ICAEW

PROFESSIONAL LEVEL

TUESDAY 7 JUNE 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

Assume that the date is 7 June 2022

You are an ICAEW Chartered Accountant working in practice as a tax adviser. One of your corporate clients, Mediwatch Ltd, develops and sells apps used by customers to monitor physical activity, diet, sleep etc.

In 2021, Mediwatch Ltd was approached by Datascientifics Ltd (a company that has experience in data analytics) with a proposal that the two companies set up a joint venture company, Healthdata Ltd.

Healthdata Ltd was incorporated on 1 April 2022 and Mediwatch Ltd and Datascientifics Ltd each subscribed for 50% of the shares issued, at par. On incorporation Healthdata Ltd was a UK-resident company.

Healthdata Ltd received some initial tax advice from another firm of tax advisers, but your firm has just been engaged to act as tax advisers to Healthdata Ltd and you are reviewing the company's tax history and plans for the future.

Healthdata Ltd uses the data generated by Mediwatch Ltd's apps and the data analytics knowledge provided by Datascientifics Ltd to identify consumer behaviour in relation to health. This information is then sold to third parties, such as pharmaceutical companies and food manufacturers to allow these companies to target their products at relevant consumer markets.

For the year ending 31 March 2023 Healthdata Ltd requires substantial investment in the development of new data analytics tools. **Exhibit 1** provides more information on the estimated tax-adjusted trading profits of the company and the costs of developing the new data analytics tools.

Many of the specialist staff employed by Healthdata Ltd work from home, in locations outside the UK. You have been sent a copy of an e-mail from one of these staff, querying whether their employment income should be taxed within the UK (**Exhibit 2**).

It is expected that from 1 April 2023 Healthdata Ltd will become more profitable. Consequently, the joint venture partners intend to migrate Healthdata Ltd to the overseas country of Netherbourg on 1 April 2023. Details of the migration of the company are set out in an electronic file note (**Exhibit 3**).

The country of Netherbourg has been identified as an ideal location for Healthdata Ltd because the corporate tax rate in Netherbourg is 1%. Netherbourg calculates trading profits subject to corporation tax in the same way as the UK.

The previous firm of tax advisers recommended a tax avoidance scheme to Healthdata Ltd to avoid payment of SDLT. On reviewing the company's previous tax affairs, you discover that no SDLT was paid on the purchase of the company's office block in April 2022, as a result of using a complex series of transactions. The finance director of Healthdata Ltd, who is a qualified accountant, has asked you not to investigate the workings of this tax avoidance scheme, because he considers that it was a legal and legitimate scheme.

Requirements

1. Calculate the estimated taxable trading profits/(losses) of Healthdata Ltd for the year ending 31 March 2023 and advise the company and its shareholders on any claims, elections or reliefs that would be available (Exhibit 1).

   For the purposes of part 1 of the requirements, ignore the consequences of the migration to Netherbourg on 1 April 2023.

2. Provide advice to Healthdata Ltd on the tax status of employees situated outside the UK, for the year ending 31 March 2023, and the tax implications this status may have for both the employees and Healthdata Ltd (Exhibit 2).

3. Identify and explain the tax consequences of Healthdata Ltd migrating to Netherbourg on 1 April 2023 (Exhibit 3).

4. Identify the ethical considerations for your firm in considering the SDLT tax avoidance scheme used for the purchase of the office block.

Total: 40 marks

Exhibit 1: Healthdata Ltd

Year ending 31 March 2023

Estimated tax-adjusted trading profit and costs of developing new data analytics tools

- Healthdata Ltd's tax-adjusted trading profit for the year ending 31 March 2023 is estimated to be £100,000.

- This figure is calculated before deduction of the following:

R&D expenditure on the development of new data analytics tools:	**£'000**
Staff costs – staff engaged in R&D and employed by Healthdata Ltd	157
Staff costs - staff engaged in R&D and sub-contracted from Datascientifics Ltd (**Note**)	450
Computer software	395
Computer hardware	575
Total	1,577

Note:
The cost to Datascientifics Ltd of the staff sub-contracted to Healthdata Ltd was £350,000.

- It is also estimated that Mediwatch Ltd and Datascientifics Ltd will have total taxable profits of £1,000,050 and £1,560,395, respectively, for the year ending 31 March 2023.

- Healthdata Ltd is classified as an SME for the purposes of R&D expenditure. The company estimates its PAYE and NIC liability in the UK will be £49,000 in the year ending 31 March 2023.

Exhibit 2: Email from Healthdata Ltd staff member

To: Healthdata Ltd payroll department

In common with a lot of my colleagues, I have taken advantage of recent global events and I now live and work full-time from my home in the country of Utopia, where I have been based since March 2020. All I need to be able to work for you is an internet connection.

Despite working from Utopia, I continue to receive my salary from Healthdata Ltd net of UK tax and national insurance contributions, under PAYE. A friend of mine has queried if this is correct, given I live full-time in Utopia. Can you please advise me if I should be taxed on my employment income in the UK?

Exhibit 3: Electronic file note: Migration of Healthdata Ltd to Netherbourg

Healthdata Ltd intends to move its place of effective management to Netherbourg on 1 April 2023. Under the UK:Netherbourg double tax treaty, this would make the company resident in Netherbourg with effect from 1 April 2023. The trade will also migrate to Netherbourg. Healthdata Ltd's UK offices will be rented to third parties from 1 April 2023 onwards.

It is assumed that on 1 April 2023, Healthdata Ltd will own the following assets:

Asset	**Cost of purchase**	**Estimated market value on 1 April 2023**
	£m	**£m**
UK office block (purchased new from the developer on 1 April 2022)	1.00	1.25
Investment property in Utopia	0.50	0.75

All other assets owned by Healthdata Ltd are items not subject to chargeable gains on disposal.

Question 2

Assume that the date is 7 June 2022

You are an ICAEW Chartered Accountant, working in practice providing tax advice to wealthy individuals and their family businesses.

Your clients, Camilla and Henry Smithers, aged 52 and 56 years old respectively, have been married for over twenty years. Their one child, Diana, is 32 years old, unmarried and has no children.

Camilla and Henry each own 50% of the share capital of Smithers Ltd, an online retailer, and both work full-time for the company. They set up Smithers Ltd 10 years ago and subscribed for 50 shares each at their nominal value of £1 each. They are each paid a salary of £9,568 pa from the company and they also receive dividends from Smithers Ltd that make each of them additional-rate taxpayers.

The couple have decided to end their marriage and will formally separate on 30 June 2022. They will finalise their divorce by 31 March 2023. You are not familiar with the tax implications of separation and divorce, so you ask another member of staff to consult the UK Government guidance on this area on the internet and this has been sent to you in an e-mail (**Exhibit**).

A valuation of the shares in Smithers Ltd has been carried out using an online valuation tool, approved by the HMRC shares and assets valuations team. The value of a 50% shareholding in Smithers Ltd at today's date is £1.7 million. It is assumed that this valuation can be used as the basis of any tax advice given to Henry and Camilla about future disposals of Henry's shares in Smithers Ltd.

After separation, the couple no longer wish to work together, so Henry will end his employment with Smithers Ltd and dispose of his 50% shareholding in the company. He has three mutually exclusive alternatives for the disposal of his shares in Smithers Ltd. Whichever alternative is chosen, he will leave his employment at Smithers Ltd on 30 June 2022.

Alternative 1
Smithers Ltd will buy back Henry's 50% stake in the company on 30 June 2022, for £1.7 million.

It is not clear if this repurchase of shares will satisfy the condition that the repurchase is for the 'benefit of the trade'. Henry will need advice about the two, different, potential tax treatments of this disposal and advice about whether the repurchase could be classed as for the 'benefit of the trade'.

Henry's shares will be cancelled on repurchase. It is assumed that Smithers Ltd has sufficient reserves to make this purchase.

Alternative 2
Camilla will buy Henry's 50% stake in Smithers Ltd herself. Camilla does not have the cash available to buy Henry's shares immediately. She has offered to buy the shares in May 2023 for £1.7 million.

Alternative 3

Henry will gift his 50% stake in Smithers Ltd to his daughter Diana on 30 June 2022, either as an outright gift or as a disposal for less than £1.7 million.

Henry's will

Henry's solicitor has recommended that Henry reviews his will when he separates from Camilla. His estate mainly comprises his half share of the couple's main residence and his shareholding in Smithers Ltd. A half share in the couple's main residence is valued at £500,000. On separation, on 30 June 2022, Henry will transfer his half share of the main residence to Camilla, in exchange for its market value of £500,000 and then buy another property to live in for £250,000.

Henry's current will leaves his entire estate to Camilla, but if Camilla dies before him, his estate would be left to his daughter, Diana. Henry's solicitor has suggested that he amends his will to leave his estate to his daughter Diana, under all circumstances.

Both Camilla and Henry hope that Diana will continue to own Smithers Ltd after their death and that she will work for the company. Diana does not intend to dispose of any of the shares in Smithers Ltd that she may receive/inherit from either parent.

Requirements

1. (a) Advise Henry of the tax consequences of each of Alternatives 1, 2 and 3 for the disposal of his 50% stake in Smithers Ltd.

   (b) Provide a recommendation to Henry of the most tax efficient Alternative out of the three for the disposal of the shares.

2. Advise Henry of the tax consequences of the arrangements under his current will and how these will change because of separation, divorce and the proposed amendments to his will.

Total: 35 marks

Exhibit:- Email

<u>Subject: Extract from www.gov.uk: Money and property when you divorce or separate</u>

If you transfer an asset when you're separated

For capital gains tax: If you lived together at any point in the tax year that you transferred the asset, the normal rules for spouses and partners apply.

For inheritance tax: Any transfers of value made between parties to a marriage at any time before the divorce is finalised are subject to the IHT spouse exemption.

If you transfer an asset after your divorce is finalised

You must pay capital gains tax and inheritance tax on assets you transfer after your relationship has legally ended by the finalisation of the divorce.

Question 3

Assume that the date is 7 June 2022

You are an ICAEW Chartered Accountant working in practice. Singh Technology plc (ST plc) is a long-standing tax client of your firm. ST plc is the holding company of a trading group of companies.

ST plc is planning to buy either 100% of the issued share capital of Lion Ltd or the trade and assets of Lion Ltd in the near future. Lion Ltd is a company that sells computer software. Lion Ltd has been loss-making for the past five years and has brought forward trading losses of £355,000 at 1 April 2022. There are no other losses brought forward by the company.

Lion Ltd is involved in protracted litigation over the failure of one of its software packages. This failure is alleged to have caused major IT security breaches at some of its customers. The legal case brought by these customers is nearing its conclusion. Lion Ltd may be liable for substantial compensation to its customers.

Details of the three, mutually exclusive, offers ST plc is proposing to make to buy the shares or trade and assets of Lion Ltd are set out in an e-mail received from the finance director (**Exhibit 1).**

A colleague has put together a working paper in the electronic client file, showing further details about the assets of Lion Ltd (**Exhibit 2**).

Lion Ltd makes up accounts to 31 March annually and is VAT-registered making standard rated supplies.

Requirement

Provide advice to Singh Technology plc about the tax implications of each of the three mutually exclusive offers proposed for the purchase of the shares or the trade and assets of Lion Ltd and recommend the most tax efficient offer from Singh Technology plc's perspective.

Total: 25 marks

Exhibit 1: Extract from an email sent to you by ST plc's finance director

As you know we intend to buy either the shares or the trade and assets of Lion Ltd.

ST plc wants to be able to take advantage of Lion Ltd's trading losses and we are confident that changes we intend to make to Lion's business model will make it more profitable. As you may know, Lion Ltd currently sells most software through a network of sales representatives, who visit businesses in person. We intend to move all sales online instead.

Even if Lion Ltd takes some time to become profitable, ST plc has other group companies that are profitable, and I am sure we can always use Lion Ltd's losses elsewhere in the group.

ST plc is considering three mutually exclusive offers to buy either the shares or the trade and assets of Lion Ltd, as follows:

Offer 1 – ST plc pays £5 million for 100% of the shares in Lion Ltd; or

Offer 2 – ST plc pays £5 million for the trade and assets of Lion Ltd; or

Offer 3 – Lion Ltd sets up a new company (Newlion Ltd) and transfers the trade and assets of Lion Ltd to the new company. The shares in Newlion Ltd are then sold to ST plc for £5 million.

Exhibit 2: Working paper – assets of Lion Ltd

	Purchase price	**Current value**
	£m	**£m**
Goodwill (arising since 2017)	0.00	2.00
Licence agreements	0.25	0.25
Land and buildings (purchased new from the developer in January 2018)	2.00	2.75
	2.25	5.00