PROFESSIONAL LEVEL

TUESDAY 8 MARCH 2022

2.5 HOURS

BUSINESS PLANNING: TAXATION

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

Marks breakdown

Question 1	40 marks
Question 2	35 marks
Question 3	25 marks

Assume that the Finance Act 2021 rates and allowances as set out in the ICAEW Learning Materials for exams in 2022 will continue to apply for 2021/22 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. 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. **Only your answer in the word processing area will be marked.** You must copy over any data for marking from the spreadsheet area to the word processing area.

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. 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 for a firm of ICAEW Chartered Accountants. Russell Sprinter is a client of your firm.

Background Information

Russell Sprinter is 64 years old. He is not married.

Russell was a self-employed mechanic until 15 April 2010 when he subscribed for all the 1,000 issued ordinary shares in Sprinter Ltd, (a new company he incorporated) at their par value of £10 each. On the same date he sold the trade and assets of his mechanics business, apart from a workshop, to Sprinter Ltd at market value. Russell retained ownership of the workshop personally and leased it to Sprinter Ltd for a market equivalent rent.

On 1 May 2021, Russell sold all his shares in Sprinter Ltd to Mully Ltd, an unconnected trading company. Following the sale, Russell continued to work in and be responsible for Sprinter Ltd.

Details of the consideration received by Russell on disposal of the Sprinter Ltd shares are in **Exhibit 1**.

Russell has also sent you an email asking for some advice **(Exhibit 2).**

Telephone conversation

During a telephone conversation you had with Sprinter Ltd's bookkeeper, he mentioned how busy he is, saying "we didn't previously record all the cash sales. Now everything's included because Russell has sales targets he wants to meet."

You have access to Sprinter Ltd's online bookkeeping system and can see that there are now significantly more cash sales in comparison with the periods before Russell sold his shares.

Requirements

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.

Total: 40 marks

Exhibit 1

Details of consideration received in exchange for Sprinter Ltd shares

In return for his shares in Sprinter Ltd Russell received:

- 5,000 preference shares in Mully Ltd with a total market value at 1 May 2021 of £300,000. These shares represent less than 1% of the total issued share capital of Mully Ltd.

- £250,000 cash payable on 1 November 2023. The payment is conditional on sales targets being met by 30 April 2023. If the targets are not met, no payment will be made. The sales targets are ambitious and there is less than a 50% chance they will be achieved.

- A further cash payment to be made on 1 November 2024. The additional amount is contingent on the results of Sprinter Ltd's trade in the three years to 30 April 2024. The best estimate of the value of the payment at today's date is £100,000. This payment could increase or decrease depending on the actual trading results achieved.

Russell is a higher rate taxpayer and did not make any other capital disposals in 2021/22.

Exhibit 2

Email from Russell Sprinter

To: Tax Adviser
From: Russell Sprinter
Date: 1 March 2022
Subject: Tax advice

I will continue to work at Sprinter Ltd until November 2024, when I will retire. My pension will provide me with an income of at least £50,000 pa on retirement.

In addition, I still own the workshop used by Sprinter Ltd, and I currently hold 5,000 preference shares in Mully Ltd. The workshop generates rental profit of £20,000 per year and the shares will pay around £20,000 in dividends each year too. Once I retire, I will not need both the rental income and the dividends.

I would therefore like to make a gift to my son Steven of either the workshop or, alternatively, the shares in Mully Ltd.

Steven is 35 years old and has three young children. Steven's wife, Claire, doesn't work and he is struggling to provide for the family on his income of £40,270 pa.

I am unsure if it would be most tax efficient to gift the workshop or the shares, and whether there is any tax advantage in making the gift to Claire rather than Steven. I would like to know the tax consequences both for me and for Steven or Claire of either gift. I know Steven and Claire may need their own tax adviser, but I would like to understand the potential tax issues that my gift may create.

Relevant details of my assets are as follows:

Asset	Market Value at 1 March 2022	Original Cost	Notes
	£	£	
Main residence	800,000	120,000	

Workshop	400,000	220,000	Let to Sprinter Ltd
5,000 preference shares in Mully Ltd	300,000	To be determined	Part consideration for shares in Sprinter Ltd

Question 2

You work as a tax adviser in the tax department of a firm of ICAEW Chartered Accountants.

Background Information

ABC plc, a longstanding client of your firm, is an AIM listed UK trading company.

ABC plc is looking to recruit three senior employees as part of an expansion programme commencing in January 2023. Your firm will also be advising on the UK tax affairs of each of the employees.

The tax partner has asked for your assistance in preparing for a meeting with Sarah Smith, the financial controller of ABC plc. Sarah has sent the following email:

To: Tax Partner
From: Sarah Smith
Re: Tax Matters

As you know, we are looking to recruit three senior employees from January 2023 and are currently negotiating the terms of their contracts. Each of the three employees will be employed on a fixed term contract for two years starting on 1 January 2023. Their employment will cease on 31 December 2024.

I have attached some background information about the employees' current positions **(Exhibit 1)** and the proposed remuneration package **(Exhibit 2)**.

The total value of the package is fixed, but it is still possible for ABC plc to make changes to the mix of benefits offered. I would like to understand the tax implications of the employment package for both ABC plc and for the employees.

Requirements

Prepare notes for use at the meeting with Sarah in which you:

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.

Total: 35 marks

Exhibit 1

Background information on employees' tax position

The three employees being recruited are Jane Summer, Harry Winter and Maisy Spring.

<u>Jane Summer</u>

Jane has been resident in the UK for tax purposes since 2011/12 but is not UK domiciled. She receives foreign income of £80,000 per year, none of which she has ever remitted to the UK. She is an additional rate taxpayer in the UK and has always claimed the remittance basis.

Jane would like to invest £200,000 in an unquoted UK trading company which is 100% owned by her friend. The company started trading in 2020, has assets of £2 million and three employees.

Jane is unsure whether she should subscribe for shares (her investment would amount to a 10% stake) or make a loan to the company. The investment will be made from previously unremitted foreign income.

Harry Winter

Harry is domiciled in Ruritania, where he has always lived and worked. He will have spent less than 20 days in the UK in each of 2020/21 and 2021/22.

In 2022/23, Harry is planning to spend 25 days in the UK, on holiday with his family.

On 1 September 2022 Harry's 13 year-old son will move to the UK from Ruritania to attend boarding school. Harry will spend a further 10 days in the UK visiting his son in October 2022. On 31 December 2022, Harry and his wife will move to the UK in advance of Harry starting work for ABC plc.

Between 6 April 2022 and 31 December 2022, Harry will earn £100,000 in Ruritania. He intends to remit £60,000 of this to the UK. From 1 January 2023, Harry will continue to receive £6,000 of Ruritanian investment income each year, which he will not remit to the UK. Investment income is not taxed in Ruritania.

Maisy Spring

Maisy was born in the UK but left in April 2011 to take up full-time employment in Ruritania. She no longer has any ties to the UK and has not spent any time in the UK since she left.

Maisy will come to the UK from Ruritania on 31 December 2022 and return to Ruritania at the end of her contract with ABC plc on 31 December 2024.

While she is in the UK, Maisy will receive Ruritanian investment income of £25,000 per year, which she will not remit to the UK. As mentioned above, investment income is not taxed in Ruritania.

Exhibit 2

Proposed remuneration package for the employees

Contracts will be for full-time work (40 hours per week) based in Manchester, UK for the entire two years. The proposed remuneration package for each employee is made up of the following:

- Basic salary of £250,000 pa

- Employer pension contribution of 10% of basic salary
- Introductory bonus of £8,000
- Share Options. To incentivise the employees to stay until the end of their contract, on 1 January 2023 they will each be granted an option to buy 15,000 shares in ABC plc for £2 per share. The options can be exercised at any time after 31 December 2024, on which date the market value of ABC plc shares is expected to be £12 per share. Currently the market value of one ABC plc share is £10.

In addition, the employees will be offered an optional remuneration arrangement and can choose one from the following:

- Provision of an electric car (and charging) for personal use throughout the contract. The taxable value of this benefit will be nil in 2022/23 and £600 in each of 2023/24 and 2024/25.
- Free use of workplace canteen facilities, at a cost to ABC plc of £5,000 per year.
- £7,000 additional salary.

Question 3

You are an ICAEW Chartered Accountant on a secondment to the finance department of Faster Food Ltd. Faster Food Ltd is wholly owned by Lithium Inc.

Background Information

Lithium Inc is a company incorporated and managed in Atlantica, a non-EEA country, where it operates a food delivery business.

In order to expand its trade into the UK, Lithium Inc incorporated Faster Food Ltd in the UK. Faster Food Ltd purchased the trade and assets of another UK company, Antelope Ltd, on 1 April 2021 for £100 million.

Antelope Ltd had owned and operated a chain of restaurants.

On 1 April 2021, the market values of Antelope Ltd's assets were as follows:

- Buildings (including fixtures) - £42 million
- Plant and Machinery - £10 million
- Trademarks - £15 million
- Net current assets - £1 million

Faster Food Ltd started trading immediately after the purchase of Antelope Ltd's trade and assets, continuing to run the restaurants. The turnover of Faster Food Ltd for the year to 31 March 2022 is forecast to be £250 million with taxable profits of £8 million. Faster Food Ltd has more than 250 employees.

Transactions between Faster Food Ltd and Lithium Inc are detailed in the **Exhibit.**

The corporation tax rate in Atlantica is 10%. The UK does not have a double tax treaty with Atlantica.

Requirements

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.

Total: 25 marks

Exhibit

Transactions between Faster Food Ltd and Lithium Inc

Loan

To finance the acquisition of Antelope Ltd's trade and assets, Lithium Inc loaned £100 million to Faster Food Ltd on 31 March 2021. Interest on the loan is charged at 15% pa on the outstanding balance.

For the first five years interest accruing on the loan from Lithium Inc will be added to the outstanding principal amount of the loan rather than being paid in cash.

The maximum Faster Food Ltd could have borrowed at arm's length would have been £30 million at an interest rate of 6% pa.

Management Support

During the year to 31 March 2022, Faster Food Ltd will receive management support services from Lithium Inc, for which Lithium Inc will charge Faster Food Ltd £3 million. This represents a profit margin for Lithium Inc of 50%. Lithium Inc provides the same service at arm's length to a company in Atlantica at a profit margin of 20%.

Food Deliveries

The restaurant trade purchased from Antelope Ltd is being expanded to include food deliveries. Customers submit orders for delivery using an online portal which is operated by Lithium Inc. Payments are made online directly to Lithium Inc, which accounts for these sales in Atlantica. Faster Food Ltd prepares the food and arranges physical delivery, recovering only its costs from Lithium Inc.

This arrangement has been put in place to ensure that profit from food deliveries made in the UK is taxed in Atlantica rather than the UK. Profit from these deliveries in the year to 31 March 2022 is forecast to be £4 million.