THE
CHARTERED
INSTITUTE OF
TAXATION

The Chartered Tax Adviser Examination

November 2008

PAPER IIC

COMPANIES

TIME ALLOWED – 3 HOURS

- You should answer all of the questions.
- Start each answer on a new sheet of paper and write on one side of the paper only.
- All workings should be shown and made to the nearest month and pound unless the question specifies otherwise.
- Marks are specifically allocated for presentation.
- Candidates who answer any relevant legal aspects in this paper in accordance with Scots law or Northern Ireland law should tick the appropriate box on the front of the answer folder.

1. Edloe Investments Ltd is a United Kingdom resident company which makes its accounts up to 31 March each year. Its sole activity is the ownership of 100% of each of Colquitt BV and Markham AG, incorporated and solely tax resident in the Netherlands and Switzerland respectively, both of which make up their accounts to 31 December each year. Colquitt BV owns 100% of the share capital of Merwin SA, a company incorporated and solely tax resident in Argentina, with a 31 October year end.

The results of each of these foreign companies (translated into sterling) for their accounting years ending in 2007 were as follows:

	Colquitt BV	Markham AG	Merwin SA
	£	£	£
Profit before tax	200,000 (Note 1)	250,000	100,000
Tax per accounts	30,000	50,000	50,000
Profit after tax	170,000	200,000	50,000 (Note 1)
Tax paid	25,000	100,000	50,000

Note 1 – In December 2007 Merwin SA paid out the whole £50,000 of its post tax profit as a dividend to Colquitt BV. This is included in Colquitt BV's profit before tax for the year ended 31 December 2007 and Colquitt BV paid no further tax on this dividend income in the Netherlands due to the Dutch participation exemption.

In February 2008, Colquitt BV paid a dividend of £170,000 to Edloe Investments Ltd and Markham AG paid a dividend of £200,000 to Edloe Investments Ltd.

Edloe Investments Ltd had no other transactions in the year ended 31 March 2008.

You are required to compute the Corporation Tax liability of Edloe Investments Ltd for the accounting period ended 31 March 2008. (10)

2. Kiddi Inc is a company in the US that sells baby clothes, toys and equipment. It is about to set up a wholly owned subsidiary in the UK, Kiddi Ltd, that will sell similar products and your firm has been engaged to provide tax advice. The CFO of Kiddi Inc, Jennifer Child, has telephoned to request advice on various Corporation Tax self-assessment administrative matters.

The CFO knows that in the UK, a company has to file a company tax return and must pay Corporation Tax but she is not sure what the deadlines are and how to work out the relevant accounting period for tax purposes. She also wants to know when HM Revenue & Customs is likely to enquire into a return so she can have some idea of how long Kiddi Ltd must keep the relevant supporting papers and records because storage space may be an issue.

She has heard that a UK company can claim capital allowances and understands what qualifies for capital allowances but is unsure about the time limits and how to actually claim capital allowances. She has been told that in the event a UK company gets a capital allowances claim wrong, the company can then make an error or mistake claim to rectify it.

Finally, she is confused about the time limits for making claims since she has been told that she has six years to make claims but she has also heard that if Kiddi Ltd wants to carry back losses it has to do so immediately.

You are required to write a letter to the CFO of Kiddi Inc covering all the above issues. (15)

3. You are a tax manager in a firm of Chartered Tax Advisers. You have been approached by the finance director of Glenmont Group plc, the United Kingdom incorporated parent company of a multinational group. The business of Glenmont UK Ltd, one of its United Kingdom incorporated subsidiaries, is the development of components for use in the transport industry. As the culmination of work done over a period of 10 years, it has developed and patented a new component which should significantly improve the fuel efficiency of aircraft. Manufacturing has begun in the United Kingdom by Glenmont Manufacturing Ltd, a fellow group company. However, demand for the product is expected greatly to exceed that company's manufacturing capacity and it will be necessary to license companies in various other jurisdictions around the world to allow them to manufacture the product; these will include both group companies and third parties.

The management of Glenmont UK Ltd has identified that the product can be enhanced through the use of a technique developed and patented by an Australian third party company and has agreed to pay £10 million for the licence to use that company's patented technique for a period of 10 years.

The success of this new product has caused Glenmont UK Ltd to decide to concentrate on the aircraft industry. Accordingly, it has decided to sell various patents developed over the last 20 years to third parties in respect of components for other forms of transport.

The finance director has asked you for a meeting to explain the tax consequences of these transactions and proposals. He has also asked for a reminder of the nature of the expenses which qualify for research and development relief in the United Kingdom and the level of reliefs available so that he can compare these with other jurisdictions. He would also be interested to know what would happen if the aircraft component patent were to be transferred to a group subsidiary in a low-tax jurisdiction such as the Netherlands Antilles.

You are required to prepare a briefing paper for the meeting. (15)

4. Previously tax avoidance schemes were based on the presumption that the courts would apply a literal construction to tax legislation and would look at the legal form of the taxpayer's affairs rather than their substance. Since the Ramsay Case, the courts have moved away from pure literalism to a more purposive interpretation of tax legislation.

You are required to:

1) Discuss the above statement with reference to case law. (10)

2) Explain the 'disclosure of tax avoidance schemes' provisions applying to Corporation Tax. (10)

Total (20)

5. You are the tax manager of Durrette plc, a United Kingdom group of companies. Negotiations have been under way for the purchase of the share capital of the Burgoyne Ltd group of companies which specialises in the manufacture of machine tools and the service thereof. The Burgoyne Ltd group has had a number of unsuccessful businesses and has sold off several companies and vacated premises in recent years, leading to a significant accumulation of cash and properties let to third parties on short-term lets. The cash will be distributed to Burgoyne Ltd's shareholders before the sale.

You have been asked to comment on the following issues:

1) 80% of the share capital in Burgoyne Ltd is owned by Inwood Investments Ltd, a privately held company with numerous investments across the engineering industry. It has made clear that it wants a specific cash sum from the transaction and, if it has to pay any tax on the sale, it will expect additional consideration from Durrette plc.

2) The remaining 20% of the share capital in Burgoyne Ltd is owned by members of the management. It is intended that they will receive consideration by way of shares in Durrette plc together with two cash payments, the first based on the profits of the years 2009 and 2010 and the second on the profits of the years 2011 and 2012.

3) Various members of the Burgoyne Ltd management hold share options in Burgoyne Ltd and have the right to exercise these on a change of control. Durrette plc does not have a share option scheme but intends to offer these employees, in exchange for giving up these rights, a cash sum in compensation together with shares in Durrette plc which will be held in trust and released to the employees in three equal annual instalments, dependent upon them still being in the employment of the Durrette plc group.

4) The managing director of Burgoyne Ltd, who is one of the shareholders, set up a family trust two years ago and that trust received a loan of £20,000 from Burgoyne Ltd. It is intended that the company write off this loan.

5) Durrette plc expects to make significant reduction in Burgoyne Ltd's cost base by eliminating Head Office support staff. This will involve redundancies, both voluntary and compulsory. The Durrette plc management wishes to understand the tax consequences of redundancy payments both for the employee and the employer.

6) Burgoyne (Northwest) Ltd is a member of the Burgoyne group which has been manufacturing machine tools in a rundown factory in the north-west of England. It is proposed that that factory be closed and that Burgoyne (Northwest) Ltd resume activity after a gap of about one year during which new premises will be built some 20 miles from its current location. All current employees will be made redundant. Burgoyne (Northwest) Ltd has accumulated trading losses of £500,000.

Continued

5. *Continuation*

7) Burgoyne Mechanical Engineering Ltd is a member of the Burgoyne group which manufactures and distributes a special precision tool. The costs of manufacture are high and the company has incurred trading losses to date of £400,000. Durrette plc considers that manufacturing in the United Kingdom should be terminated and the manufacturing activity transferred to a newly incorporated subsidiary in India where costs are significantly lower. Burgoyne Mechanical Engineering Ltd would continue to undertake the distribution itself.

8) Burgoyne Ltd occupies a Head Office leased from the local authority on a lease with 30 years left to run. The rent is calculated under a formula based on the turnover and employee numbers of the group at the start of the lease period. Both have fallen considerably and Durrette plc wishes to offer a payment of £200,000 to the local authority to agree a change in the lease payments to reflect the current trading activity.

You are required to explain the tax issues arising. (20)

6. You are the tax manager working at Freya Ltd, a UK company that designs, manufactures and sells standard and bespoke dancewear and costumes for theatre companies, dance schools and private individuals in the UK. The company has recently become hugely profitable due to the popularity of certain television shows and is no longer a small or medium sized company for Corporation Tax purposes.

Recently the company has started selling to private individuals in France by mail order and the USA via the internet.

The company is now looking to set up a place of business in Denmark. Freya Ltd will send two of its UK employees to Denmark to help start the business there. It is envisaged the UK employees will be in Denmark for about a year. The main role of the Danish entity will be to find new customers. The Danish entity will keep a stock of standard items, such as ballet shoes, to sell. However, for specific requests, such as special ballet tutus or costumes, Freya Ltd will manufacture these in the UK. It will then send the finished goods to the Danish entity for onward sale to the end customer in Denmark. The managing director has decided the Danish entity will offer promotional prices to begin with so it is likely to be loss making initially but should become profitable within three years. The managing director is keen to establish a wholly owned subsidiary but the finance director considers a Danish branch would be better.

The finance director has requested your assistance in relation to these matters.

You are required to write a memo to the finance director covering:

1) The VAT treatment of sales to France, the USA and Denmark. (5)

2) The PAYE and National Insurance consequences of sending the two UK employees to Denmark. (5)

3) Whether the Danish entity should be set up as a branch or subsidiary. (10)

You may assume the Double Tax Agreement between Denmark and the UK follows the OECD model. You are not required to discuss specific non-UK taxation, but should highlight areas where the overseas equivalent to UK provisions may need to be considered.

Total (20)