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

General comments

The candidate is in the role of a corporate tax specialist working in practice.

The first part of the question concerns overseas expansion – candidates are required to analyse the difference in tax treatment between setting up a (profitable) overseas permanent establishment (PE) or a subsidiary, where the UK entity had trading losses.

The requirements asked for a recommendation of the most tax-efficient route and identification of missing information.

The second element of the question involved the income tax implications of individuals being seconded to the UK; this required consideration of the statutory residence test and the availability of split-year treatment for those arriving into the UK.

1.1	**Marks**
In setting up an overseas business, Savoury Ltd (Savoury) could either: • operate the business as a permanent establishment of the UK company, Savoury; or, • set up a separate company registered and resident in Tasland.	
(a) The difference between these two options for tax purposes would be to determine in which tax jurisdiction(s) the profits of the proposed business in Tasland would be taxed.	
<u>Trading as an overseas permanent establishment (PE) of Savoury Ltd</u>	
If the Tasland business is set up as an overseas PE, the profits of the overseas PE would be calculated, for UK tax purposes, in the same way as UK profits and included within the UK Taxable Total Profits (TTP) of Savoury.	2
Savoury can make an election to exempt all its foreign PE taxable profits and losses from UK corporation tax. This election can be made before Savoury has any foreign PEs and would apply from when it begins to hold a foreign PE. However, as Savoury Ltd may expand overseas in other countries and this election would become irrevocable and apply to all of Savoury's foreign PEs, we would need to understand the implications of this election before making it (see part 1.1 (c)).	1 1
Where a foreign PE is in a jurisdiction with a higher tax rate than in the UK and the UK Co has trading losses, a PE election would be beneficial because the trading losses would not be used against PE profits.	2
If an exempting election were made, there would be no UK CT to pay on the profits of the PE in either accounting period. Savoury Ltd would also not utilise any of its losses against the profits of the PE. These losses could be c/fwd in Savoury Ltd under s.45 and used against future profits of the same trade.	2
If an exempting election was not made the trading profits of the PE for each period would be calculated as follows:	

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Profits of Tasland PE	**4 months ending 31 December 2019**	**Year ending 31 December 2020**	
	£	**£**	
Taxable profits	1,000,000	2,000,000	
Less capital allowances:			
Total qualifying for AIA	(200,000)	0	
Assume 18% on £50,000	(9,000)	(7,380)	
Taxable profits	791,000	1,992,620	1
Withholding tax at 28%	(221,480)	(557,934)	
Net profits	£569,520	£1,442,066	

In calculating the TTP of the PE for the purposes of the UK CT computation for the 4 months ending 31 December 2019, the PE incurs capital expenditure of £250,000. Assuming that Savoury has not already used the AIA of £200,000 (see 1.1 (c) below), this could qualify for £200,000 of AIA and the remaining £50,000 of capital expenditure could qualify for WDA at 18%.

The PE will also be taxed in Tasland (using identical CT rules, but at a rate of 28%), Savoury would be able to deduct Tasland tax withheld at source under double tax relief. Because Savoury Ltd has trading losses, we would need to consider claims for double taxation relief to ensure that we did not waste losses. Assuming there is no double tax treaty between the UK and Tasland (see part 1.1 (c) below), we could consider both unilateral relief and expense relief to determine the most tax efficient method of receiving relief for the tax withheld in Tasland.

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Both unilateral relief and expense relief methods of obtaining double tax relief for the year ending 31 December 2019 would result in no corporation tax being payable by Savoury for the accounting period. However, as any corporation tax due on the PE's profits in the UK would be covered by DTR, there would be nothing to be gained by claiming trading loss relief under s 37 in the years ending 31 December 2019 and 2020. DTR could be claimed using the unilateral method.

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The trading losses in Savoury could be carried forward against the first available profits of the same trade under s 45.

Savoury Ltd: CT computation	**Year ending 31 December 2019**	**Year ending 31 December 2020**	
	£	**£**	
Trading Profits (UK business)	0	0	
Tasland PE profits unilateral relief	791,000	1,992,620	
Less: s.37 loss relief	(nil)	(nil)	
Taxable Total profits	£791,000	£1,992,620	
CT at 19%	150,290	378,598	
Less: DTR (UK tax is lower than Tasland tax)	(150,290)	(378,598)	
UK CT payable	£0	£0	2
Trading losses c/fwd in Savoury	£(800,000)	£(1,400,000)	1

<u>UK and Tasland tax costs if business set up as a separate overseas subsidiary</u>

If Savoury Limited is set up as a separate company, resident in Tasland, the profits of that company would be taxed in Tasland, and, if remitted to the UK, might also be taxed in the UK.

1

The method of remittance would determine how the profits would be taxed in the UK. Dividend income received by a UK company, even from an overseas company, is usually exempt from corporation tax. Profits could therefore be remitted to the UK in the form of dividends without any UK tax consequences. The profits would however be taxed in Tasland at 28%.

1

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Because Savoury Ltd has financed the set up costs for the new business, interest paid by a Tasland company to Savoury Ltd would be non-trading loan relationship income. This income, unlike dividend receipts would be subject to UK corporation tax. However, the interest income could be covered by s 37 current year trading loss relief.

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Savoury Ltd Corporation Tax Computation	**Year ending 31 December 2019 £**	**Year ending 31 December 2020 £**	Marks
UK trading profits	0	0	
Non trading loan relationship interest			1
(7% x£2,500,000)	58,333	175,000	
Less s.37 loss relief	(58,333)	(175,000)	
TTP	0	0	

W2 Tasland subsidiary	**Year ending 31 December 2019 £**	**Year ending 31 December 2020 £**	Marks
Taxable profits	1,000,000	2,000,000	
Less: capital allowances (£200,000 x 4/12)+ (£183,333 x 18%x 4/12)	(77,666)		
18% reducing balance on TWDV b/fwd		(31,020)	1
Less: interest payable (£2,500,000 x 7%) x4/12	(58,333)		
£(2,500,000) x 7%		(175,000)	
Taxable total profits	£864,001	1,793,980	
Tasland tax at 28%	(241,920)	(502,314)	
Net dividend remitted to the UK	£699,747	£1,322,686	

In summary:

Year ending 31 December 2019	**Overseas PE £**	**Subsidiary £**	Marks
Tax payable - UK	0	0	
Tax payable -Tasland	221,480	241,920	
Losses available to carry forward	(800,000)	(741,667)	
Year ending 31 December 2020			
Tax payable - UK	0	0	
Tax payable - Tasland	557,934	502314	2
Losses available to carry forward	(600,000)	(425,000)	

1.1 (b) Based on the tax payable worldwide, It would be beneficial for the business to start trading as a PE for the first accounting period and then incorporate for the second accounting period. Although the difference in tax payable is only £55,620. There would however, also be more trading losses preserved in Savoury under the incorporation route.

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We would have to bear in mind the tax costs of incorporating a PE, although these could be mitigated by incorporation relief. We would need to assess these costs fully before making any final decisions (see part 1.1 (c))The decision would be based on the likelihood of Savoury Ltd becoming profitable in the UK trade in future years and being able to use these losses.

1.1 (c)We would need additional information about:

- The future plans of the company – and how they affect a potential election to exempt PE income and losses. 1
- The tax costs of incorporation. 1
- The client's projected profits for the UK business, to identify if losses can be used in future accounting periods. 1
- Advice from a Tasland tax specialist. 1
- The use of the AIA allowance of £200,000 by Savoury Ltd in the year ended 31 December 2019.
- Verify that there is no tax treaty between Tasland and the UK

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Candidates in the main, displayed good knowledge of the differing tax consequences between operating as a PE or subsidiary. The higher scoring answers provided calculations of the profits under each option and recognised the interaction of loss relief and double tax relief (DTR). The weaker candidates did not consider DTR and in some instances did not provide calculations to support their decisions. There was also some confusion as a number of candidates discussed CFC's; showing a lack of application skills using the scenario presented.

The majority of candidates concluded that a PE was preferable. Some candidates then went off on a tangent and discussed the subsidiary as though it was the incorporation of an existing PE. This was largely irrelevant in the context of the question. Candidates did not appreciate that each structure was mutually exclusive at the outset and that incorporation of the PE was only relevant in the future.

Total possible marks	31
Maximum full marks	26

1.2	Marks
UK tax implications for Tasland employees undertaking secondments to the UK (ignoring NIC)	
The residence and domicile status of an employee and the location in which he carries out his duties determine the tax treatment of his earnings.	1
Domicile:	
An individual is domiciled in the country of their permanent home. The Tasland employees are only coming to the UK on secondment and can be assumed to be domiciled in Tasland.	1
Residence:	
The residence of an individual is determined by the statutory residence tests. This status usually applies for whole tax years, however, in certain circumstances the tax year can be split and an individual can be treated as UK resident for only part of the tax year.	
To identify if an individual is classified as UK resident, we must first see if that individual satisfies any of the automatic overseas tests. If the individual satisfies any of these tests he will be classified as non-UK resident.	
For 2019/20 the secondees were:	
• Not UK resident in any of the previous three tax years and they will spend more than 46 days in the UK	1
• Not UK resident in one or more of the three previous tax years and they spent 16 days or more in the UK.	1
They therefore failed the automatic overseas test.	
They also failed the full-time work overseas test as from 1 January there will be more than 31 UK work days spent in the UK.	2
If none of the automatic overseas tests are met, we then look to see if an individual can be classified as UK resident by either satisfying one of the automatic UK tests or the full-time UK work test.	
For 2019/20 secondees will not spend at least 183 days in the tax year in the UK or have a home in the UK that they visit for 30 days or more in the tax year.	2
They therefore fail the automatic UK tests.	
However, they are likely to satisfy the full-time UK work test. This is satisfied if all the conditions are met:	

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• Secondees will spend a period of 365 days (the secondment is from 1 January 2020 to 30 June 2021), all or part of which falls within the tax year, when the taxpayer works an average of 35 hours a week in the UK (the secondment stipulates 37 hours' work a week in the UK);	1
• Within the 365-day period, there are no significant breaks of more than 30 days when they do not work in the UK (ignoring annual and sick leave);	1
• Within the 365-day period the individual is working 100% in the UK, this satisfies the test that at least 75% of the individual's working days must be in the U; and,	1
• There is at least one day where the secondees will work, in the UK, for 3 hours.	1
There will be no need to apply the sufficient ties test, as the full-time UK work test has been satisfied.	
Split-year treatment	
Normally UK residence applies for a whole tax year, however, if the individual was not resident in the previous tax year and is arriving in the UK, they will only be treated as UK resident for part of the tax year in certain, limited circumstances.	1
Our secondees were not resident in the UK in 2018/19 and as they arrive to work in the UK for a 365 day period starting in 2019/20; a tax year in which they satisfy the UK full-time work criteria. If they do not have sufficient UK ties before they start work in the UK, the individual will only be UK resident from 1 January 2020, the date they start to work in the UK.	1
The number of days used in applying the sufficient ties tests is reduced to 8/12 of the numbers for a full year, because there are 8 whole months from 6 April 2019 to 31 December 2019. In the period before 1 January 2020, if the secondees have spent minimal time in the UK, they would not have to determine if they met any of the sufficient ties tests and would be classified as UK resident from 1 January 2020 onwards.	2
If the number of days spent in the UK in 2018/19, prior to 1 January 2020, exceeded 30, (46 days × 8/12) then the employees would have to consider if they satisfied at least four of the sufficient ties tests. This is unlikely. Therefore it is likely that the secondees will be treated as UK resident from 1 January 2020 onwards.	1
For 2020/21, the employees will not meet any of the automatic overseas tests and are likely to meet the automatic UK tests, because they will spend at least 183 days in the UK and because they should (as in 2019/20), satisfy the full-time UK work test. The secondees should cease to be UK resident from 1 July 2021, when they cease to work in the UK, using the split year treatment.	1
In being taxed as a UK resident, the secondees will be taxed on their UK employment income on an arising basis under the PAYE scheme, which deducts income tax and at source, from gross pay. Employees then receive their pay net of income tax.	1
If the secondees are classified as UK resident for the duration of their secondment, they should be entitled to a full UK personal allowance for each tax year of residence.	1
Provision of benefits in relation to UK employment is usually regarded as taxable. In the case of the secondees, they are provided with rent-free accommodation and with travelling expenses. Because their employment in Tasland continues, their secondment to the UK will be treated as a temporary workplace, therefore rent-free accommodation and travel expenses will be tax-free benefits.	1
Candidates generally scored very well on this section showing good knowledge and application of the statutory residence tests. Common errors were to treat the secondees as satisfying the automatic UK test in 2019/20. A number of candidates also failed to comment on the availability of the split year treatment.	
Total possible marks	21
Maximum full marks	14
Overall maximum marks	40
Overall marks available	52

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Question 2

Total Marks: 35

General Comments

The candidate is in the role of a trainee chartered accountant working in practice.
This question concerned providing advice to two separate, individual clients on the most tax-efficient way of structuring their new business ventures (incorporated or unincorporated); and of the tax implications of extracting profits.

The first client would be initially loss making and growing very quickly and the owner had recently been made redundant and had termination payments to consider. The second client was purchasing an existing, profitable corporate business.

This question was testing higher level skills and asked for students to make a recommendation of the most tax efficient business structure for each individual.

Choice of business structure is a core part of the BPT syllabus and students should have been well prepared to answer this question.

2.1	Marks
Tax is only one consideration when determining the structure of a business venture.	
(a) Both new businesses can choose between commencing to trade as a sole trader business or as a limited company	
A sole trader business owner would pay income tax and national insurance contributions on the profit made by the business, regardless of the level of drawings. Whereas a limited	1
company would pay corporation tax on its profits. The owner of the company would pay tax on the amount of these after tax profits paid out to the owners. Profits from a company could	1
be paid out in the form of salary, dividends or pension contributions. Salary would be subject to income tax and NIC on the owner of the business as an employee. Dividends are income	1
tax free for the first £5,000 paid to an individual and would then be taxed at increasing rates, depending on the tax band the dividend income falls into. No NICs are payable on dividends, however, unlike a salary, the dividends themselves are not deductible from the taxable profits of the company.	1
Losses in a new business can be used differently depending on the type of business structure. In a company, losses can only be deducted from the income of the company in the current period or carried forward against income of future periods. Losses are therefore	1
locked into the company unless/until the company makes a profit. On the other hand, sole trader losses in opening years can be used against the sole trader's other general income of	1
the same, following or earlier years. This allows start-up sole trader businesses making losses to generate refunds of tax, which can be a useful cash flow advantage to a new business.	
Dennis Yang	
Dennis's business is making a trading loss in the opening years of his trade. As a result it would be beneficial to commence to trade as a sole trader. This is because the losses would be available under s. 72 loss relief to use against Dennis's general income from before the business commenced. If Dennis were to trade as a company, the losses would be locked in the company and could only be relieved, in the future, when the company became profitable.	2
This would generate a tax refund for Dennis.	1
The amount of tax saved by using the losses as a sole trader is relatively small, therefore it is possible that Dennis might choose to commence to trade through a company instead. Once Dennis's business becomes profitable it might be more beneficial for Dennis to trade as a limited company. If he incorporates his business there would be a tax cost because assets would be deemed to have been sold and reacquired by the company on incorporation, although it is possible that these gains could be mitigated by incorporation or gift relief, if the conditions for the reliefs were satisfied.	2

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Year ending	5 April 2020 £	5 April 2021 £	5 April 2022 £	
Taxable trading (loss)/profit before capital allowances	(54,000)	22,500	247,500	
Less capital allowances:				
Van and equipment AIA	(33,000)	(7,500)	(7,500)	
Adjusted taxable (loss)/profit	(87,000)	15,000	240,000	2

Use of loss of the year ending 5 April 2020:

Loss arises in 2019/20 (basis period actual basis). 0.5

This loss could be deducted from general income under s.64 in 2019/20, if Dennis had other income. However, Dennis has no taxable income in 2019/20. 0.5

The loss could be carried forward and deducted from Dennis's general income of 2020/21. However, Dennis only has general income of £15,000, being his taxable profit from his business in 2020/21. As the majority of this income will be covered by the personal allowance, it would be inefficient to use £15,000 of the £87,000 loss to cover this income 0.5

The loss could be carried back, as it is a loss in the opening (first four years) of trade under s.72 and deducted from general income of the three tax years prior to 2019/20, earliest years first (2016/17, 2017/18 and 2018/19). 1

	2016/17 £	2017/18 £	2018/19 £	2019/20 £	
General income					
Salary	40,000	40,000	30,000	0	
Termination payment:					
Statutory redundancy pay			0		
Payment in lieu of notice			10,000		2
Ex gratia payment			0		
Loss under s72	(40,000)	(40,000)	(7,000)		
Trading income				0	
Taxable income	0	0	33,000	0	2
Less personal allowance			(11,500)		
Taxable income	0	0	21,500	0	

Tax due before loss relief:

	2016/17	2017/18	2018/19	2019/20	
Salary	40,000	40,000	40,000	0	
Personal allowance	(11,000)	(11,500)	(11,500)	(LOST)	
Taxable income	29,000	28,500	28,500		1
Tax due at 20%	£5,800	£5,700	£5,700		

Loss memorandum:

2019/20	£
Basis Period (Actual Basis): Year ending 5 April 2020	87,000
2016/17	(40,000)
2017/18	(40.000)
2018/19	(7,000)
Loss remaining	£ Nil

Dennis could incorporate his business at a later date, on becoming profitable, either for tax reasons, to gain a tax advantage in the taxation of his remuneration, or alternatively for commercial reasons. There are costs attached to incorporation, usually in the form of capital profits. However, incorporation relief or gift relief can often be used, if conditions are satisfied, to mitigate the tax costs of incorporation. 2

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2.1 (b)	Marks
Amy: Because Amy is buying an existing business, the business is profitable from the first accounting period. As she is not making any losses, there would be no advantage in commencing to trade as a sole trader in terms of the use of losses.	
The decision about the business structure would therefore depend upon any differences in the tax treatment of Amy's business and the differences in terms of the taxation charged on profits withdrawn from the business.	
Amy has incurred £100,000 on buying the goodwill of the existing business. This goodwill will not give rise to any tax deduction, regardless of whether she trades as a sole trader or a company.	1
Amy would also incur loan interest of 5% on the loan of £500,000. If she were a sole trader, this interest would reduce the taxable profits of the business. If she operates as a company, the loan interest payable by Amy would be a qualifying loan to purchase shares in a close company and Amy would be able to deduct the loan interest from her taxable income.	1
In addition, Amy incurs £25,000 of qualifying R&D expenditure each year. As a qualifying SME, she would be entitled to a deduction of an additional 130% of the R&D expenditure, each year from her taxable profits. Sole traders do not get an additional deduction for R&D expenditure.	2
Because Amy can gain an additional deduction for the R&D expenditure, her taxable profits as a company, would be £32,500 lower each year, than if she were a sole trader.	
The cost of extracting profits from the company would be the corporation tax payable on her profits and any personal tax she suffered on extracting profits from the company. Because she can pay herself in the form of dividends as a company and not incur any NICs on these profits and because she can take the first £5,000 of drawings from the company tax free as a dividend, Amy would be advised to incorporate her business.	1

Years ending 5 April	2020	2021	2022	Marks
	£	£	£	
Taxable profits	50,000	150,000	355,000	
Less: Qualifying R&D expenditure (130% x 25,000)	(32,500)	(32,500)	(32,500)	1
Taxable trading profits	17,500	117,500	322,500	

The weaker candidates tended to "knowledge dump" in this part of the question and mainly compare the general differences between operating as a sole trader and a company, as opposed to using the information in the scenario to structure their answer. As the examination is completely open-book, there are lists of the issues to consider on differing business structures in the study text, which students can refer to in the exam. These weaker candidates tended to copy out these lists, without any application or analysis of the points to be made.

Often there was a lack of calculations to support answers and candidates just discussed the various loss relief options for unincorporated traders in very general terms. The information presented in the scenario made it obvious that s72 loss relief was in point but candidates wasted time discussing in great detail, the other loss relief options.

In terms of Amy's position, candidates correctly recognised that setting up a company would allow the enhanced R&D deduction to be claimed. Good knowledge and application was displayed in this part of the question.

Total possible marks	28.5
Maximum full marks	20

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2.2		Marks
(a)		
Dennis Yang		
If Dennis were to extract £25,000, net of taxes, from his sole trader business, there would be no tax consequences. Dennis pays income tax and national insurance contributions based on the profit he makes from the business, rather than the drawings he makes from the business. As the business is loss making for the year ending 5 April 2020, there are no profits on which to pay taxes.		1 1 1
(b)		
Amy Slack		
If Amy were to extract £25,000 from her business, assuming that business were a company, it could be extracted as a salary, a dividend or a pension contribution. Each of these different types of profit extraction would have different tax consequences.		1
Amy has never had any earnings prior to starting her business, but she has used her full personal allowance of £11,500 against her investment income. We assume that her basic rate band is available to use against any remuneration taken from the company.		1
Payment of a dividend:		
If she extracts £25,000 from the company in the year ending 5 April 2020 as a dividend, she would save NICs on the dividend, however, the company would not be able to claim a tax deduction for the dividend from the profits subject to corporation tax.		1
The first £5,000 of the dividend would be tax free in Amy's hands, the remainder of the dividend would be taxable at Amy's marginal rate of tax. As Amy has no other income, this would be 7.5%.		1
The payment required for a £25,000, net of tax receipt would be:		
	£	
Payment required by Amy	25,000	2
Tax at (25,000 – 5,000) 7.5%/92.5%	1,622	
Cash dividend	26,622	1
The dividend would be paid out of after tax profits of the company and would not have been tax deductible.		
The corporation tax due on the profits used to pay the dividend would have been:		
26,622 /81% x 19% = £6,244.		2
Therefore the total tax suffered by Amy for her to receive a net £25,000 dividend is £7,866.		
Payment of a salary		
	£	
After tax payment required by Amy	25,000	2
This would be after income tax at 20% has been deducted and employees national insurance contributions have been deducted at the rate of 12% on all salary apart from the first £8,164.		
This works out as a gross salary of:		
Gross salary required by Amy	35,324	
Less Income Tax (20%)	(7,065)	
Less Employees NIC (salary - £8,164 x 12%)	(3,259)	
After tax amount	25,000	

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For corporation tax purposes this would have been tax deductible along with the employers' NIC due on the gross salary:	
CT Computation:	
Profits 17,500	1
Less gross salary (+ Employers' NIC) (39,072)	
Total taxable profits £0	
Which results in no corporation tax being payable. CT on TTP = £0	1
Salary + Employers' NIC 35,324 +3,748 = £39,072	
Employers' NIC	
First £8,164 x 0%	
Therefore 35,324 – 8,164 = £27,160	1
Employers' NIC = 27,160 x 13.8% = £3,748	
Total taxes	
Corporation tax 0	
ER's NIC 3,748	1
EE's NIC 3,259	
Income Tax 7,065	
£14,072	
The tax cost of paying a net salary of £25,000 is much greater than paying a net dividend of £25,000.	1
Payment of a pension contribution	
If either Amy or the company contribute to a pension scheme on Amy's behalf, this would not be taxable remuneration for Amy. However, there are limits as to the maximum amount of tax deductible pension contributions that can be paid in a tax year. Unless Amy pays herself a salary there will be no earnings against which to pay contributions and the maximum contributions possible will be £3,800.	1

Surprisingly, despite recognising that Dennis would be subject to income tax on the profits of the business, in this part of their answers, candidates produced confused answers stating that Dennis would need to take drawings or would need to extract a dividend.

The higher scoring answers correctly recognised that Dennis would be taxed on the profits of the business and produced very accurate calculations for Amy, considering the various ways in which profits could be extracted. The net cash position has been tested in previous sittings and there has been a marked improvement in candidates approach to these types of question.

Total possible marks	20
Maximum full marks	15
Overall maximum marks	35
Overall total available marks	48.5

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Question 3

Total Marks: 25

General Comments

This question first asked for a revised computation of taxable total profits for a UK company; this included the issues of thin capitalisation, the disposal of a residential property (including the ATED) and the migration of one of its subsidiaries, which had subsequently sold an asset on which an exit charge would be due.

The second element of the question had two distinct parts; the personal service company (IR35) legislation, and an ethical dilemma about whether a 'lease and lease-back' transaction could be caught by the Disclosure of Tax Avoidance Schemes (DOTAS) rules, and the impact of those rules applying.

3.1	**Marks**
Lemon plc Revised corporation tax computation for the year ended 31 March 2018	

	£	
TTP (per draft computation	12,250,000	
Interest (1)	59,000	
Property (2)	115,750	
	(5,779)	2
Migration (3)		
Gain on UK investment property	300,000	
Gain crystallising on sale of Outlandia factory	663,000	
Revised TTP	13,381,971	

1) Lemon plc will not be allowed a tax deduction for the interest on the loan from Orange Inc if it is thinly capitalised. HMRC will consider how much Lemon plc could have borrowed from a third party. The maximum amount the bank would have lent was £2,550,000 of which £2,200,000 was actually taken. Therefore, any amount of the loan that exceeds £350,000 will not be allowable interest and only interest at the rate that an independent third party would lend to Lemon plc at will be allowed on the first £350,000. — 0.5, 0.5, 0.5, 0.5

   The adjustment required is therefore adding back to profit: £350,000 x 2% (8%-6%) = £7,000 and £650,000 x 8% = £52,000. Total add back = £59,000. — 1

2) The property is likely to fall within the scope of the annual tax on enveloped dwellings as the property was worth £1.85m at 1 April 2012 therefore worth more than £500,000 and is owned by a company. The annual charge is £23,550, which has yet to be paid by the company. Because the property was sold on 31 March 2018, this cannot be reduced as the property was owned throughout the whole of the ATED year. — 1, 1, 1

   In addition, CGT is calculated using a cost equal to the market value of the property on 5 April 2013. Therefore:

	£	**Marks**
Proceeds	3,200,000	0.5
Cost (MV April 2013)	(2,200,000)	
	1,000,000	1
CGT at 28%	280,000	

   The element of the gain prior to 5 April 2013 is charged to corporation tax:

	£	**Marks**
Proceeds (MV April 2013)	2,200,000	0.5
Cost	(1,750,000)	
	450,000	
Indexation allowance:		
279.2-234.4/234.4 =0.191 x 1,750,000	(334,250)	
	115,750	1

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Therefore an additional £115,750 needs to be added to TTP as this is subject to CT with the CGT being paid under the normal capital gains rules.	
In terms of NIC, as this is a property worth more than £75,000 there would be an additional benefit assessable on Clare so there is additional class 1A that can be deducted from the TTP. The additional benefit is calculated as: (£1,750,000-£75,000) x 2.5% = £41,875 plus annual value of £65,000 = £106,875. Class 1A in total would be 13.8% x £106,875 = £14,749 with only £8,970 having been deducted. An additional £5,779 can be deducted against TTP.	0.5 1.5
3) Company migration A company is resident in UK if it is incorporated in UK and/or centrally managed and controlled in UK. Orange Inc was incorporated in Outlandia and central management and control has moved to Outlandia therefore the company has migrated.	0.5 1.5
When a company migrates from the UK, gains become chargeable on the company immediately before it becomes non-resident as if the items are sold for MV.	0.5
UK factory used in trade £400,000 Not chargeable in UK because it would be a permanent establishment in UK following migration and therefore still within the scope of UK Corporation Tax.	1
UK investment property £300,000 Immediately chargeable to UK Corporation Tax with no scope to defer.	1
Outlandia Net Gains As Orange Inc is a 100% subsidiary of Lemon plc (therefore at least 75%), the two companies may jointly elect to defer net gains on assets situated outside of the UK and used for the purposes of a trade carried on outside the UK.	1
This means that net gains of £884,000 (£750,000 Outlandia Factory + £250,000 Outlandia Goodwill - £116,000 Outlandia Warehouse) will be deferred at the date of migration.However, Orange Inc sold the Outlandia factory on 28th December 2017, therefore within 6 years of migration. This will crystallise part of the gain deferred. The gain chargeable will be net gain x gain at date of migration on asset sold/gross gain at migration. This will become chargeable in Lemon plc so we need to recognise:	1 1
£884,000 x £750,000/1,000,000 = £663,000.	1
Most candidates recognised that thin capitalisation was in point in the first part of this question and correctly calculated the adjustment required. The higher scoring answers also correctly dealt with the ATED on the property. The weaker candidates did not recognise that ATED was an issue and instead discussed the benefit in kind consequences and calculated a straightforward gain. This is a new rule so candidates should have been able to recognise its relevance as a topical issue. The weaker candidates really struggled with the consequences of company migration; despite it being a mainstream topic area. They included deferral of gains on the UK factory and UK investment property which displayed a misunderstanding of the nature of and application of the rules.	
Total marks possible Maximum full marks	21.5 15

3.2	**Marks**
(a)	
Normally, receipts by a company for consulting services provided are taxed under corporation tax rules, and there are no income tax or national insurance consequences for the shareholders of the company until they in turn received a payment (of salary or dividends) from the company.	0.5
However, anti-avoidance rules can apply in certain circumstances to treat payments which are received by a company as employment income of the company's shareholder. These are	0.5

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often referred to as 'IR35' or 'the intermediaries rules'. They apply where, if there had not been a company involved and the individual had provided the services directly, the contract would have been one of employment.	0.5
In order to determine whether Sarah would actually be an employee or not and therefore, if the tax and national insurance payments would be deductible, a number of factors would be taken into account.	
These include whether the worker has a right to send a substitute; whether she can benefit from the way in which she manages her business, the degree of control exercised over her work, and whether she provides her own equipment.	1
• Under the Board's proposals, it would almost certainly be treated as akin to an employment arrangement for these purposes, as Sarah would work a set number of hours and be expected to be on the premises.	1
• Under Sarah's proposals, the fixed fee arrangement means that she would clearly be able to benefit from her efficiency in running the projects etc. The fact that she would contract to do a specific task implies that there would be a different (weaker) kind of day to day supervision of her work, too. It is unclear whether she envisages being able to employ staff to work on the company's projects under her supervision (her proposals certainly don't preclude that), but if she did and that was permitted by the contract terms, it is very unlikely that the arrangements would be treated as having the characteristics of employment.	1
We do not have enough information to reach a definite conclusion on the two sets of proposals, but there is a much higher risk that the Board's proposals would result in the IR35 rules applying.	
At one level, this would not directly affect Lemon plc. Lemon plc would pay Sarah without needing to deduct income tax or national insurance contributions at source, regardless of whether IR35 applies (as Lemon plc is not a public authority). If it applies, Sarah would be treated as making a deemed salary payment to Sarah of 95% of the income on the contract (adjusted for certain allowable costs, and national insurance contributions). The deemed salary payment would be subject to employer's and employee's national insurance contributions, as well as income tax in the hands of Sarah, and it can be deducted in computing Ambrosia plc's profits. Sarah's tax and national insurance bill would therefore be significantly higher, and she may expect to be paid more for his services as a result.	1
Unfortunately the only way to ensure that IR35 does not apply here, and avoid the additional tax and national insurance cost for Sarah, is to change the commercial substance of the transaction. Case law has indicated that if an employee can send a substitute (so that an arrangement is no longer a contract of personal service) the IR35 rules will not apply. It may be worth considering whether an arrangement whereby Sarah has the right to send a substitute, or to subcontract work, would be acceptable if he undertook to supervise the work and ensure it was of a suitable standard.	1

3.2 (b)	**Marks**
The structure of the leasing arrangement appears to fall within the scope of the DOTAS regime. Schemes must be notified to HMRC where they allow a user to obtain a tax advantage as the main benefit or one of the main benefits of the scheme and which bear at least one of the prescribed hallmarks.	0.5 0.5
There is a specific hallmark of avoidance in relation to leasing arrangements which have a cost of at least £10 million for a period of at least 2 years.	2
Therefore, the tax advisers as the scheme promoters must make a disclosure to HMRC within 5 days of the scheme being made available. However, overseas schemes must be notified by the user within 30 days. The promoters should be sent a SRN but if they fail to disclose they are liable for a penalty. Lemon plc must make clear its use of the scheme on its tax return. Failure to do so will result in a penalty of £5,000.	1 1 1

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As I am an employee of Lemon plc and have been asked to give specific advice, I can outline the position to the board and advise that if there is non-disclosure, this could be viewed as tax evasion and possible money laundering. I would need to follow the internal money laundering regulations if Lemon plc has an MLRO. However given Lemon plc is a manufacturing business, it is unlikely that there will be a dedicated Money Laundering Officer so if the board decline to follow my advice then I could make a report direct to NCA.	1 1

(a)
Most candidates recognised that IR35 was an issue. However, this question again demonstrated candidates preference to state the rules (as they did with the employment status indicators), without then applying them to the particular scenario. Weaker candidates just listed the tests and did not then consider how this fitted with the individual's position.

(b)
This part of the question was completed relatively well, with candidates recognising the relevance of DOTAS and the hallmarks of the particular scheme. The weaker candidates adopted the common approach of immediately jumping to the conclusion that this was tax evasion and explaining the consequences of money laundering in immense detail. Ethics scenarios require the candidates to actually use the facts presented in the question and then think about the principles, the consequences and the actions instead of writing practiced answers which have no relevance to the scenario.

Total marks possible	14.5
Maximum full marks	10
Overall total maximum marks	25
Overall total marks available	36

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