

Examination Paper, Solutions and Examiner's Report

Paper: Corporate Taxation

April 2010

SECTION A – Answer ALL 16 COMPULSORY SHORT FORM questions

Marks will be awarded for explanations and workings.

QUESTION 1

Describe the difference between tax evasion and tax avoidance.

(2 marks)

QUESTION 2

In what circumstances can pre-trading expenditure be claimed as a Schedule D Case I deduction?

(2 marks)

QUESTION 3

Beckham plc owns 80% of Brooklyn Ltd, both of which make up accounts to 31 March. The results for 31 March 2010 show the following:

| | Beckham plc | Brooklyn Ltd |
|---------------------------|--------------------|---------------------|
| | £ | £ |
| Schedule DI profit/(loss) | (120,000) | 35,000 |
| Schedule DIII income | 10,000 | 15,000 |
| Chargeable gains | 40,000 | 30,000 |

Required:

Calculate the maximum Schedule DI loss that can be claimed by Brooklyn Ltd from Beckham plc for the year ended 31 March 2010.

(2 marks)

QUESTION 4

Hypia Ltd sells and delivers standard-rated goods to one of its UK customers on 4 June 2009. The customer pays for the goods prior to delivery on 7 May 2009. Hypia Ltd issues a VAT invoice on 12 June 2009.

Required:

State the basic and final tax points for the sale of the goods from Hypia Ltd. You must explain your answer.

(2 marks)

QUESTION 5

Riera plc has brought forward surplus advance corporation tax of £50,000 at 1 May 2008. Riera plc is a stand-alone company. During Riera plc's year ended 30 April 2009, the company's taxable profits amounted to £220,000. Riera plc paid a dividend of £8,000 and received a dividend of £2,000 during the period.

Required:

Calculate the final corporation tax liability for Riera plc for the year ended 30 April 2009. State the amount of surplus ACT carried forward as at 30 April 2009.

(3 marks)

QUESTION 6

Briefly discuss the corporation tax implications of foreign exchange differences.

(2 marks)

QUESTION 7

Torres Ltd owns 100% of the share capital of Drogba Ltd and both are trading companies. Torres Ltd transferred a factory to Drogba Ltd for £20,000 in May 2004, when the market value of the factory was £300,000. Torres Ltd originally acquired the factory in January 1994 for £40,000. In September 2008 Torres Ltd sold its entire shareholding in Drogba Ltd to a third party.

Required:

Calculate any chargeable gains arising as a result of the sale of the Drogba Ltd shares.

Relevant RPIs:

| | |
|----------------|-------|
| January 1994 | 141.3 |
| May 2004 | 186.5 |
| September 2008 | 217.5 |

(4 marks)

QUESTION 8

The following information has been taken from the accounts and corporation tax computation of Alonso Ltd:

| | Year ended 31 March 2010 | Year ended 31 March 2009 |
|---|-------------------------------------|-------------------------------------|
| | £ | £ |
| Net book value of fixed assets | 10,500,000 | 9,700,000 |
| Net book value of fixed assets not qualifying for capital allowances | 3,200,000 | 3,100,000 |
| Tax written down value | 5,300,000 | 5,150,000 |

Required:

Assuming Alonso Ltd pays corporation tax at 28%, what is the deferred tax charge or credit in the income statement for the year ended 31 March 2010?

(3 marks)

QUESTION 9

Carrick Ltd has the following extracts from its draft corporation tax computations:

| | Year ended 31 December 2009 | Nine months ended 31 December 2008 | Year ended 31 March 2008 |
|---------------------------|--|---|-------------------------------------|
| | £ | £ | £ |
| Schedule DI profit/(loss) | (150,000) | 50,000 | 30,000 |
| Schedule DIII income | 10,000 | 15,000 | 20,000 |
| Schedule A income | 20,000 | 15,000 | 10,000 |
| Charges paid | (4,000) | (4,000) | (4,000) |

Required:

Assuming that losses are utilised as early as possible, calculate the amount of Schedule DI losses carried forward as at 31 December 2009.

(3 marks)

QUESTION 10

Briefly discuss the VAT implications of:

- a transfer of a going concern; and
- a sale of shares.

(2 marks)

QUESTION 11

Mastic Ltd is a UK company with one 100% subsidiary, Scroll Ltd. Mastic Ltd claimed £100,000 of losses as group relief from Scroll Ltd in relation to the year ended 31 March 2009. Its taxable profits prior to the group relief were £200,000.

Required:

Calculate the corporation tax saved by Mastic Ltd as a result of claiming £100,000 of group relief for the year ended 31 March 2009.

(2 marks)

QUESTION 12

Gerrard Ltd sells one acre of land out of a total holding of 50 acres. The proceeds on sale are £8,000 and the total market value of the land prior to the disposal was £100,000.

Required:

Briefly explain why this transaction would be exempt from chargeable gains.

(2 marks)

QUESTION 13

Define a long life asset and state its tax treatment for capital allowance purposes.

(3 marks)

QUESTION 14

Briefly outline the corporation tax treatment of intangible assets, ensuring that you give examples of intangible assets.

(3 marks)

QUESTION 15

Benitez plc, a UK VAT-registered company, sold goods to a UK customer on 1 May 2009 for £100,000 plus VAT, paying over the output VAT on its VAT return to 30 June 2009. It is now January 2010 and the customer has not yet paid the invoice which was due for payment by 30 June 2009.

Required:

Briefly describe how Benitez plc can claim bad debt relief and the VAT effect on the customer of such a claim.

(3 marks)

QUESTION 16

Scrap Ltd purchased an antique vase in May 2001 for £3,000. Scrap Ltd sold the vase in August 2009 for £8,500.

Required:

Calculate the final chargeable gain on the sale of the vase in August 2009.

Relevant RPIs:

| | |
|-------------|-------|
| May 2001 | 174.2 |
| August 2009 | 223.0 |

(2 marks)

(Total 40 marks)

SECTION B – Answer ONE COMPULSORY question

QUESTION 1

It is April 2010.

You have just been appointed as the tax manager for Findlay Homes plc, a kitchen manufacturer selling to other UK companies. Your first assignment is to prepare the corporation tax return and computation for the year ended 28 February 2009 which your predecessor failed to start.

Findlay Homes plc is wholly owned by Andrew Swann who also owns the entire share capital of Back-to-Date Taps Ltd.

Your immediate boss, the finance director, is keen for the computation to be prepared quickly as he understands it should have been sent to HMRC by now. No corporation tax has been paid to date in respect of this period. He therefore wishes to understand the implications of late filing and payment.

Extracts from the income statement for the year ended 28 February 2009 are included in Appendix 1. Capital transactions for this period are included in Appendix 2.

Required:

- a) **Calculate the corporation tax liability for Findlay Homes plc for the year ended 28 February 2009. You must provide brief explanations of any adjustments that you make.**

(17 marks)

- b) **Briefly outline the penalty and interest implications for late filing and late payment of corporation tax for the year ended 28 February 2009.**

(3 marks)

(Total 20 marks)

APPENDIX 1

Extracts from the income statement of Findlay Homes plc for the year ended 28 February 2009.

1. The profit before tax amounted to £400,000.
2. Depreciation of £77,500 was charged during the year.
3. Included within cost of sales is the movement in stock provisions of £5,700. This is analysed as follows:

| | £ |
|--|---------------|
| General provision at 1 March 2008 | (97,200) |
| Specific provision at 1 March 2008 | (28,700) |
| Stock written off | 4,300 |
| General provision at 28 February 2009 | 85,900 |
| Specific provision at 28 February 2009 | <u>41,400</u> |
| | <u>5,700</u> |

4. Bad debts are not usually a big problem and therefore no provision is made for trade debtors. However during the year, one of the customers went into liquidation and its entire debt of £22,750 was written off.
5. Employee remuneration includes a £30,000 accrual for bonuses at 28 February 2009. In accordance with the bonus scheme rules, the bonus was paid to employees on 21 December 2009. The equivalent accrual for the year ended 29 February 2008 was £27,000 which was paid on 21 December 2008.
6. The entertainment expense of £8,700 comprises the following:

| | £ |
|-----------------------------|--------------|
| UK customers | 3,900 |
| Proposed overseas customers | 800 |
| Staff | 1,400 |
| Gifts to 50 customers | <u>2,600</u> |
| | <u>8,700</u> |

7. The company leases a company car for the finance director. The car is a Renault Megane Sport which has a list price of £19,500 and CO₂ emissions of 192g/km. The monthly lease charge expensed in the income statement is £420. The three-year lease commenced on 1 January 2008.
8. Rental income of £21,200 was credited to the income statement whereas only £19,500 was physically received during the year.
9. Dividends of £1,800 were received from small investments in UK companies, and were credited to the income statement.

APPENDIX 2

Capital transactions during the year ended 28 February 2009.

1. The following additions were debited to fixed assets in the balance sheet:

| Item | Date | Cost £ |
|--------------------------------------|------------------|-----------|
| New computers | 14 March 2008 | 8,500 |
| Air conditioning (integral fixtures) | 13 June 2008 | 25,000 |
| Sink moulding press | 1 September 2008 | 48,000 |
| Renault Espace car (173g/km) | 14 December 2008 | 20,000 |

2. Three old computers were sold during the year for total proceeds of £600 (original cost £4,500). In addition a Ford Mondeo (see note 3) was sold for £6,000 (original cost £13,000). All items were sold at their net book values included within the accounts.
3. The tax written down values for capital allowance purposes at 1 March 2008 were:

| | £ |
|--------------|---------|
| General pool | 285,000 |
| Ford Mondeo | 7,500 |

4. Findlay Homes plc qualifies as a small company for capital allowance purposes.

SECTION C – Answer TWO out of THREE questions

QUESTION 2

Protect Alarms Ltd is a stand-alone UK company drawing up accounts to 30 June each year. For the first time in its history, the company had taxable profits in excess of £1.5m for the year ended 30 June 2009.

During the current period (the year to 30 June 2010) the taxable trading profits are currently forecast to be £1.3m. However, there is a large degree of uncertainty regarding the company's total profits for tax purposes. This uncertainty is due to two potential capital disposals. The actual timing of each transaction is not yet known, but it is likely that they will take place in June or July 2010. Details of these disposals can be found in Exhibit 1.

The directors of Protect Alarms Ltd need to understand the company's corporation tax payments on account and you have been asked to advise them on the dates and amounts of each payment on account assuming:

- Both disposals take place in July 2010
- Both disposals take place in June 2010
- Only the sale of land takes place in June 2010

The directors of Protect Alarms Ltd are considering the purchase of a 60% stake in Remote Care Ltd, a UK-resident company. This transaction is due to take place on 1 January 2011. The remaining 40% of Remote Care Ltd will be owned by another UK-resident company.

Remote Care Ltd is a loss-making company and is expected to make a trading loss of £200,000 for the year to 30 June 2011. It also has taxable investment income of £20,000 per annum.

The directors of Protect Alarms Ltd are keen to understand the taxation issues surrounding the purchase of Remote Care Ltd and, in particular, whether it can access the losses.

Required:

- a) **Calculate the chargeable gains/losses arising on the sale of the building and land in June/July 2010.**

(3 marks)

- b) **For each of the three scenarios outlined above, briefly outline the corporation tax payment on account obligations for Protect Alarms Ltd for the year to 30 June 2010.**

(10 marks)

c) **Draft notes to the directors of Protect Alarms Ltd regarding the taxation implications of purchasing Remote Care Ltd. Your notes should cover the following:**

- i) **use of losses for the year ending 30 June 2011; and**
 - ii) **other corporation tax implications of the purchase.**
- (7 marks)**

(Total 20 marks)

Note: You should assume that corporation tax rates remain the same as those for FY2008 shown on your rates sheet.

Relevant RPIs are:

| | |
|------------|-------|
| March 1982 | 79.44 |
| June 1990 | 126.7 |
| June 2010 | 230.0 |
| July 2010 | 230.0 |

Relevant lease percentages:

| | |
|----------|--------|
| 40 years | 95.457 |
| 20 years | 72.770 |

Exhibit 1

Proposed sale of building and land in June/July 2010

Building

Protect Alarms Ltd purchased a 40-year leasehold building in June 1990 for £200,000. It is expected to be sold in 2010 for £700,000 when it will have 20 years remaining of the lease (ignore the effect that one month has on the lease term if sold in June or July).

Land

The land was acquired in March 1982 for £130,000. Protect Alarms Ltd wishes to retain part of the land and only plans to sell half of it. The land is expected to be sold for only £30,000. The market value of the part retained would be £20,000.

Both the land and building will be sold for their respective net book values and hence no profit/loss on sale will be recorded in the income statement.

QUESTION 3

You have been the tax adviser to Marner Ltd ('Marner') for several years. Marner manufactures and sells computer hard drives for sales directly to retailers. Marner is a wholly-taxable business for VAT purposes, as the sale of hard drives is standard rated. Marner's year end is 30 September.

Due to a recent downturn in demand for its products, Marner is proposing to sell its Lancaster factory in May 2010 for £370,000 (plus VAT if applicable). The factory was acquired in September 1998 for £120,000. No VAT elections were made in respect of this property.

On 31 March 2010 a smaller seven-year old factory was purchased in Preston for an agreed VAT-exclusive price of £210,000. Marner is still waiting to receive an invoice for this factory purchase and are therefore not sure whether VAT has been charged or not. You have ascertained that the property has been "opted to tax" by the vendor.

Marner's directors are keen to understand the corporation tax, VAT and stamp duty land tax implications on the sale of the Lancaster factory and the purchase of the Preston one. You should note in particular what is meant by the "option to tax" and discuss the advantages and disadvantages of Marner "opting to tax" the Preston factory themselves.

Finally Marner sold 20,000 of its 30,000 shares in January 2010 that it owned in Granary Systems UK plc for £205,000, to assist in the cash flow for the remainder of its businesses. Marner acquired the shares in Granary Systems UK plc as follows:

| | Number | Cost (£) |
|---------------------------------------|---------------|-----------------|
| May 1986 | 15,000 | 40,000 |
| September 1990 (1 for 1 rights issue) | 15,000 | 30,000 |

You have been asked to calculate the net cash retained by Marner on the sale of the shares on the assumption that corporation tax is payable at 28%.

Required:

a) Discuss and quantify the implications of the sale of the Lancaster factory and purchase of the Preston factory for:

(i) Corporation tax purposes; **(7 marks)**

(ii) Stamp duty land tax purposes; and **(2 marks)**

(iii) VAT purposes, including a discussion of the option to tax. **(7 marks)**

- b) Calculate the chargeable gain on sale of the Granary Systems UK plc shares. Calculate the net cash retained by Marner following this sale.

(4 marks)

(Total 20 marks)

Relevant RPIs are:

| | |
|----------------|--------|
| May 1986 | 97.85 |
| September 1990 | 129.30 |
| September 1998 | 164.40 |
| January 2010 | 226.00 |
| May 2010 | 229.00 |

QUESTION 4

Matthew Arteck, the chief accountant of Hartnet Ltd ('Hartnet'), has written to you with regard to a number of recent developments in the group. Hartnet is a UK-resident company with one wholly-owned subsidiary, Jackman SA ('Jackman'), a company resident in Spain.

Jackman has just opened a sales office in England, selling goods within the UK. Matthew has asked you to confirm that the profits from the sales office will not be liable for UK corporation tax, due to it being owned by a Spanish company.

Hartnet Ltd has started trading through a brand new company Damon Inc, a company resident in the Cayman Islands. Hartnet has transferred many of its existing profitable sales contracts to Damon Inc to try to lower the UK corporation tax payable by the group as a whole. There is no equivalent tax to pay on profits in the Cayman Islands. Matthew has sought your advice as to whether there are any UK pitfalls relating to this new company Damon Inc.

Matthew informs you that Hartnet is about to start paying patent royalties to an unconnected German company again, having last done so four years ago. Matthew remembers having to complete CT61s and deducting tax at 22%, but would appreciate a quick recap of the current position. Hartnet does not receive any income with tax already suffered.

Finally, Hartnet is proposing to start selling its products directly to France and USA, both to companies and directly to individual consumers. Hartnet's products are all standard rated for UK VAT. Matthew has sought your advice on the VAT implications of selling to France and USA.

Required:

Draft a letter to Hartnet explaining the following:

- a) UK corporation tax implications of the new sales office;
- b) UK corporation tax implications of the Cayman Islands company, Damon Inc;

- c) Current CT61 regime and the payment of royalties to Germany;
and**
- d) VAT implications of selling goods from the UK to France and
to the USA.**

(Total 20 marks)

TAX TABLES

CORPORATION TAX

| | FY 2006 | FY2007 | FY2008 |
|--|----------------|---------------|---------------|
| Small companies rate | 19% | 20% | 21% |
| Full rate | 30% | 30% | 28% |
| Small rate ends at: | £300,000 | £300,000 | £300,000 |
| Full rate starts at: | £1,500,000 | £1,500,000 | £1,500,000 |
| Marginal fraction – between small and full | 11/400 | 1/40 | 7/400 |

CAPITAL ALLOWANCES

Size of enterprise for capital allowances:

Medium enterprise:

| | |
|-----------|----------|
| Turnover | ≤ £22.8m |
| Assets | ≤ £11.4m |
| Employees | ≤ 250 |

Small enterprise:

| | |
|-----------|---------|
| Turnover | ≤ £5.6m |
| Assets | ≤ £2.8m |
| Employees | ≤ 50 |

Rates of capital allowances

| <u>Rate</u> | <u>Dates</u> | <u>Trader</u> | <u>Assets</u> |
|-------------|--------------|----------------------------|---|
| 10% | From FY2008 | All | Long life assets and integral fixtures |
| 20% | From FY2008 | All | All plant and machinery |
| 25% | Up to FY2007 | All | All plant and machinery |
| 40% | Up to FY2007 | Small & medium enterprises | All plant and machinery other than cars, ships or long life assets |
| 50% | Up to FY2007 | Small enterprises | All plant and machinery other than cars, ships or long life assets |
| 100% | From FY2008 | All | First £50,000 on all plant and machinery other than cars |
| 100% | All | All | Registered energy saving and environmentally beneficial plant or machinery |
| 100% | All | All | Low emission cars (up to 110 g/km). Equipment used to refuel vehicles with natural gas or hydrogen fuel |

VALUE ADDED TAX

| | From 1 April 2007 | From 1 April 2008 |
|-----------------------|----------------------|----------------------|
| Standard rate | 17.5% | 17.5% |
| Registration limit | £64,000 | £67,000 |
| De-registration limit | £62,000 | £65,000 |

STAMP TAXES

Stamp Duty

Sales 0.5%

Stamp Duty Land Tax

| | Residential* | Non-residential |
|---------------------|--------------|-----------------|
| £0 - £125,000 | 0% | n/a |
| £0 - £150,000 | n/a | 0% |
| £125,000 - £250,000 | 1% | n/a |
| £150,001 - £250,000 | n/a | 1% |
| £250,001 - £500,000 | 3% | 3% |
| Over £500,000 | 4% | 4% |

Stamp Duty Land Tax on NPV of rent

| | Net present value of rent | |
|----|---------------------------|----------------------|
| | Residential* | Non-residential |
| 0% | £0 - £125,000 | £0 - £150,000 |
| 1% | Excess over £125,000 | Excess over £150,000 |

* - The residential 0% threshold has been temporarily increased to £175,000 for transactions completed between 3 September 2008 and 2 September 2009.

SOLUTIONS

This solution covers all the points that the examiner had expected to see in answers to the examination paper. As such, the solution includes more than would be expected from an individual candidate in the time available to answer the question under exam conditions.

Although comprehensive, the solution is not intended to be exhaustive.

SECTION A

QUESTION 1

Tax avoidance is the arrangement of a company's tax affairs in a legitimate way to reduce the amount of tax payable. This is legal.

Tax evasion is the understatement of taxable income, overstating expenses or making false claims for allowances. Tax evasion is illegal and is a criminal offence.

QUESTION 2

Relief is available for expenditure incurred by a company up to seven years before the commencement of trade. It only allows for a deduction on the first day of trade, for items of expenditure which would have been deductible had they been incurred after the commencement of trade. This does not include capital expenditure.

QUESTION 3

Beckham does not have to offset the loss against its own profits of £50,000 before considering a surrender to Brooklyn.

As Beckham owns at least 75% of Brooklyn, there is no restriction in the amount of group relief that can be surrendered to Brooklyn other than Brooklyn being able to use it.

As Brooklyn's taxable profits are only £80,000, this is the amount which can be claimed by Brooklyn.

QUESTION 4

The basic tax point will be the date the goods are delivered to the customer, ie 4 June 2009.

The basic tax point is superceded in a number of scenarios. One of these is if either the VAT invoice or payment is received before the basic tax point.

As payment is received before the basic tax point, the final tax point will revert to the date of payment which is 7 May 2009.

QUESTION 5

| | | |
|-------------------------------|----------------|-----------------|
| | £ | £ |
| PCTCT at 21% (£220,000 x 21%) | | 46,200 |
| Less: ACT offset (see below) | | <u>(42,500)</u> |
| Final CT payable | | <u>3,700</u> |
| Maximum ACT Offset: | | |
| PCTCT x 20% | | 44,000 |
| Less: shadow ACT | | |
| Dividends paid | 8,000 | |
| Less: dividends received | <u>(2,000)</u> | |
| | <u>6,000</u> | |
| | x 20/80 | <u>(1,500)</u> |
| Maximum ACT offset | | <u>42,500</u> |

Surplus ACT carried forward at 30 April 2009 = £50,000 - £42,500 = £7,500

QUESTION 6

Foreign exchange gains and losses are taxed/allowed as they accrue in the income statement if they relate to a trading transaction. Hence no adjustment is required via Schedule DI.

If the transaction is non-trading, any gains and losses must be removed from Schedule DI and assessed as part of Schedule DIII.

QUESTION 7

Firstly, the sale of the Drogba Ltd shares will be exempt via the substantial shareholdings exemption (SSE), as more than 10% of the shares have been held for the last 12 months.

A de-grouping charge will arise as an intra-group transfer has taken place within six years of the recipient company leaving the group.

The de-grouping charge will be calculated at the time of the intra-group transfer as follows:

| | |
|--|-----------------|
| | £ |
| Proceeds (MV May 2004) | 300,000 |
| Less: cost (Jan 1994) | <u>(40,000)</u> |
| Unindexed gain | 260,000 |
| Less: IA | |
| $(186.5 - 141.3) / 141.3 = 0.320 \times £40,000$ | <u>(12,800)</u> |
| Chargeable gain | <u>247,200</u> |

This gain will be taxable on Drogba Ltd in the CAP in which it leaves the group.

It is possible to elect for the gain to be taxable in Torres Ltd's corporation tax return for the same CAP instead.

QUESTION 8

| | Year ended 31 March 2010 £ | Year ended 31 March 2009 £ |
|---------------------------|----------------------------------|----------------------------------|
| Qualifying NBV | 7,300,000 | 6,600,000 |
| TWDV | <u>5,300,000</u> | <u>5,150,000</u> |
| Difference | <u>2,000,000</u> | <u>1,450,000</u> |
| Provision required at 28% | <u>560,000</u> | <u>406,000</u> |

Increase in provision = £154,000 which is a charge (debit) to the income statement for the year ended 31 March 2010.

QUESTION 9

If losses are to be utilised as early as possible, a current year claim followed by a carry back claim should be made. This carry back is to the 12 months prior to the start of the loss making period, ie to 1 January 2008. Therefore it is necessary to pro-rate (to 3/12) the taxable profits for the year ended 31 March 2008.

| | y/e 31 Dec 09 £ | p/e 31 Dec 08 £ | y/e 31 Mar 08 £ |
|---------------|-----------------------|--------------------|--------------------|
| Schedule DI | nil | 50,000 | 30,000 |
| Schedule DIII | 10,000 | 15,000 | 20,000 |
| Schedule A | 20,000 | 15,000 | 10,000 |
| Total profits | 30,000 | 80,000 | 60,000 |
| c/y claim | (30,000) | | |
| c/b claim | | (80,000) | (15,000) |
| Charges | - | - | (4,000) |
| PCTCT | nil | nil | 41,000 |

Schedule DI loss carried forward = £150,000 - £30,000 - £80,000 - £15,000 = £25,000

All of the charges paid in the year to 31 December 2009 and the period to 31 December 2008 are lost.

QUESTION 10

A transfer of a going concern is the sale of a business (not a company) which is capable of being operated in its own right as a business.

If there is a transfer of a going concern, then the sale is outside the scope of VAT.

The sale of shares is the sale of part or all of a company and is an exempt supply for VAT purposes.

QUESTION 11

As there are two associated companies in the group, the CT limits must be divided by two.

Revised CT Limits (FY08):

| | |
|--------|---------------------|
| 21% | £0 - £150,000 |
| 29.75% | £150,000 - £750,000 |
| 28% | £750,000 + |

Before claiming group relief its taxable profits (£200,000) are in the marginal band by £50,000. After claiming group relief its taxable profits (£100,000) are £50,000 below the small companies limit.

$$\text{CT saved} = (29.75\% \times £50,000) + (21\% \times £50,000) = £25,375$$

Note: the same result could be achieved by completing a full computation of the tax before and after the loss relief, by taxing at 28% less marginal relief. Full marks will be given for either approach.

QUESTION 12

As this is the disposal of a small part of a larger holding of land, sold for proceeds of up to £20,000 and does not constitute more than 20% of the total value of the land, no gain will arise on the disposal.

QUESTION 13

A long life asset is an asset which has an economic life, when new, of at least 25 years.

If spend on long life assets exceed £100,000 in a 12 month period, all such expenditure is allocated to the special rate pool ('SRP') with only 10% WDAs available per annum.

If the spend does not exceed £100,000, all the expenditure in the period can be allocated to the general pool with WDAs available at 20%, or may attract the Annual Investment Allowance.

The £100,000 de minimis limit is divided by the number of associated companies in the group.

QUESTION 14

Common intangible assets are goodwill, intellectual property, copyrights and patents.

The normal taxation treatment of intangible assets follows the accounting treatment and hence no adjustment is required for debits and credits in the income statement.

If however the items are non-trading related, the debits and credits must be removed from Schedule DI and instead treated as part of Schedule DVI.

It is possible for the company to elect to ignore the accounting treatment and to instead claim a 4% tax deduction per annum from Schedule DI. In this scenario, any accounting debit/credit must be removed from Schedule DI.

QUESTION 15

As the debt is now more than six months overdue, VAT bad debt relief can be claimed by Benitez plc.

This will enable Benitez plc to recover the output VAT of £17,500 from HMRC on its next VAT return, ie the return to 31 March 2010.

It will also be necessary for the customer to pay back the input VAT that it claimed (if it did so) on its next VAT return after being informed by HMRC.

QUESTION 16

This is a non-wasting chattel sold at a profit for proceeds in excess of £6,000. Therefore, any resulting chargeable gain cannot exceed 5/3 of the difference between the gross proceeds (£8,500) and £6,000.

| | |
|--|----------------|
| | £ |
| Proceeds | 8,500 |
| Less: cost | <u>(3,000)</u> |
| Unindexed gain | 5,500 |
| Less: IA (223.0 – 174.2)/174.2=0.280 x £3,000 | <u>(840)</u> |
| Chargeable gain | <u>4,660</u> |

Compare with:

$$5/3 \times (\pounds 8,500 - \pounds 6,000) = \pounds 4,167$$

Therefore gain = £4,167

SECTION B

QUESTION 1

(a)

Corporate tax computation
Year ended 28 February
2009
Findlay Homes Plc

| | £ |
|--------------------------|----------------|
| Schedule DI (W1) | 336,264 |
| Schedule A (W1) | <u>21,200</u> |
| PCTCT | <u>357,464</u> |
| | |
| FII (£1,800 x 100/90) | <u>2,000</u> |
| Profits | <u>359,464</u> |

As two companies are controlled by one individual, both companies will be treated as associates. Hence the revised CT limits will be:

| | | FY07 | FY08 |
|-----------------|------------|-------------|-------------|
| Small companies | £0 - | | |
| rate | £150,000 | 20% | 21% |
| Full rate | £750,000 + | 30% | 28% |

As the CAP spans FY07 (one month) and FY08 (eleven months), it is necessary to split the CAP between the financial years.

| | One month FY07 | | 11 months FY08 | |
|---------------------------------|-------------------|-----------------|-------------------|------------------|
| | | £ | | £ |
| PCTCT £357,464 x 1/12/11/12 | | 29,789 | | 327,675 |
| FII £2,000 x 1/12/11/12 | | <u>167</u> | | <u>1,833</u> |
| Profits | | <u>29,956</u> | | <u>329,508</u> |
| Limits: | 20% | £0-£12,500 | 21% | £0-£137,500 |
| | 30% | £62,500 | 28% | £687,500 |
| | | 30% - MR | | 28% - MR |
| CT payable | | | | |
| PCTCT @ 30%/28% | | 8,936.70 | | 91,749.00 |
| 1/40 x (£62,500-£29,956) x | | | | |
| <u>£29,789</u> | | | | |
| £29,956 | | (809.06) | | |
| 7/400 x (£687,500 - £329,508) x | | | | |
| <u>£327,675</u> | | | | |
| £329,508 | | | | (6,230.01) |
| | | <u>8,127.64</u> | | <u>85,518.99</u> |

Total CT payable for CAP = £93,646.63

WORKING 1 – Schedule DI adjustments

| PBT | £ | £ |
|--|----------------|----------------|
| | | 400,000 |
| Add: | | |
| Depreciation - capital | 77,500 | |
| Bad debts (note 2) | 0 | |
| Bonus accrual (note 3) | 30,000 | |
| Entertaining (note 4) | 7,300 | |
| Expensive car leasing (note 5) | <u>969</u> | |
| | | 115,769 |
| Deduct: | | |
| Reduction in general stock provision (note 1) | 11,300 | |
| Bonus paid (note 3) | 27,000 | |
| Rental income (note 6) | 21,200 | |
| Dividends (note 7) | 1,800 | |
| Plant and machinery allowances (W2) | <u>118,205</u> | |
| | | (179,505) |
| Adjusted Schedule DI profit | | <u>336,264</u> |

NOTES:

1. Any movement in a general provision needs to be adjusted for under Schedule DI. As the general stock provision has decreased from £97,200 to £85,900 (a reduction of £11,300) at February 2009, this credit to the income statement must be deducted from Schedule DI.
2. As this is a specific bad debt write off, no adjustments are required.
3. Any remuneration accruals paid more than nine months after the end of the CAP must be added back to Schedule DI and deducted in the CAP in which they are actually paid. The £30,000 bonus accrual as at 28 February 2009 is not paid before 30 November 2009 and therefore must be added back. The same situation applied for the £27,000 accrual for the year ended 29 February 2008. As it has been paid in the current CAP, a deduction can now be claimed.
4. All client entertaining must be added back (UK and overseas) as well as the client gifts (cost > £50 each). Staff entertaining is an allowable deduction.
5. As the list price of the car exceeds £12,000 (and emissions > 110g / Km) part of the lease charge must be disallowed.

$$\frac{1}{2} \frac{(\pounds 19,500 - \pounds 12,000)}{\pounds 19,500} \times (\pounds 420 \times 12) = \pounds 969$$

6. Rental income is taxable as part of Schedule A and therefore must be deducted from Schedule DI. It is taxable on an accruals rather than a receipt basis, and so the £21,200 will be shown as Schedule A income.
7. UK dividends received are not taxable and must be deducted. The grossed up amount will be treated as FII.

Working 2 – Plant and machinery allowances

| | AIA 100% £ | FYA 50% £ | WDA £ | Mondeo £ | Espace £ |
|-------------------------|------------------|-----------------|----------|-------------|-------------|
| TWDV b/f - 1 March 2008 | | | 285,000 | 7,500 | |
| Additions - FY07: | | | | | |
| New computers | | 8,500 | | | |
| Additions - FY08: | | | | | |
| Air conditioning | 25,000 | | | | |
| Moulding press | 20,833 | | 27,167 | | |
| Renault Espace | | | | | 20,000 |
| Disposals: | | | | | |
| Computers | | | (600) | | |
| Mondeo | | | | (6,000) | |
| Qualifying expenditure | 45,833 | 8,500 | 311,567 | 1,500 | 20,000 |
| FYAs @ 50% | | (4,250) | | | |
| AIA @ 100% | (45,833) | | | | |
| WDAs @ 20.42% / £3,000 | | | (63,622) | | (3,000) |
| Balancing allowance | | | | (1,500) | |
| Transfer balance | | (4,250) | 4,250 | | |
| TWDV c/f - 28 Feb 2009 | nil | nil | 252,195 | nil | 17,000 |

Total PMAs = £45,833 + £4,250 + £63,622 + £1,500 + £3,000 = £118,205

Notes:

Hybrid WDA rate = $(25\% \times 1/12) + (20\% \times 11/12) = 20.42\%$

Annual Investment allowance (FY08) = $11/12 \times £50,000 = £45,833$

It is most tax effective to allocate the integral fixture to the AIA rather than the special rate pool as only 10% WDAs are available.

(b) Late Filing Penalty

- The corporation tax computation for the year ended 28 February 2009 should have been filed with the HMRC by 28 February 2010.
- As the return is late a penalty of £100 will be levied.
- Interest will run on any late payment of corporation tax which was due by 1 December 2009 (9 months and 1 days after the end of the CAP) until the date the tax is paid.
- In addition to a penalty, HMRC will have more time to look at the tax return before it opens an enquiry. HMRC will have 12 months from the next quarter date after filing. The quarter dates are 31 January, 30 April, 31 July and 31 October.
- Therefore if the tax return is filed in May 2010, HMRC will have until 31 July 2011 in which to open an enquiry.

QUESTION 2

(a)

| | |
|--|------------------|
| i) Sale of building | £ |
| Proceeds | 700,000 |
| Less: cost | |
| £200,000 x 72.770 / 95.457 | <u>(152,467)</u> |
| Unindexed gain | 547,533 |
| Less: IA | |
| (230.0 – 126.70)/126.70=0.815 x £152,467 | <u>(124,261)</u> |
| Chargeable gain | <u>423,272</u> |

ii) Sale of land – part disposal

| | |
|--|-----------------|
| | £ |
| Proceeds | 30,000 |
| Less: cost | |
| £130,000 x £30,000 / (£30,000 + £20,000) | <u>(78,000)</u> |
| Unindexed loss | (48,000) |
| Less: IA – cannot increase a loss | <u>nil</u> |
| Chargeable loss | <u>(48,000)</u> |

(b) Current position

- Protect Alarms Ltd (Protect) was a large company (paying corporation tax entirely at the full rate as taxable profits exceeded £1.5m) in the prior year (year ended 30 June 2009).
- If Protect is a large company for the year ended 30 June 2010, corporation tax payments on account will be due for this year.
- If payments on account are due, the dates of payment will be:

14 January 2010
14 April 2010
14 July 2010
14 October 2010

- The first of these payments is now overdue and the second one is due this month.
- Interest will accrue on any amounts underpaid from the due dates up to the date they are paid.
- The amount of each payment on account will equal 25% of the total current year's forecast corporation tax liability. Therefore the level of taxable profits is paramount for calculating each instalment.

Scenario 1

- If both disposals take place in July 2010, the taxable profits for the year ended 30 June 2010 are expected to be £1.3m. Therefore Protect will not be a large company (profits do not exceed £1.5m) for the period and hence payments on account will not be required.
- Corporation tax will be at 28% less marginal relief. This amounts to £364,000 less £3,500, ie £360,500.
- Corporation tax would be payable in one lump sum on 1 April 2011.

Scenario 2

- If both disposals took place during the year ended 30 June 2010, the taxable profits would be:

| | £ | £ |
|-------------------------|-----------------|------------------|
| Schedule DI | | 1,300,000 |
| Chargeable gains | 423,272 | |
| Less: chargeable losses | <u>(48,000)</u> | |
| Net gains | | <u>375,272</u> |
| PCTCT | | <u>1,675,272</u> |

- As this exceeds £1.5m, corporation tax would be payable at the full rate for two consecutive years and hence payments on account would be required for the year ended 30 June 2010.
- The liability for this year would be $28\% \times £1,675,272 = £469,076.16$
- Payments on account would be £117,269.04 on each of the dates highlighted.
- As nothing was paid on 14 January 2010, a payment of £234,538.08 (50% of the total liability) should be paid by 14 April 2010 to prevent further interest accruing.

Scenario 3

If only the sale of land takes place in June 2010, the capital loss would be carried forward against the gain in July 2010. A capital loss can only be used against chargeable gains of the current or future periods. Hence the taxable profits for the year ended 30 June 2010 would be £1.3m with no payments on account required. The corporation tax of £360,500 would be due on 1 April 2011.

Conclusion

Payments on account would be required if the sale of the building takes place in June rather than July. An assessment of the likelihood of this taking place in June must be made to determine whether payments on account should be made.

(c)

i) Utilisation of the loss from Remote Care Ltd.

- The purchase of a 60% stake in a UK company creates a consortium if the other 40% is held by another UK company. This is the case as each company owns at least 5% of the shares in another company and when the shareholdings are added together, they amount to at least 75% all of which is satisfied in this scenario.
- Consortium relief is therefore applicable which will enable the consortium members to claim a proportion of the loss from the consortium company, Remote Care Ltd.
- Losses can only be shared for the period since acquisition, ie for the six months to 30 June 2011.
- Assuming that profits and losses have accrued evenly over the year, the post-acquisition position for Remote Care Ltd would be:

Schedule DI loss (£100,000)
Other profits £10,000

- The maximum loss relief that can be claimed by the consortium members is further reduced by any taxable profits Remote has in the current year (£10,000). As a result, only £90,000 of the loss could be surrendered.
- Therefore maximum surrender to Protect is:

$60\% \times £90,000 = £54,000$
Protect's profits – assumed greater than
£54,000

- Hence £54,000 could be claimed by Protect for its year ended 30 June 2011.
- A joint claim needs to be signed by all consortium members and Consortium Company.

ii) Group Implications

- The purchase of more than 50% of the shares in Remote by Protect creates an additional associate for Remote for its year ended 30 June 2011.
- Hence its revised limits will be:

21% £0-£150,000
28% £750,000

- This may have implications on Remote's payment on account position as lower thresholds may lead to two consecutive years of being a large company.
- In addition, Protect will be part of a 51% group, resulting in dividends received by Remote from Protect being ignored for franked investment income purposes.

QUESTION 3

(a)

Sale of Lancaster factory

i) *Corporation tax*

- Any profit or loss on sale of the factory must be removed from Schedule DI profits.

- A chargeable gain will arise on the sale of the factory as follows:

| | £ |
|--|------------------|
| Proceeds (May 2010) | 370,000 |
| Less: cost (Sept 1998) | <u>(120,000)</u> |
| Unindexed gain | 250,000 |
| Less: IA | |
| $(229.0 - 164.4) / 164.4 = 0.393 \times \text{£}120,000$ | <u>(47,160)</u> |
| Chargeable gain | <u>202,840</u> |

- This gain will form part of the taxable profits for the year ended 30 September 2010.
- Any legal fees incurred in the period in relation to this sale can be deducted from the sale proceeds above, thus reducing the overall gain. If these legal fees are expensed in the income statement, then they must be added back for Schedule DI purposes.

ii) *Stamp duty land tax*

This is the responsibility of the purchaser and hence has no implications for Marner.

iii) *VAT*

- As the building is more than three years old (and no option to tax has been made), the sale of the Lancaster building is an exempt transaction and hence no VAT should be charged on sale.
- Any VAT suffered on the legal fees incurred in relation to the sale of the factory would not be recoverable as they relate to an exempt sale. This is subject to the de-minimis rules.

Purchase of Preston Factory

i) *Corporation tax*

- Any legal fees incurred on the acquisition of the Preston factory must be added back for Schedule DI purposes if expensed in the income statement.
- A qualifying asset (Lancaster factory) has been sold and a new qualifying asset (Preston factory) has been acquired. Part of the proceeds have been reinvested from the sale of the Lancaster to the Preston factory, reinvestment relief is available to defer part of the gain.

- Reinvestment takes place within one year before sale (ie from May 2009) and up to three years after (ie up to May 2013)
- The relief is rollover relief as reinvestment is in a non-depreciating asset (ie an asset which has a life of more than 60 years).
- Not all of the gain of £202,840 can be deferred as not all the proceeds (£370,000) have been reinvested (only £210,000 reinvested). Therefore £160,000 has been retained, meaning that £160,000 of the gain cannot be deferred. The remaining £42,840 can be deferred.
- The £160,000 gain will be taxable in the year ended 30 September 2010.
- The gain of £42,840 is deferred via rollover relief, reducing the cost of the Preston factory as follows:

| | |
|-----------------------|-----------------|
| | £ |
| Original cost | 210,000 |
| Less: rollover relief | <u>(42,840)</u> |
| Revised cost | <u>167,160</u> |

ii) Stamp duty land tax

- As the Preston property has been opted to tax, SDLT is payable on the VAT inclusive price of £246,750 (£210,000 x 1.175)
- SDLT payable = 1% x £246,750 = £2,467 (rounded down)
- This must be payable within 30 days of completion, ie by 30 April 2010.

iii) VAT

- By default a seven-year old building will be an exempt supply as it is more than three years old.
- As the vendor has opted to tax the factory, this turns an exempt supply into a standard rated one, hence 17.5% VAT will be added to the purchase price (£210,000 x 17.5% VAT = £36,750).
- Marner can recover the £36,750 as it makes wholly taxable sales.
- The property is not caught by the capital goods scheme as its purchase price is less than £250,000.
- If Marner does not opt to tax the building, any supplies (rent or sale) of the building will be exempt for VAT purposes and may restrict the recovery of any related expenses.

- If Marner does opt to tax the Preston factory, standard rated VAT must be added to the sale or rent of this property in the future. This may not be an issue if the rent/sale is to a wholly taxable business as they can recover the related VAT.
- However if rented/sold to a non-VAT registered or partially exempt business then they would not be able to recover the VAT charged and hence this is an additional cost. They may decide to rent/buy someone else's property who has not opted to tax.

(b)

| FA 85 pool | Number | Cost £ | Indexed cost £ |
|--|-----------------|-----------------|-------------------|
| May 1986 purchase | 15,000 | 40,000 | 40,000 |
| index to September 1990 (129.3 - 97.85)/97.85 x £40,000 | | | 12,856 |
| Sep 1990 RI | <u>15,000</u> | <u>30,000</u> | <u>30,000</u> |
| | 30,000 | 70,000 | 82,856 |
| Index to January 2010 (226.0 - 129.3)/129.3 x £82,856 | | | 61,966 |
| As at January 2010 | 30,000 | 70,000 | 144,822 |
| Less: sale | <u>(20,000)</u> | <u>(46,667)</u> | <u>(96,548)</u> |
| C/fwd | <u>10,000</u> | <u>23,333</u> | <u>48,274</u> |

| | £ |
|------------------------------|-----------------|
| Proceeds | 205,000 |
| Less: cost | <u>(46,667)</u> |
| Unindexed gain | 158,333 |
| Less: IA (£96,548 - £46,667) | <u>(49,881)</u> |
| Chargeable gain | <u>108,452</u> |

Net cash retained = £205,000 - (28% x £108,452) = £174,633

QUESTION 4

LETTERHEAD

10 April 2010

Dear Matthew

Thank you for your recent letter regarding the current and future plans for the Hartnet Ltd Group. I have addressed each of your four queries below and would suggest a meeting to discuss these issues further once you have had a chance to look through my initial advice.

UK sales office

Generally income generated by a Spanish resident company will only be taxable in Spain. However where there is a 'permanent establishment' (PE) in the UK of an overseas resident company, the UK tax authorities have the right to tax the income generated by the PE.

This is subject to the wording of a double taxation treaty between the UK and Spain. There is usually a clause in a treaty which stipulates which country's tax authorities have the right to tax such income from a PE.

Whether a PE actually exists depends on whether there is an enduring presence in the UK. For instance, has a building been purchased by the Spanish company in the UK and whether they are employing personnel in the UK.

If the sales office were to make a loss, it is possible to group relieve these losses to Hartnet Ltd and vice versa.

Cayman Islands – Damon Inc

The activities of Damon Inc could be constituted as a controlled foreign company (CFC) or be treated automatically as UK resident if it can be argued to be centrally managed and controlled from the UK.

A CFC is a company which is:

- resident outside the UK;
- controlled by a company which is UK resident; and
- subject to a lower level of taxation (nil in this case) than the UK (28%)

It would appear that all three tests are satisfied and therefore Damon Inc could be treated as a CFC.

If treated as a CFC, all of Damon Inc's profits will be taxable in the UK via Hartnet Ltd, the company which controls Damon Inc effectively reverting the position back to what it was previously.

There are a number of exclusion tests which could prevent Damon Inc from being a CFC:

- distributing at least 90% of Damon Inc's profits back to the UK;
- exempt activity test – if Damon Inc has a business establishment in the Cayman Islands and its business affairs are managed from there;
- publicly quoted – this is not applicable as Damon Inc is not a quoted company;
- motive test – the company must not have been set up with the main purpose of reducing UK tax – which it appears to be; and
- de-minimis – where taxable profits do not exceed £50,000.

If any of these conditions can be satisfied/argued, then Damon Inc will not be treated as a CFC and hence none of its profits taxable in the UK.

CT61 regime

When a patent royalty is paid outside of the UK, there is a requirement to withhold basic rate income tax from such a payment. The current basic rate is 20%, not 22% when you previously made such payments in the past.

The 20% income tax withheld from these payments should be paid to the UK's HMRC via the CT61 system.

The CT61 is a form which must be completed on a calendar quarter basis (31 March, 30 June, 30 September and 31 December). Details of the patent royalties paid (and tax withheld) must be included within this form.

Payments of the withheld income tax must be made to HMRC within 14 days of the end of each quarter.

Overseas sales – VAT

- (i) To EU countries eg France

If sales are being made to another EU country, it is important to ascertain whether the customer is VAT registered in their country of residence.

If the customer is VAT registered, you must obtain their VAT registration number, quote this on the invoice, and zero-rate the goods from the UK. The customers will have to deal with any applicable French VAT via their own VAT returns.

If the customer is not VAT registered, the goods must be charged as if they were being sold to a UK customer ie add standard rated VAT on the goods which would be payable to HMRC via your quarterly VAT return.

(ii) To non-EU countries eg USA

Whether the customer in USA is VAT registered or not is not relevant. The goods will be zero-rated to them and they will deal with the USA sales tax implications themselves.

As you can see from the above analysis, there are many issues that need to be concluded before future tax returns are produced. I therefore look forward to hearing from you in the future so that we can conclude matters.

Yours sincerely

A N Accountant

MARKING SCHEDULE

Evidence

Section B Question 1

Requirement (a)

CT pro-forma
 Span FYs/limits/split
 Tax rates
 CT payable
 Schedule DI - add backs
 - deductions
 Clarity of explanations
 PMAs
 Other

Restrict to

Requirement (b)

Filing date
 Late/penalty
 Interest
 Enquiry
 Other

Restrict to

| | Potential marks |
|--|-----------------|
| | |
| | |
| | |
| | 1 |
| | 3 |
| | ½ |
| | 2 |
| | 2½ |
| | 2 |
| | 2 |
| | 6½ |
| | |
| | 17 |
| | |
| | ½ |
| | 1 |
| | ½ |
| | 1½ |
| | |
| | 3 |

Section C
Question 2

Requirement (a)

Sale of building

Sale of land

Other

Total

Requirement (b)

Prior yr large and why

Current yr POA/dates

Overdue

Interest

Amount of each POA

Both July disposals- no POA and why

- date

Both June disposals- PCTCT

- POA and why

- CT/POAs

- now due

Land June/building July – no POA and why

Conclusion

Other

Restrict to

Requirement (c)

Consortium/conditions

Pro-rate

Amount/claim

Associate/limits

POA

51% group

Other

Restrict to

| | Potential marks |
|--|------------------------|
| | |
| | 1½ |
| | 1½ |
| | 3 |
| | |
| | 1 |
| | 2 |
| | 1 |
| | ½ |
| | ½ |
| | 1 |
| | ½ |
| | 1 |
| | 1 |
| | 1 |
| | 1 |
| | 1 |
| | ½ |
| | 10 |
| | |
| | 2½ |
| | 1 |
| | 2 |
| | 1 |
| | ½ |
| | 1 |
| | 7 |

Question 3

Requirement (a)

(i) Profit/loss
Chargeable gain
Legal fees
SDLT
VAT- exempt
- legal fees
(ii) Legal fees
Rollover relief
SDLT
VAT- input VAT/recover
- not CGS
- not opt to tax
- opt to tax
Other

Restrict to

Requirement (b)

Layout
Acquisition
IA
Pro-rate sale
Chargeable gain
Cash retained
Other

Restrict to

| Potential marks |
|-----------------|
| $\frac{1}{2}$ |
| $1\frac{1}{2}$ |
| 1 |
| $\frac{1}{2}$ |
| 1 |
| 1 |
| $\frac{1}{2}$ |
| 4 |
| $1\frac{1}{2}$ |
| 2 |
| $\frac{1}{2}$ |
| 1 |
| 2 |
| 16 |
| $\frac{1}{2}$ |
| 1 |
| 1 |
| $\frac{1}{2}$ |
| 1 |
| $\frac{1}{2}$ |
| 4 |

Question 4

Sales office - generally

- DTT

- PE?

- loss

Damon Inc - Central management and control

- CFC

- Implications

- exclusions/meaning

CT61 regime - basic rate

- CT61/HMRC

- Quarters

- Payment

Overseas sales - EU VAT registered

- zero-rate

- standard rate

- non-EU

Clarity of writing

Other

Restrict to

| Potential marks |
|-----------------|
| 1½ |
| 1 |
| 1 |
| 1 |
| 1 |
| 2 |
| 1 |
| 2½ |
| 1 |
| 1 |
| 1 |
| ½ |
| 1 |
| 2 |
| 1½ |
| 1½ |
| 1 |
| 20 |

EXAMINER'S REPORT

GENERAL

The overall paper average for this diet was 50.1%, a little lower than the previous diet. The pass rate was similar to recent diets at 62.3%.

A number of very good scripts were presented by candidates showing that all questions were achievable and that high marks could be scored where appropriate work and question practice had been done in preparation for the examination. There remains a significant minority of candidates who present themselves for the exam unable to complete the paper and with insufficient revision. Almost 10% of candidates scored less than 30% indicating a lack of preparation, particularly on exam-standard questions.

The 13% of candidates scoring in excess of 70 are to be commended.

Comments regarding the various sections of the paper are detailed below.

SECTION A – 16 Short form questions

The average mark for Section A was 22.2 out of 40, a slight rise on the previous diet. The questions covered core syllabus areas with a mixture of both numerical and written answers. Candidates are once again reminded to practice the written short questions as well as the numerical short questions, as very few candidates who score less than half marks in this section go on to pass the exam.

Particular questions that caused the most difficulty were:

- Qu.3 Group relief
- Qu.5 Surplus ACT
- Qu.9 Loss relief
- Qu.10 VAT on share transactions and TOGC

SECTION B – Compulsory Question

This question required candidates to carry out a standard corporation tax computation, including an adjustment of profits and a calculation of capital allowances. Where appropriate, brief explanations of adjustments should have been given. The second part asked about penalty and interest implications of late filing and payment in respect of corporation tax. The average mark reflected the standard nature of the question, and was 13.1 out of 20.

Parts of this question were answered well by students although many lost marks in the following areas:

- Although most appreciated that 2 Financial Years were involved and that marginal rate calculations were needed, workings were often absent or very poorly displayed. It is important to show clearly what the limits are for

each FY, what rates of tax will therefore apply and the workings for any calculations.

- The stock adjustment was added rather than subtracted by a significant minority – this was a reduction in a general provision and so would have been shown as income in the income statement. To remove this from a computation it should be deducted.
- Notes detailing why DI adjustment should have been made were too brief in some cases. Where the question asks for comments, there will be marks for these and reasons were required – not simply “not allowed – add back”.
- Late filing penalties were very poorly done – many candidates discussed VAT surcharges and almost no candidate gave the correct penalty.

SECTION C – Optional Questions

Two questions from a choice of three from section C were to be attempted by candidates. Most candidates attempted questions 3 and 4.

QUESTION 2

Question 2 was split into three parts and had an average mark of 8.5 out of 20.

Part a) required the calculation of two gains/losses on disposal. On the whole this was well done, however, a significant number of candidates were unable to deal with the leasehold adjustment. Where a short lease is disposed of, the original cost must be apportioned to reflect that what is now being sold is not the same asset as was originally acquired.

Part b) asked candidates to explain how the timing of the transactions would affect the corporation tax payment obligations of the company. The key was that depending in which year each transaction fell, the company may or may not be classed as a ‘large’ company and have to make payments on account. Where payments on account would be required it was important to address the point that none of these had been made to date and therefore there would be interest implications. Candidates frequently had difficulty ordering their thoughts and succinctly outlining the consequences. Long narratives rather than short statements added to the problem. Within the calculations, a number of candidates wrongly set the capital loss against Schedule DI (trading) profits of the year. Only better candidates drew any conclusions at the end of this section, eg advising directors on whether to start making CT payments.

Part c) required an analysis of the impact of purchasing shares in a new subsidiary, with particular focus on the use of losses. This was handled reasonably well by those candidates that completed the question.

QUESTION 3

This question was split into two parts and had a disappointing average mark of 8.6 out of 20. This is disappointing as similar questions have appeared in many past papers. Candidates appeared to have left themselves insufficient time to complete the question.

Part a) required notes to be written covering the corporation tax, VAT and stamp tax implications of the sale of one factory and the purchase of another. Candidates could have discussed the chargeable gain, the ability to roll this over, the stamp duty land tax amount and timing and the VAT including the option to tax. Most candidates illustrated a good understanding of:

- Calculating of the chargeable gain
- Recognition of the importance of a building being < or > 3 years old
- Possibility of rollover relief

Areas for improvement included:

- Candidates should think further behind the obvious points e.g. most spoke of the effects of age of the building, and exempt / standard VAT, but few went on to give effects of the relevant rate e.g. in relation to reclaim of VAT on legal fees etc.
- Many compared the **gain** with the replacement cost for rollover purposes
- Many also included the VAT inclusive price for the Preston factory with the proceeds of the Lancaster factory
- Rollover relief was not sufficiently explained e.g. time limits, effect on cost of replacement asset

Part b) required the candidates to deal with the sale of some shares. Generally, this was well done, with candidates correctly laying out the FA1985 pool.

QUESTION 4

This question asked candidates to write a letter covering four areas of international tax, and had a very poor average mark of 6.6 out of 20.

On the whole, this question was very poorly answered with many students appearing to run out of time to answer it. In addition, many failed to read the question thoroughly before answering it.

The four parts focused on:

- a) Tax implications of sales office
- b) Controller Foreign Companies (Cayman Islands)
- c) CT61 reporting
- d) VAT on international transactions.

The Cayman Islands problem was reasonably well attempted although many did not go on to discuss exclusion tests.

Most also had an understanding of the CT61 regime but failed to give detailed information regarding submissions of the returns.

There were some creditable answers re: the overseas sales, although some candidates had a poor grasp of the situation with regards to sales to the USA.

Confusion between zero-rated and exempt status was evident.