PROFESSIONAL LEVEL EXAMINATION

MONDAY 4 DECEMBER 2017

(2½ HOURS)

BUSINESS PLANNING: TAXATION

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

1. Ensure your candidate details are on the front of your answer booklet. You will be given time to sign, date and print your name on the answer booklet, and to enter your candidate number on this question paper. You may not write anything else until the exam starts.

2. Answer each question in black ballpoint pen only.

3. Answers to each question must begin on a new page and must be clearly numbered. Use both sides of the paper in your answer booklet.

4. The examiner will take account of the way in which answers are presented.

5. When the assessment is declared closed, you must stop writing immediately. If you continue to write (even completing your candidate details on a continuation booklet), it will be classed as misconduct.

Assume that the Finance Act 2016 rates and allowances will continue to apply in future years unless you are specifically instructed otherwise.

IMPORTANT Question papers contain confidential information and must **not** be removed from the examination hall. **DO NOT TURN OVER UNTIL YOU ARE INSTRUCTED TO BEGIN WORK**	You **must** enter your candidate number in this box. | | | | |

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1. You are an ICAEW Chartered Accountant employed in the tax department of a firm of ICAEW Chartered Accountants. Your firm's clients Philip and Estelle Thompson have requested some tax advice in relation to their plans for retirement.

Background information

Philip and Estelle have been married for many years and are both UK- resident and UK-domiciled. Thompson Ltd was incorporated by Philip and Estelle in March 1990 when they subscribed, at par, for 50,000 £1 ordinary shares each (100,000 shares in total) in the company.

Thompson Ltd is a successful company in the retail sector. The company has generated surplus cash, some of which was used to purchase a portfolio of residential properties, which the company rents out. 37% of net profit for the most recent accounting period ended 30 September 2017 was from residential property letting income.

Although Philip and Estelle still own 100% of the shares in Thompson Ltd and work as full-time company directors, their roles are now mainly administrative. Alan and Sandra, (Philip and Estelle's children) have taken over the management of the company together with Francis (the company's managing director, who is not related to the Thompson family).

Philip and Estelle would like to retire from the company in the near future. They have e-mailed you, outlining their plans for retirement (**Exhibit 1**). In preparation for this, valuations of shares in Thompson Ltd as at November 2017 were calculated (**Exhibit 2**). You were also sent information by Thompson Ltd about the values of the company's tangible net assets on 1 December 2017 (**Exhibit 3**).

Philip and Estelle are higher rate taxpayers and each has capital losses brought forward of £10,000, from an unsuccessful property investment they made many years ago.

Alan works full-time at Thompson Ltd for a salary of £55,000 pa. Sandra works part-time at the company for 21 hours a week and she earns £25,000 pa.

Philip and Estelle have requested a meeting with you to discuss the tax consequences of their retirement plans.

Requirements

In preparation for the meeting with Philip and Estelle Thompson:

1.1 Set out the current and future taxation implications of Philip and Estelle's retirement plans, as explained in Exhibit 1;

1.2 Recommend and justify the most tax efficient course of action from the alternatives suggested by Philip and Estelle;

1.3 Identify any further information you would need in order to make a full recommendation to Philip and Estelle.

Total: 40 marks

Exhibit 1
E-mail received from Philip and Estelle Thompson

To: Tax Adviser
From: Philip and Estelle Thompson
Subject: Retirement plans
Date: 1 December 2017

As you know, we intend to retire from Thompson Ltd in February 2018. Although we still work full-time for the company, our children, Alan (aged 35) and Sandra (aged 32) together with Francis, the managing director, are already running the company on a day-to-day basis and can manage without us. We are not getting any younger and would like to enjoy some well-earned time off. We plan to:

(1) Sell 40% of the total shares in Thompson Ltd (20% from each of us) to Francis. Francis has just inherited a large sum of money following the death of his father and has offered us £800,000 for the 40% stake in the company.

(2) Gift the remaining 60% of the company's shares (30% from each of us);

- Either to Alan and Sandra directly, in equal shares (so 30% of the company each);
- Or, to a trust, under the terms of which Alan and Sandra would be among the beneficiaries.

We know very little about the types of trusts available, the differences between them in terms of tax consequences, and the advantages or disadvantages of using a trust for this purpose. Any advice you could give would be helpful.

(3) We would also like to consider if there are any tax advantages in distributing the current cash balance in the company of £300,000 prior to the share sale and gift. The cash balance was being held for the purchase of more residential property and is surplus to the working capital requirements of the company.

Can we arrange a meeting next week, to discuss the tax consequences of the three issues above? We would also like your advice about the most tax efficient course of action to take.

It would also be useful if you could let us know at that meeting if there is any further information you need in order to finalise your advice.

Best wishes

Philip and Estelle

Exhibit 2
Valuation of Thompson Ltd shares

A valuation of Thompson Ltd shares was carried out in November 2017, which values the shares as follows:

	£ million
100% shareholding	3.25
60% shareholding	1.75
50% shareholding	1.2
40% shareholding	0.8
30% shareholding	0.6

Exhibit 3

Information provided by Thompson Ltd
Thompson Ltd's tangible net assets are made up as follows:

	Carrying Amount 1 December 2017 £	**Market Value £**
Property plant and equipment:		
Plant and equipment	24,500	24,500
Retail premises	50,000	250,000
Residential investment properties	225,000	750,000
Cash	300,000	300,000
Total of other assets less liabilities	21,400	21,400
Net assets	£620,900	£1,345,900

Note: All individual items of plant and equipment were bought for and have market values of less than £6,000.

2. You are an ICAEW Chartered Accountant, employed as a tax specialist at TabletTech Ltd (TT Ltd). The company manufactures and sells accessories for tablet computers.

The directors of TT Ltd identified a potential company to purchase; PhoneCharger Ltd (PC Ltd), which manufactures and sells phone chargers compatible with popular mobile phones.

PC Ltd was incorporated by Alice Crane in 2010, when she subscribed £2 million for 2 million ordinary shares of £1 each. She still owns 100% of the share capital of PC Ltd and continues to work full-time for the company.

The latest balance sheet of PC Ltd is attached (**Exhibit**). All assets on the balance sheet are shown at a carrying amount of historic cost less accumulated depreciation, apart from the property, which is shown at market value. The property was purchased on incorporation in 2010 for £2.4 million. The indexed cost of the property at the current date is £3.12 million. In addition, the business has significant non-purchased goodwill, which has been created over the last seven years. The company has always been profitable.

Alice stated that she expects to receive net cash, after tax, for the sale of PC Ltd of £20 million. As part of the deal to sell her company Alice has also asked that at least £5 million of any purchase consideration is paid into a bank account held by a nominee in the Cayman Islands (a tax haven).

The directors of TT Ltd have asked for your advice about how to structure the purchase of the business of PC Ltd. The purchase can be either:

- 100% of the shares in PC Ltd; or
- 100% of the company's trade and assets.

If TT Ltd buys the assets of PC Ltd, PC Ltd will cease to trade and will then be liquidated.

Alice is a higher rate taxpayer and uses her capital gains tax annual exempt amount each tax year against gains she makes on her investments.

Requirements

Prepare extracts for inclusion in a report to the board of directors of TT Ltd. The extracts should:

2.1 Identify the amount of consideration that would need to be paid to Alice Crane, so that she received cash of £20 million, net of tax, under each of the alternative methods of purchasing PC Ltd.

2.2 Determine which method of purchase would be the most tax efficient for TT Ltd.

2.3 Identify and explain the implications for you, as an ICAEW Chartered Accountant, of Alice Crane's request that £5 million of purchase consideration should be paid to a nominee account in the Cayman Islands

Total: 35 marks

Exhibit

PhoneCharger Ltd - Balance Sheet as at 30 September 2017

	£'000	£'000
Tangible fixed assets		
Property		3,600
Plant and equipment		1,000
		4,600
Current assets		
Stock	6,800	
Trade debtors	6,600	
	13,400	
Less Creditors: amounts falling due within one year		
Trade creditors	(1,800)	
Net current assets		11,600
Net assets		16,200
Capital and reserves		
Called up share capital		2,000
Revaluation reserve		1,200
Profit and loss account		13,000
		16,200

3. You work for a firm of ICAEW Chartered Accountants and are asked to assist your manager in preparation for a meeting with Lewis Gordon, the finance director of Elm plc, a UK quoted company.

You have been provided with some background information on the structure of the Elm plc group and details of outstanding issues to be considered in order to prepare corporation tax computations for the group companies for the year ended 31 March 2017.

Background information
The Elm plc group companies all have a 31 March year end.

On 31 March 2017, the group structure was as follows - Elm plc owned:

- 75% of the ordinary share capital of Terrapin Ltd;
- 51% of the ordinary share capital of Labrador Ltd;
- 76% of the shares in Walker SARL, which is registered in Ruritania, a non-EU country.

Terrapin Ltd also owns 75% of the share capital of Cat Ltd. Terrapin Ltd's 75% shareholding in Cat Ltd was acquired on 31 January 2017 for £4 million. Cat Ltd had brought forward capital losses of £550,000 at the date of acquisition.

Outstanding issues
Lewis Gordon asked for your firm's advice on the tax treatment of the following issues which need to be resolved in order to complete the corporation tax computations of the Elm plc group companies for the year ended 31 March 2017:

(1) In 2007, Elm plc set up a permanent establishment (PE) in Ruritania, a non-EU country. The PE made substantial profits in recent years. On 1 April 2016, the trade of the PE was transferred to a company, Walker SARL, which is resident in Ruritania. The transfer was made in exchange for 300,000 £1 ordinary shares (an 100% shareholding) in Walker SARL valued at £3.2 million, which was equal to the market value of the trade and assets transferred. Details of the assets transferred to Walker SARL are in the **Exhibit**. On 1 January 2017, Elm plc sold 72,000 of the shares in Walker SARL for £1.35 million. At that date the market value of Elm plc's remaining holding was £2.1 million. The indexation allowance on the sale of the shares was £12,288. The rate of corporation tax in Ruritania is 18%.

(2) On 7 May 2016, Labrador Ltd issued 75,000 shares to a third party, reducing Elm plc's holding from 75% to 51%. In January 2014 Elm plc transferred part of its trade to Labrador Ltd, including an office block which was transferred at its historical cost of £1,400,000 when its market value was £2,400,000. The office block had originally been acquired in May 2003. The indexation factor from May 2003 to January 2014 is 0.392.

(3) On 26 September 2016, Elm plc sold its 100% shareholding in Parrot Ltd to an unconnected third party in exchange for cash of £12 million. The shares were acquired in April 2007 for £14 million. Parrot Ltd owns an investment property that makes up more than 50% of its net assets and accounts for at least 30% of its income.

(4) In October 2016 Elm plc and Terrapin Ltd both sold their shareholdings in Basset Ltd, a trading company, which was originally set up as an industry-wide joint venture. 8% of the shares were held by Elm plc, and 8% by Terrapin Ltd. Each company paid £40,000 for its shareholding in January 2007, and received sale proceeds of £125,000. The indexation allowance for each company is £12,540.

(5) In addition to any gains or losses arising from the above transactions, Terrapin Ltd realised a chargeable gain of £140,000 on 4 October 2016 from the sale of land.

Your files show that, before any adjustment for the items noted above, the taxable total profits of companies taxable in the UK for the year ended 31 March 2017 were:

	£
Elm plc	2,500,000
Labrador Ltd	325,000
Terrapin Ltd	10,000
Cat Ltd	1,200,000
Parrot Ltd	60,000

In addition, Terrapin Ltd had brought forward capital losses of £36,000.

The group has no other losses, of any kind, other than those mentioned or resulting from the transactions above.

Requirement

Prepare detailed notes for your manager, to be used at a meeting with Lewis Gordon, outlining the tax implications of each of the outstanding issues.

Notes:
- Where appropriate, include calculations in your notes.
- You are not required to calculate the corporation tax liability for any group company.

Total: 25 marks

Exhibit
Details of assets transferred to Walker SARL by the Ruritanian PE on 1 April 2016

Asset	**Date of purchase**	**Indexation factor from date of purchase to 1 April 2016**	**Cost** £	**Market value on 1 April 2016** £
Factory **(Note)**	January 2007	0.297	250,000	700,000
Warehouse	January 2009	0.244	550,000	500,000
Fixed plant and machinery	May 2015	0.011	200,000	250,000
Goodwill	January 2007	0.297	-	1,250,000
Trading stock	N/A	N/A	200,000	500,000

All of the assets transferred are located in Ruritania.

Note: Walker SARL sold the factory to an unconnected third party on 31 December 2016 for £900,000.