PROFESSIONAL LEVEL EXAMINATION

TUESDAY 4 DECEMBER 2018

(2½ 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

1. Please read the instructions on this page carefully before you begin your exam. If you have any questions, raise your hand and speak with the invigilator before you begin. The invigilator cannot advise you on how to use the software.

2. Please alert the invigilator immediately if you encounter any issues during the delivery of the exam. The invigilator cannot advise you on how to use the software. If you believe that your performance has been affected by any issues which occurred, you must request and complete a candidate incident report form at the end of the exam; this form must be submitted as part of any subsequent special consideration application.

3. Click on the **Start Exam** button to begin the exam. The exam timer will begin to count down. A warning is given five minutes before the exam ends. When the exam timer reaches zero, the exam will end. To end the exam early, press the **Finish** button.

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

5. The examiner will take account of the way in which answers are structured. Respond directly to the exam question requirements. Do not include any content or opinion of a personal nature. A student survey is provided post-exam for feedback purposes.

6. Ensure that all of your responses are visible on screen and are not hidden within cells. Your answers will be presented to the examiner exactly as they appear on screen.

Assume that the Finance Act 2017 rates and allowances as set out in the ICAEW Learning Materials for exams in 2018 will continue to apply in 2017/18 and future years unless you are specifically instructed otherwise.

Question 1

You are an ICAEW Chartered Accountant, working in practice for a firm of ICAEW Chartered Accountants as a tax adviser.

Background information

Your client, Savoury Ltd, is a UK registered company, incorporated many years ago and with a year end of 31 December.

Savoury Ltd manufactures and distributes a savoury spread, popular in the UK, called Vegemar. Savoury Ltd has sold Vegemar exclusively within the UK, but as sales and profitability in the UK have declined, the company is considering expanding manufacturing overseas. Recent market research indicates there is a potentially large market for Vegemar in the non-EU, overseas country of Tasland.

From 1 September 2019 Savoury Ltd will manufacture Vegemar in Tasland.

Your tax manager has provided you with a briefing note (**Exhibit 1**) explaining the tax advice required by Savoury Ltd, in respect of the new Tasland business operations.

The Human Resources Department at Savoury Ltd has also asked for your firm's advice on the UK employment tax position of employees seconded to the UK, from the new Tasland business (**Exhibit 2**).

Requirements

1.1 In relation to Exhibit 1, prepare notes which:

(a) for each of the two accounting periods identified (periods ending 31 December 2019 and 31 December 2020):

- explain the differing corporation tax consequences of each proposed business structure; and
- calculate the estimated corporation tax liabilities in both the UK and Tasland.

(b) advise Savoury Ltd on which business structure would be the most tax efficient in each accounting period; and

(c) identify any additional information you would need in order to finalise your advice in Part 1.1(b).

1.2 In relation to Exhibit 2, prepare notes explaining the UK income tax implications for employees of the Tasland business undertaking the proposed UK secondments.

Ignore national insurance contributions in answering this question.

Total: 40 marks

Exhibit 1:

Briefing note from your tax manager:
Tax advice – Tasland expansion

Savoury Ltd has asked our firm to provide tax advice on the business structure to be used for the new Tasland-based business.

The two alternative business structures being considered for the Tasland business are:

1. operating the Tasland business as a permanent establishment of Savoury Ltd; or

2. incorporating the Tasland business as a Tasland-registered company.

Trade will commence in Tasland on 1 September 2019. Savoury Ltd would like to understand how profits made in Tasland will be taxed in both the UK and Tasland. Savoury Ltd requires an explanation of the corporation tax implications of each of the alternative business structures together with illustrative calculations of the corporation tax due in both the UK and Tasland. It would also be useful to consider the availability of double tax relief and whether there are beneficial claims or elections in relation to this.

Savoury Ltd has estimated tax-adjusted trading losses of £800,000 for the year ending 31 December 2019 and £600,000 for the year ending 31 December 2020. Both of these figures are calculated excluding any profits/losses of the Tasland business.

The estimated tax-adjusted profits, before capital allowances, and the capital expenditure of the Tasland business for the period ending 31 December 2019 and for the year ending 31 December 2020 are shown below:

Tasland business:

	Four months ending 31 December 2019 (estimated) £	**Year ending 31 December 2020 (estimated) £**
Taxable profits before capital allowances	1,000,000	2,000,000
Capital expenditure on plant and machinery	250,000	0

Notes:

(1) The taxable total profits of Savoury Ltd for the year ending 31 December 2018 are estimated to be £nil.

(2) Assume that the Tasland and the UK corporate tax rules are identical, except for the rates of withholding tax and corporate tax in Tasland, which are both 28%.

(3) On 1 September 2019, finance of £2.5 million will be required to set up the business in Tasland. Savoury Ltd will provide this money out of its own funds. If incorporated, this finance will be converted into a commercial loan between the Tasland company and Savoury Ltd. Interest on the loan will be 7% pa.

(4) If incorporated, the Tasland company will remit interest on the loan to the UK. The Tasland profit after tax will be remitted to Savoury Ltd in the UK by way of dividend.

Please recommend the most corporation tax-efficient business structure to adopt in each accounting period and provide details of any additional information we would need, to be able to finalise our advice about the choice of business structure.

Exhibit 2:

Secondment package for Tasland business staff seconded to the UK

The Tasland business is sending staff to the UK for training in the Vegemar manufacturing plant. Staff being seconded are all domiciled in Tasland and have been tax resident in Tasland for many years.

They will be offered an 18-month secondment to the UK, from 1 January 2020 to 30 June 2021.

Staff will be required to return to Tasland for three days, four times a year, for training. Whilst in the UK they will work 37 hours per week.

Most staff will not bring their families with them and will expect to return to Tasland at least one weekend per month. They will travel to Tasland on the Friday evening and return to the UK in time for work on the Monday morning.

None of the staff has ever visited the UK for work before, although some of the staff have taken short holidays in the UK in recent years.

Most staff expect to spend their four weeks annual holiday in Tasland with their families.

Whilst in the UK, the staff will be provided with rent-free accommodation and have all of their travelling costs between the UK and Tasland paid for by Savoury Ltd. Their salary will be paid into a UK bank account in £sterling. However, the employees on secondment will retain employment rights with the Tasland business and their employment in Tasland will not be treated as ceasing. They will return to their previous employment in Tasland at the end of the secondment.

Question 2

You are a trainee ICAEW Chartered Accountant working for Smith LLP, a firm of ICAEW Chartered Accountants. Smith LLP recently acquired two separate start-up businesses as new clients.

The two new clients submitted background information in advance of their initial tax consultations. Your manager e-mailed you with the information provided by the two businesses, Dennis Yang (**Exhibit 1**) and Amy Slack (**Exhibit 2**).

Your manager has asked you to prepare briefing notes in preparation for each of the two consultations, based on this information.

Both Dennis and Amy wish to extract £25,000, after tax, from their businesses in the first year of operation.

Requirements

Prepare briefing notes for your manager in which you:

2.1 Outline the main differences for tax purposes between operating as an unincorporated business or a limited company and recommend the most tax efficient business structure for:

(a) Dennis's business; and
(b) Amy's business,

Your answer should provide explanations and calculations, in each case, to justify your recommendations.

2.2 Calculate and explain, based on your recommendations regarding business structures in Part 2.1, the tax implications of extracting an after tax amount of £25,000 in the first year of operation for:
(a) Dennis and;
(b) Amy.

Total: 35 marks

Exhibit 1:Dennis Yang

Dennis aged 54, is employed as a graphic designer. In his spare time he is an amateur gardener and he intends to start his own business, designing and building gardens for private clients.

Since 6 April 2016, Dennis's only income has been his gross salary of £40,000 pa. His employer recently announced a voluntary redundancy scheme and Dennis agreed to a redundancy date of 1 January 2019.

His redundancy package will be as follows:

- Statutory redundancy pay of £7,335.
- Payment in lieu of notice of £10,000.
- Discretionary termination payment of £10,000.

Dennis intends to start trading as a garden designer on 6 April 2019. He has provided the following relevant information, extracted from his business plan:

Years ending 5 April	**2020**	**2021**	**2022**
	£	**£**	**£**
Taxable trading profit/(loss) before capital allowances	(54,000)	22,500	247,500

In addition, the business will incur capital costs as follows:

Years ending 5 April	**2020**	**2021**	**2022**
	£	**£**	**£**
Van	25,000	-	-
Plant and equipment	8,000	7,500	7,500

Exhibit 2: Amy Slack

Amy is 22 and graduated from university with a degree in business. Amy has never had any paid employment, but her investment income is usually equal to the level of the personal allowance each tax year.

Her father is a wealthy businessman and is prepared to guarantee a bank loan, with which Amy will finance the purchase of an existing, successful business at an interest rate of 5% pa. She has identified an existing business to purchase. The business is a small, limited company, currently owned by an unconnected third party and manufactures and sells organic beauty products.

Amy negotiated a purchase price of £500,000 to buy the assets and the goodwill of the business. The assets have a market value of £400,000.

Amy will take over the business on 6 April 2019 and her accounts will be made up to 5 April annually. Amy will need to decide whether she will run the business as a limited company or as an unincorporated trader.

Amy's business plan estimates the taxable profits of the business will be as follows:

Years ending 5 April	**2020**	**2021**	**2022**
	£	**£**	**£**
Taxable profit after deduction of capital allowances (**Note**)	50,000	150,000	355,000

Note: Taxable profits are stated after deduction of capital allowances and £25,000 of R&D expenditure per annum, but before any adjustment for the amount paid for the goodwill of the business or the interest payable on the loan to purchase the business.

HMRC has indicated that the R&D expenditure will constitute qualifying revenue R&D expenditure for tax purposes.

Question 3

You are a newly-qualified ICAEW Chartered Accountant working in the finance department at Lemon plc. Lemon plc is the parent company of a group, which manufactures materials used in the building industry. It is a large, international company, with business premises, suppliers and customers in a number of countries.

Lemon plc has two, wholly-owned subsidiaries, Apple Ltd and Orange Inc. Orange Inc is currently resident in the non-EEA country of Outlandia. Lemon plc and Apple Ltd are both UK-tax resident companies.

The Finance Assistant (a trainee ICAEW Chartered Accountant) was finalising the corporation tax computation for Lemon plc for the year ended 31 March 2018, but was taken ill. The Finance Director asks you to complete the computation.

The Finance Assistant calculated taxable total profits (TTP) for Lemon plc of £12.25 million. However, she left a file note of three outstanding issues **(Exhibit 1)**.

You have also received an e mail from the Business Development Director **(Exhibit 2)** asking for your advice.

Requirements

3.1 Calculate the revised taxable total profit for Lemon plc for the year ended 31 March 2018, providing explanations for any adjustments you make.

3.2 Respond to the e-mail from the Business Development Director (Exhibit 2). You should include:

(a) an explanation of how the proposed contract with Sarah would be treated for tax purposes.

(b) an explanation of why the scheme may be within the Disclosure of Tax Avoidance Schemes (DOTAS) regime, the consequences of non-disclosure, if within the DOTAS regime, and any action you should take.

Total: 25 marks

Exhibit 1:

File note - outstanding issues for the completion of the corporation tax computation of Lemon plc for the year ended 31 March 2018

(1) On 1 April 2017, Lemon plc purchased machinery costing £3.2 million. To fund the purchase it borrowed £1 million from Orange Inc at an interest rate of 8% pa. The remaining £2.2 million was borrowed from a UK bank at an interest rate of 6% pa. The maximum amount the bank was prepared to lend Lemon plc was £2.55 million.

Interest paid on both loans has been deducted in calculating the TTP.

(2) On 31 March 2018, Lemon plc sold a residential property situated in Manchester for £3.2 million. The property was originally purchased on 1 April 2011 for £1.75 million. The market value of the property over recent years has been as follows:

	£'000
1 April 2012	1,850
1 April 2013	2,200
1 April 2014	2,450
1 April 2015	2,875
1 April 2016	3,000
1 April 2017	3,100

Clare Bednarz, one of the directors of Lemon plc, has lived in the house rent free since it was purchased. The house has an annual value of £65,000.

The gain on disposal has not been included in TTP. In addition, there has been a deduction for Class 1A NICs paid of £8,970.

The annual tax on enveloped dwellings for 2016/17 of £23,350 was paid on 30 April 2017. The annual tax on enveloped dwellings for 2017/18 is yet to be paid.

Assume the RPI at March 2018 is 279.2

(3) On 1 April 2017, Orange Inc relocated its central management and control to Outlandia, a non-EEA country where Orange Inc is registered. Prior to this date the company was treated as a UK resident.

At the date of migration the following gains/(loss) would have arisen if the company's assets had been sold at market value:

	£
- UK factory used in trade	£400,000
- UK investment property	£300,000
- Outlandia factory used in trade	£750,000
- Goodwill of the trade in Outlandia (purchased pre April 2002)	£250,000
- Outlandian warehouse used in trade	(£116,000)

On 28 December 2017, Orange Inc sold the Outlandian factory to an unconnected third party for £1.2 million generating a chargeable gain of £860,000.

The intention is to include the net gains on migration as part of Lemon plc's profits.

Exhibit 2

E mail from Business Development Director

To: Finance
From: Business Development Director

I have a meeting with the Board next week and would like some advice.

Marketing Director

Lemon plc's Marketing Director, Sarah Windle has resigned because she wants to set up her own consulting company. The Board of Directors do not want to lose Sarah's expertise and experience, so Sarah has agreed to do some consultancy work for Lemon plc via her own consulting company. The Board of Directors and Sarah do not agree on the way in which the consultancy will be operated.

The Board of Directors would like Sarah to be on Lemon plc's premises and commit to working a set number of hours. Sarah does not agree with the Board's suggestion and instead wants to be engaged for projects on a fixed fee basis.

I need to understand the difference for income tax and national insurance (NIC) purposes between the two alternative ways of structuring Sarah's consultancy work.

I would also like to know if there is any way in which any tax or national insurance costs associated with the proposals could be reduced. I would like to know these answers so I can pass the advice onto Sarah.

Tax saving scheme

Our tax advisers told me about a tax saving scheme. This would involve Lemon plc purchasing properties and then leasing them to an offshore company. The offshore company would then lease back the properties to Lemon plc for substantial rents. This will allow Lemon plc to make large deductions for lease payments against profits. The leases involved will have costs in excess of £10 million and have lease terms of between three and ten years. Our tax advisers advise that as the leasing arrangement would be for genuine commercial purposes (because Lemon plc is looking to expand operations abroad); any disclosure to HMRC is not necessary.