THE
CHARTERED
INSTITUTE OF
TAXATION

The Chartered Tax Adviser Examination

May 2009

Advanced Corporation Tax

Advisory Paper

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 only. Do not write in the left-hand margin.
- 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 the law elements in this paper in accordance with Scots law or Northern Ireland law should tick the appropriate box on the front of each answer folder.

1. You have recently been appointed as the tax manager of Monkswood Industries plc, a UK company, which designs and manufactures aero engine components. The finance director has just returned from a conference and believes it is possible that the company may be eligible for research and development tax benefits. The company is a large company for the purposes of the reliefs.

   He has asked you to explain what constitutes research and development for tax purposes, what expenditures will qualify for relief and how the relief will be calculated.

   You are required to write a memo to the finance director responding to his query. (10)

2. Valentine Ltd is a trading company with three wholly owned trading subsidiaries, Heart Ltd, Spade Ltd and Diamond Ltd. Heart Ltd is tax resident in Guernsey and does not trade in the UK; the other two companies are tax resident in the UK and trade exclusively here. All four companies have a December year end.

   Bob Steers, the group finance director, is currently preparing the tax returns for the group companies for the year ended 31 December 2008. You are a tax manager for a firm of Chartered Tax Advisers and Bob telephoned you in March 2009 to discuss the following matters:

   1) In August 2004, Keith, an employee of Spade Ltd, was granted free of charge an EMI option over 15,000 ordinary shares in Valentine Ltd. The exercise price is 75 pence per share. A valuation of £1.00 per share was agreed with HM Revenue & Customs at the time of grant. Keith exercised the option over all of the shares in December 2008.

   2) In June 2003, Bill, an employee of Valentine Ltd, was granted free of charge an option over 10,000 shares in Diamond Ltd. The exercise price was £1 per share and Bill exercised the option over all of his shares in December 2008.

   3) In December 2008, Ravi, who is employed by Heart Ltd and works entirely outside of the UK, was awarded 200 shares in Valentine Ltd. He agreed to pay 50 pence per share.

   Valentine Ltd commissioned a report from an independent expert who estimated the value of Valentine Ltd's shares to be £5 per share as at 31 December 2008 and Diamond Ltd's shares to be £1.50 per share as at 31 December 2008.

   In January 2008, the directors of Valentine Ltd approved the creation of an Employee Benefit Trust (EBT) to provide certain benefits for employees of Valentine Ltd who meet targets set for them in their annual appraisals. It was determined that each year, a payment of 10% of Valentine Ltd's audited profits before tax would be made to the EBT. The costs of establishing the EBT and related professional fees were £5,500 and Valentine Ltd made a contribution of £600 of initial funds to the EBT. Valentine Ltd then made a further contribution of £67,000 in cash to the EBT. The trustees immediately used the cash to buy the following assets:

   1) 200 quoted shares in Socks plc. They cost £7,000 to purchase. Half of the quoted shares were immediately awarded to employees as a bonus.

   2) Three motor cars, costing £15,000, £20,000 and £25,000. The first car was made available to an employee of Valentine Ltd for his private use. The second car was given to another employee in January 2009. Its market value was estimated to be £18,000 at that time and the employee paid nothing for the car. The third car remains the property of the EBT and has not been made available to anyone, pending a decision about a suitable recipient.

   Bob Steers suggests that you and he meet to consider the above matters further.

   You are required to prepare a file note for your meeting with Bob Steers outlining the UK tax consequences for the Valentine group companies of the above transactions. (15)

3. Your firm has been asked to prepare the Corporation Tax computation for Vincem Ltd for the year ended 31 March 2009.

The principal activity of Vincem Ltd in the year ended 31 March 2009 was civil engineering. The summary trading profit and loss account together with extracts from the financial statements are set out below. In addition, your client has informed you of the following matters:

1) Miscellaneous expenses included a donation to a political party of £2,000 and £3,000 spent sponsoring an art show. In return for sponsoring the art show, Vincem Ltd received free tickets to the show worth £500.

2) Legal and professional fees (totalling £31,455) included £4,250 spent on advice in respect of the purchase of the company's own shares.

3) The tax written down value of the general pool at 1 April 2008 was £3,499,144. Included in the additions figure on the balance sheet is machinery costing £13,122. It was delivered on 1 May 2009 with payment due only on delivery.

The tax written down values of the expensive cars at 1 April 2008 were:

Expensive cars	TWDV at 1 April 2008
	£
Audi	2,576
VW Passat	3,800

During the year, the VW Passat was disposed of for £2,600 and a Mitsubishi Shogun was purchased for £15,900.

4) Rental income arose from an investment property; there was no related expenditure.

5) Vincem Ltd holds 20% of the voting power of Vinne Inc, a non-UK resident company. On 1 January 2009, Vincem Ltd received a gross dividend from Vinne Inc of £36,000 (tax withheld of £1,800). The tax manager at Vincem Ltd believes that underlying tax of £12,000 can be claimed as follows:

- £3,000 of tax at 10% on profits of £30,000 (excluding dividends received) out of which a dividend of £27,000 was paid;

- £9,000 of tax at 50% on the profits of Violi pty (an overseas 100% subsidiary of Vinne Inc). Violi pty paid a total dividend to Vinne Inc of £45,000 of which £9,000 was the element paid through to Vincem Ltd in the dividend of £36,000. No tax was paid on profits arising from previous years.

6) There were no other trading companies in the same group as Vincem Ltd.

Continued

3. *Continuation*

Trading and profit and loss account

			£
Sales			23,345,962
Cost of sales			(19,174,809)
Gross Profit			£4,171,153
Other income			
	Rents received	10,345	
	Overseas dividends received	36,000	
	Bank interest received	65,642	
			111,987
Administrative expenditure			(2,685,760)
Finance costs			
	Bank charges	13,875	
	Bank interest	12,254	
	Hire purchase	76,455	
			(102,584)
(Loss)/ Profit on disposal of fixed assets			
	Plant and machinery	(54,874)	
	Fixtures and fittings	3,142	
	Motor vehicles	2,147	
			(49,585)
Amounts written off investments			
Provision for diminution in value of investment			(29,000)
Net Profit			£1,416,211

Extracts from the financial statements

Exceptional items

Included within administrative expenses are exceptional items of £300,000 comprising a loan due from a third party, Seena Developments Ltd, which has been written off during the year.

Amounts written off investments

The company's investment of £29,000 in its subsidiary undertaking, Venn Ltd, has been written off as Venn Ltd has ceased to trade and had net assets of £34 as at 31 March 2009.

Continued

3. *Continuation*

Tangible fixed assets

	Freehold Property £	Plant and machinery £	Fixtures and Fittings £	Motor Vehicles £
Cost or valuation				
At 1 April 2008	1,046,980	7,885,452	62,147	1,005,784
Additions	0	1,925,242	10,114	158,209
Disposals	0	(1,322,798)	(3,542)	(77,045)
At 31 March 2009	£1,046,980	£8,487,896	£68,719	£1,086,948
Depreciation				
At 1 April 2008	238,241	3,043,874	36,712	427,895
Charge for year	59,330	1,091,857	3,756	258,965
Eliminated on disposal	0	(749,854)	(2,785)	(57,303)
At 31 March 2009	£297,571	£3,385,877	£37,683	£629,557
Net book value				
At 31 March 2009	£749,409	£5,102,019	£31,036	£457,391

You are required to prepare the Corporation Tax computation for Vincem Ltd showing the Corporation Tax liability. (15)

4. You are the tax manager of Franz Group plc, a UK group providing training services to businesses involved in the oil and gas industries. The group, all of whose activities had previously been carried out in the UK, has recently completed the acquisition of the Pepperrell Group, the parent company of which is incorporated and headquartered in Switzerland, which provides similar services from a number of international locations using subsidiary companies incorporated in these locations. A principal attraction of the Pepperrell Group is the existence of certain patented techniques which are owned by a Pepperrell Group company incorporated in the Cayman Islands, which does not impose any corporate taxation. Most of the Pepperrell Group head office functions, previously carried on in Switzerland, will be moved to the UK group headquarters.

The board of Franz Group plc intends to use this acquisition to develop the business internationally. This will include new businesses in various countries, the set-up of which will require to be financed by loans from Franz Investments Ltd, the company within the Franz group which provides finance to the group businesses. Due to the size of some of the proposed ventures, it is likely that the Franz Group will require to enter into joint venture arrangements with third parties in some locations, probably by way of local companies to ring-fence any corporate risks.

The board of Franz Group plc is also interested in manufacturing its own safety equipment, both for use within its own companies and for sale to external customers. It is, therefore, investigating the possibility of setting up a Chinese subsidiary company to undertake low-cost manufacturing along with a distribution company in a low-taxed jurisdiction, to undertake both third party and intra-group sales.

You are required to prepare a report to the board explaining the UK tax issues arising from these arrangements. (20)

5. You are a tax manager working for an accountancy firm that prepares the Corporation Tax computations for Wanmiu Ltd, a UK company.

In the 12 month accounting period ended 31 December 2007, Wanmiu Ltd entered into a contract for differences based on a reference portfolio of commercial property. The contract had a maturity of five years and a strike of 5%. The initial value of the portfolio was £8 million. The accounts for the year ended 31 December 2007 showed the fair value of the contract to be £8,900,000. However, in the accounts for the year ended 31 December 2008, the fair value of the contract had decreased by £350,000 to £8,550,000.

Wanmiu Ltd entered into two other property derivative contracts in the year ended 31 December 2007 and continued to hold them throughout the year ended 31 December 2008. It made the following gains and losses on those contracts:

	Year end 31 December 2007	Year end 31 December 2008
Contract 1	(£300,000) loss	(£1,000,000) loss
Contract 2	£1,600,000 gain	£400,000 gain

In addition, in 2007 Wanmiu Ltd had an allowable loss of £1,700,000 from a disposal of land and in 2008, a non-derivative chargeable gain of £800,000.

At 1 January 2007, Wanmiu Ltd had no capital losses brought forward. There were no chargeable gains in accounting periods prior to 2007.

In the year ended 31 December 2008, Wanmiu Ltd wrote off a debt of £510,000 owed to it by Jakey Inc, a US company. The shareholdings of the respective companies throughout the period were as follows:

	Wanmiu Ltd	Jakey Inc
Mr A	51	80
Mr B	49	0
Mr C	0	20
Total ordinary £1 shares	100	100

Mr A and Mr B were the directors of Wanmiu Ltd. Mr A and Mr C were the directors of Jakey Inc.

The Shareholders Agreement of Wanmiu Ltd states the following:

1) Each shareholder may appoint one director each.
2) The two appointed directors shall be directors for their life time unless through voluntary resignation or legal disqualification.
3) Each shareholder relinquishes any right to replace, remove or substitute any director appointed by him under 1).
4) The dismissal of any director requires the prior consent of all directors.
5) Each director has one vote each at a meeting of Board of Directors; there is no casting vote.

Mr A resigned as a director of Wanmiu Ltd in February 2009. He had never been involved in the management of the day-to-day business of Wanmiu Ltd; that had been carried out by the other director, Mr B, together with a number of managers.

Mr B wishes to obtain a tax deduction for the bad debt write-off of £510,000 but he does not want HM Revenue & Customs to raise an enquiry. He is therefore seeking further advice from your firm.

Continued

5. *Continuation*

You are required to:

1) **Calculate the gains or losses to Wanmiu Ltd arising under the derivative contracts provisions for the years ended 31 December 2007 and 2008, assuming that claims to carry back losses are made where possible. You should set out your workings and provide explanations, including the details for making a carry back claim.** (12)

2) **Prepare a briefing note to your tax partner on whether Wanmiu Ltd should claim the impairment loss of £510,000 in its Corporation Tax return for the year ended 31 December 2008. You should include references to relevant tax legislation where appropriate.** (8)

Total (20)

6. You are a tax manager at a firm of Chartered Tax Advisers and have recently met with the finance director of a new client, Toolco Ltd in March 2009. He has requested advice on a number of matters.

Toolco Ltd has three wholly owned subsidiaries, Nail Ltd, Chisel Ltd and Torque Ltd which it has owned for many years. It also owns 70% of the shares in Drill Ltd, and 40% of the shares in Nut Ltd. The remaining shares in both companies are owned by unconnected third parties, none of whom owns a controlling interest in either company. Chisel Ltd has a wholly owned subsidiary, Wrench Ltd.

In June 2008, Torque Ltd transferred a freehold shop used in its trade to Chisel Ltd. The shop was bought in January 2003 for £75,000 and was sold to Chisel Ltd for £300,000 when its market value was £400,000. Chisel Ltd immediately granted a 40 year lease over the shop to Wrench Ltd for a premium of £200,000. The lease was valued by an independent surveyor at £180,000.

It is now proposed to sell Chisel Ltd and Wrench Ltd to an unconnected company. The finance director informs you that Torque Ltd is proposing to buy a new shop for use in its trade for £250,000. Toolco Ltd is also proposing to buy a shop for £450,000 to let out on the open market.

In November 2008, Toolco Ltd assigned the lease of an office to Drill Ltd for a premium of £150,000. The lease was assigned to Toolco in November 1999 for £50,000. In November 2008, the lease had exactly 45 years left to run. In the same month Toolco Ltd also sold a painting to Drill Ltd for £6,500. The painting was purchased for £500 in January 1980. The value at 31 March 1982 has been independently assessed as being £100.

In June 2004, Drill Ltd and Nail Ltd acquired 8% and 5% respectively of the ordinary share capital of Spanner Ltd. The remaining share capital is owned by unconnected third parties. Drill Ltd also acquired 10,000 5% preference shares in Spanner Ltd. An unconnected third party has approached Drill Ltd and offered to purchase their 8% holding of ordinary shares plus their holding of 10,000 5% preference shares in Spanner Ltd.

Toolco Ltd acquired 200 shares in Key Ltd, representing 20% of the ordinary share capital, in May 2005. In April 2007, it sold 150 of the shares. It has now received an offer from an unconnected company which wishes to buy the remaining 50 shares.

Nut Ltd acquired a 15% interest in the share capital of Bubble Ltd, in October 2005. It has now received an offer to buy its entire interest from an unconnected company.

Toolco Ltd, Drill Ltd, Nut Ltd and Nail Ltd are investment companies. The remaining companies are all trading companies which specialise in selling goods from retail outlets.

You are required to write a letter to the finance director of Toolco Ltd in which you explain, with the aid of calculations where appropriate, the Corporation Tax consequences of the above matters. (20)