excellent answers in the top range, considering how child benefit may be affected and analysing the overall situation from a family perspective.

Total possible marks	**32**
Maximum full marks	**20**

3.

Professional and ethical issues arising from telephone conversation with Sprinter Ltd's bookkeeper

It is possible there may be an irregularity which has resulted in an underpayment of tax in previous years, based on the bookkeeper's comment, which is backed up by the increase in cash sales.
There could, however, be a legitimate reason for the increase in cash sales. For example, it could be due to legitimate business changes introduced following the takeover.
If sales have been understated, it appears that this may be deliberate. Corporation tax would have been deliberately underpaid, which constitutes tax evasion and is illegal.
There is a threat to the reputation of my firm through being associated with tax evasion. Russell Sprinter and Sprinter Ltd are longstanding clients, and my firm would have prepared the accounts which may be incorrect.
There is also a third party – Mully Ltd – involved, who could be losing out if targets in the purchase contract were based on information which was deliberately incorrect.
There is a threat to my integrity and professional behaviour as I am aware that previous years' sales may have been deliberately understated.
I must therefore encourage Sprinter Ltd to disclose the errors and make them aware of potential penalties and interest.

<u>Actions</u>
Discuss my concerns with my manager and speak with the firm's money laundering officer. As a firm we must be careful not to tip off the client, but if after discussions with them the client does not disclose the errors then we must review our position as advisers and consider making a report to the NCA.
If there are errors and the client refuses to disclose we should check the engagement letter to see if we have authority to disclose.
If the client refuses and we do not have authority we should cease to act, we should inform HMRC but not tell them why.

Examiner's comments

Ethics was very well answered in general. There was a habit amongst a significant number of candidates to treat the information as being true and their answers leapt straight into discussions on evasion and penalties. Candidates should always show professional scepticism and verify the accuracy of information before reaching an immediate conclusion.

Total possible marks	**9**
Maximum full marks	**6**

Total possible marks	**59**
Maximum full marks	**40**

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Question 2

Total Marks: 35 marks

General comments

This question focussed on the residence status for UK income tax of new employees and planning based on a number of benefits the company could offer, with candidates required to give a recommendation as to the most effective combination from a tax saving point of view. The requirements were:

1. Explain the UK tax status of each of the employees as a result of taking up employment with ABC plc and any claims or reliefs which will reduce their UK tax liabilities.

2. Explain the tax treatment of each of the benefits in the remuneration package and any changes which could be made to make the package more tax efficient for either ABC plc or the employees.

You should include calculations, where relevant, and state any further information required.

1.

An explanation of the tax residence status of each of the employees as a result of taking up employment with ABC and any claims or reliefs which will reduce their UK tax liabilities

Jane Summer

Jane has been UK resident since 2011/12 and will remain UK resident when she joins ABC, as she will be working full-time in the UK.

As a UK resident she is taxable on her worldwide income and gains in the UK. Because she is not UK domiciled and has been in the UK less than 15 out of the previous 20 years, she can claim the remittance basis so that her foreign income is only taxed in the UK if it is remitted.

The 2023/24 tax year when Jane's employment with ABC starts will be her 12th year in the UK, therefore if she claims the remittance basis, she must pay the remittance basis charge of £30,000.

In 2024/25 Jane will have been in the UK for at least 12 out of the previous 14 years, so the remittance basis charge will increase to £60,000.

As Jane is an additional rate taxpayer, UK tax on her foreign income if the remittance basis is not claimed would be £36,000 (£80,000 x 45%). Therefore, it may be beneficial for Jane to claim the remittance basis in 2023/24 as she would save £6,000, but a claim will not be beneficial in future years due to the increased remittance basis charge.

Further information is required relating to foreign tax on Jane's non-UK income. If the income has already been taxed abroad, it is likely that double tax relief will reduce UK tax due so that Jane may be better off not claiming the remittance basis.

Investment

Jane can bring her foreign funds into the UK to invest in her friend's unquoted company either as a loan or a purchase of shares. Provided the funds are invested within 45 days of being brought into the UK, Business Investment Relief will apply so the remittance will not trigger a tax charge.

It appears that the investment Jane will make may fall within the conditions for the Enterprise Investment Scheme (EIS). If this is the case, Jane should subscribe for newly issued shares rather than making a loan to the company, because subscribing for shares will entitle her to a deduction from her income tax liability of up to 30% of the investment, saving up to £60,000 (£200,000 x 30%) tax.

As an additional rate taxpayer, it is likely that Jane will have sufficient tax liability to make full use of the relief. Jane can claim to carry back the investment to the previous tax year, to accelerate the relief.

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To establish whether the investment will qualify for EIS relief, further information is needed about the company's trade and whether it has previously raised funds under EIS or VCT schemes, and about Jane's connections with the company, to ensure that she is a qualifying individual.

Harry Winter

In 2022/23 Harry will not meet any of the automatic overseas tests because he will spend more than 91 days in the UK.

Harry will meet the full-time UK work test from 1 January 2023 because there is a 365-day period, part of which falls in the tax year, when he will work full-time in the UK. Therefore, he will be UK resident in 2022/23.

Split year treatment will apply if Harry does not have sufficient UK ties in the period before he starts work with ABC on 1 January 2023. There are 8 whole months between 6 April 2022 and 1 January 2023, so the number of days in applying the sufficient ties tests are reduced by 8/12.

Harry will have spent 36 days in the UK prior to starting work. Scaled up, this equates to 54 days (36 x 12/8). This means that he will be UK resident if he has four UK ties. He did not have accommodation available in the UK, did not work in the UK, and did not spend 90 days or more in the UK in either of the previous two tax years. Therefore, he will only be treated as UK resident from 1 January 2023 until the end of the tax year.

There are no tax consequences when Harry remits £60,000 from Ruritania to the UK, because this income is earned in the period before Harry becomes UK resident.
In the period from 1 January 2023 to 5 April 2023 Harry's Ruritanian investment income will be £1,500 (£6,000 x 3/12). As this is less than £2,000, the remittance basis applies automatically and if the income is not remitted it will not be taxed in the UK.

In 2023/24 and 2024/25 Harry can claim the remittance basis with no remittance basis charge, as he will have been in the UK for less than 7 of the previous 9 tax years.

Claiming the remittance basis means Harry loses his entitlement to the personal allowance, but that will be lost in any case due to the level of his income from ABC. If he claims the remittance basis, Harry will also lose his entitlement to the annual exempt amount for capital gains. If he makes no disposals this will have no effect on tax payable.

If Harry leaves the UK at the end of his contract on 31 December 2024, he will still be UK resident in 2024/25 due to having spent more than 183 days in the UK. Depending on the circumstances, he may be able to claim split year treatment so that he is no longer UK resident after the date he leaves the UK.

Maisy Spring

In 2022/23 Maisy will not meet any of the automatic overseas tests because she will spend more than 91 days in the UK.

She will meet the full-time UK work test from 1 January 2023, so will be UK resident in 2022/23.

Split-year treatment will apply, so Maisy will be UK resident from 1 January 2023. She will remain UK resident in 2023/24 and 2024/25. It is likely that when Maisy leaves the UK on 31 December 2024, she will cease to be UK resident if she either no longer has a UK home, or if she leaves the UK to work full-time abroad.

Maisy is likely to be deemed to be UK domiciled because she was born in the UK. Therefore, the remittance basis is not available to her and she will be taxed in the UK on her Ruritanian investment income from 1 January 2023 until the time she becomes non-UK resident.

Examiner's comments

Candidates dealt well with the residence and domicile status of each individual. Over previous sessions, candidates have clearly become comfortable with this type of question. They logically went through the residence tests and applied them to the circumstances in the scenario. A number of candidates did not deal with the availability of business investment relief and some erroneously concluded that Maisy was not

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UK domiciled and would qualify for the remittance basis. Answers to this part of the question showed good knowledge and skill.

Total possible marks	**30**
Maximum full marks	**22**

2.

An explanation of the tax treatment of items in the remuneration package in Exhibit 2 and any amendments which would make the package more tax efficient.

Employer pension contributions

Pension contributions are an exempt benefit.
Given that salaries will be more than £240,000, each employee will be entitled to a reduced annual allowance, with a minimum of £4,000. Jane may have unused amounts from previous years to increase the annual allowance.

Assuming a minimum annual allowance of £4,000, a contribution from ABC of 10% of base salary will exceed the annual allowance by £21,000.
This means that each employee will be subject to an excess contributions charge of £21,000 x 45% = £9,450. The overall effect of this is that employees only receive tax relief on pension contributions up to the £4,000 annual allowance.

Consideration could be given to reducing the pension contribution to £4,000 in order to avoid the annual allowance charge. However, as employer contributions are not treated as earnings for NIC purposes, there is a slight advantage to ABC making pension contributions for the employees rather than paying additional salary, even though the charge applies.

Signing on bonus

A signing on bonus is subject to tax and NI through PAYE. However, reasonable relocation expenses of up to £8,000 can be reimbursed to the employees free of tax. Therefore, consideration should be given to replacing the bonus with the reimbursement of relocation expenses. This would potentially save tax and NI of £3,760 (£8,000 x 47%) for each employee and employer NI of £3,312 (£8,000 x 3 x 13.8%) for ABC.

Share Options

There are no tax implications for either the employees or for ABC on the grant of share options at the start of the contract.
When the options are exercised, the employees will be taxed on the difference between market value and the amount they pay on the date of exercise. Using the expected market value this will be £150,000 ((£12 – 2) x 15,000). Because ABC is listed on the AIM the shares appear to be readily convertible assets so national insurance contributions will be due. £150,000 is taxed through PAYE and is liable to tax and NI in the same way as cash salary.
ABC will qualify for a corporation tax deduction equal to the amount which is taxed on the employees.
When the employees sell the shares, any profit will be subject to CGT. The base cost will be the price paid plus the amount taxed totalling £180,000. If there is a gain, this will not be taxed in the UK if they are non-resident at the time of the sale.

Optional Remuneration Arrangement

The taxable value of benefits where cash is sacrificed is the higher of the taxable value and the value of the cash sacrificed. The taxable amount is treated as a benefit and subject to Class 1A NI rather than Class 1. Therefore, there is an NI saving for the employees in receiving benefits rather than cash, but no NI saving for ABC.

Ultra-low emission cars are exempt from this rule, so tax on the electric car option is calculated in accordance with the usual rules for taxing company cars, and should employees choose this benefit they will be taxed on the taxable value of nil in 2022/23 and £600 in 2023/24 and 2024/25.
The fuel benefit charge does not apply to electricity supplied by the employer. Charging facilities provided by ABC are exempt.

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The taxable amount for canteen facilities if they are offered in place of cash will be £7,000, because that is the value of the cash sacrificed. This can be reduced to £5,000 if the option of £7,000 cash is removed, saving tax of £900 (£2,000 x 45%) for the recipient of the benefit, and Class 1A NI for ABC of £276 (£2,000 x 13.8%) per recipient. If canteen facilities were to be provided generally to all employees outside of the optional remuneration arrangement, the benefit would be exempt.

Examiner's comments

Candidates' answers to this part were quite brief. They explained in great detail the rules for the various share option schemes, instead of focussing their answer on the scenario. This wasted time and again conveys the fact that the "open book" is often used to knowledge dump when this is a skills based paper. The higher scoring answers showed excellent knowledge and a strong grasp of "planning", with candidates competently comparing the cost and after cash cost of the various options for both the employees and the company. Benefits are covered in detail in Tax Compliance and the majority of this part of the question was straightforward, but did rely on brought forward knowledge.

Total possible marks	**16**
Maximum full marks	**13**
Total possible marks	**46**
Maximum full marks	**35**

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Question 3

Total Marks: 25 marks

General comments

This question required candidates to assess the corporation tax implications of a purchase of trade and assets, identifying the corporation tax administrative points and also the practical tax implications. The second requirement focussed on corporate anti avoidance measures including transfer pricing, thin capitalisation and diverted profits tax. The requirements were:

1. Explain the corporation tax implications for Faster Food Ltd of the purchase of Antelope Ltd's trade and assets and of the commencement of trading by Faster Food Ltd. You should include relevant calculations relating to the allocation of consideration between the assets acquired.

2. Explain the corporation tax implications for Faster Food Ltd of the transactions detailed in the Exhibit and calculate any corporation tax adjustments required.

1.

Corporation tax implications for Faster Food Ltd of the purchase of Antelope Ltd's trade and assets and the commencement of trading by Faster Food Ltd.

Faster Food started trading on 1 April 2021 and must notify HMRC that it is within the charge to corporation tax. The commencement of a trade brings about the end of an accounting period and the start of a new one.

Any pre-trading expenditure is treated as incurred on the first day of trading, and deductible in the first accounting period of the trade, subject to the usual rules on deductible expenses.

The company will be required to complete corporation tax returns. The returns will be based on the accounting dates of the company. If Faster Food does not change its accounting year end, the first return will be for the 12 months to 31 March 2022, due to be filed by 31 March 2023.

Corporation tax will be due 9 months and 1 day after the end of the accounting period (1 January 2024), provided Faster Food has not previously had an accounting period 12 months long.

With profits of £8 million Faster Food will be classed as a large (or possibly very large) company and will pay corporation tax by instalments in future periods. The threshold of £10m to determine whether a company can be large is divided by at least two (and more if there are other 51% related companies).

Each instalment will be 25% of the estimated tax due for the relevant accounting period.

The attribution of the consideration for the trade of Antelope Ltd is likely to be based on market values with the balance attributable to purchased goodwill as follows:

	£ million
Buildings	42
Plant and Machinery	10
Trademarks	15
Net current assets	1
Goodwill	32

The price paid for buildings will be apportioned between the buildings themselves and the fixtures. The amount apportioned to buildings will be the base cost on any future disposal. Capital Allowances may be available in relation to fixtures.
£1 million of plant and machinery is likely to qualify for the annual investment allowance so that tax relief is available in the year to 31 March 2022 against trading profits. Additions above £1 million will be added to the main pool or the special rate pool, depending on the type of asset, and capital allowances claimed at 18% or 6%.

Tax relief for trademarks is given in line with amounts amortised in the accounts. Alternatively, Faster Food could elect to disallow accounting amortisation and instead claim a tax deduction of 4% pa.

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As the purchase is from an unrelated party and includes other intellectual property, tax relief will be given on the goodwill acquired at 6.5% (£2 million) p.a. There is no restriction to this relief, as the cost of the goodwill purchased is less than six times the cost of the trademarks.

Any losses brought forward in Antelope Ltd cannot be passed to Faster Food Ltd because the purchase was of the trade and assets rather than the company.

The purchase of the business is likely to be treated as transfer of going concern for VAT purposes as all of the assets are being transferred, the business is a going concern and there is no break in trade.

There will be stamp duty land tax payable on any land and buildings transferred.

There may also be implications under the capital goods scheme, depending on what items contained within plant and machinery. Further information is required on this.

Examiner's comments

Answers to this part of the question polarised between excellent and very poor. The higher scoring answers produced very accurate answers and clearly understood how the purchase of trade and assets would affect the company. Other candidates mistakenly interpreted the question as a sale of shares and the usual answers in relation to loss groups, chargeable gains groups, pre acquisition losses and substantial shareholding were produced.

The very poor answers were exceptionally brief and neither mentioned transfer of going concern or new accounting periods. Instead the approach was to copy from the workbook on a purchase of shares and scored very low marks.

Total possible marks	**16**
Maximum full marks	**10**

2.

Corporation Tax implications for Faster Food Ltd of the transactions with Lithium Inc.

Loan

As Faster Food Ltd has used the loan to purchase assets for its trade, associated debits will in principle be deductible in the calculation of Faster Food's trading profit. The amount allowable for tax would usually follow the accounting treatment.

However, as interest is not being paid for the first 5 years of the loan and Lithium is not subject to UK corporation tax, tax relief may be delayed until actual payment. This will be the case if Atlantica is classified as a tax haven.

Where interest is paid to Lithium 20% income tax must be deducted by Faster Food as Lithium is not a UK company.

As the loan from Lithium Inc exceeds the amount Faster Food could have borrowed from an independent third party, the thin capitalisation rules will apply so that only the amount of interest which would be payable on an arm's length loan will be allowable.

Interest on the loan from Lithium is £15 million per year. Interest on the amount Faster Food could have borrowed at arm's length would be £1.8 million (£30m x 6%). Only £1.8 million interest on the loan will be tax deductible and Lithium's taxable trading profits will be increased by the disallowed amount of £13.2 million. This will result in additional corporation tax of £2,508,000 (£13.2 m x 19%) payable by Faster Food.

Management Support

Faster Food alone has assets over 43 million euros and revenue over 50 million euros. Therefore, the group is large and the transfer pricing rules apply to transactions between Faster Food and Lithium.

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Faster Food must make a transfer pricing adjustment to adjust for the tax advantage gained due to the artificially high management fee. The arm's length price of management services provided by Lithium would be £1,875,000 [(£3,000,000 x 0.5)/0.8] so the expense is overstated by £1,125,000.

Faster Food's expenses should be reduced by £1,125,000 resulting in additional corporation tax payable of £213,750 (£1,125,000 x 19%).

Food Delivery

The food delivery business is being operated by Lithium Inc, which contracts with customers directly. Therefore, these sales do not form part of Faster Food's turnover and are not included in the calculation of its taxable profits.

Faster Food is incurring expenses relating to the deliveries but is recharging these expenses to Lithium Inc. so the effect for Faster Food should be tax neutral.

DPT may apply to the delivery arrangement between Faster Food and Lithium because:

- Faster Food is a UK resident company carrying out a trade
- Faster Food has an arrangement with Lithium by way of transactions relating to deliveries
- The two parties are connected
- The arrangement causes an 'effective tax mismatch' as the increase in tax in Atlantica of £400,000 is less than 80% of the reduction in UK tax of £760,000 (£4m x 19%).
- The arrangement is designed to ensure profits are taxed at the lower Atlantica tax rate, so the 'insufficient economic substance' condition is met.

DPT is not self-assessed. Faster Food must notify HMRC within 3 months of the end of its accounting period if it is potentially within the scope of DPT. DPT is assessed by HMRC and charged at 25% of diverted profits. DPT on profit of £4 million will be £1 million.

However, where a transfer pricing adjustment is made to ensure arm's length amounts are used, no DPT will be charged. Faster Food should make a transfer pricing adjustment to increase sales by £4 million. Corporation tax at 19% on this adjustment will be £760,000. This is £240,000 less than the tax cost if no adjustment is made and DPT is assessed by HMRC.

Examiner's comments

Candidates were well prepared for this type of question and answers were of a high standard. Excellent answers on the principles of transfer pricing and thin capitalisation together with accurate calculations were produced. Candidates were also very comfortable with the diverted profits tax rules and were able to apply their knowledge really well.

Total possible marks	**23**
Maximum full marks	**15**
Total possible marks	**39**
Maximum full marks	**25**

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