Professional Level – Options Module

Advanced Taxation (Irish)

Monday 3 December 2007

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

This paper is divided into two sections:

Section A – BOTH questions are compulsory and MUST be attempted

Section B – TWO questions ONLY to be attempted

Tax rates and allowances are on pages 2–6

Do NOT open this paper until instructed by the supervisor.
During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.
This question paper must not be removed from the examination hall.

The Association of Chartered Certified Accountants

Paper P6 (IRL)

SUPPLEMENTARY INSTRUCTIONS

1. You should assume that the tax rates and allowances shown below, for the Finance Act 2006, will continue to apply for the foreseeable future.
2. Calculations and workings need only be made to the nearest Euro.
3. All apportionments should be made to the nearest month.
4. All workings should be shown.

TAX RATES AND ALLOWANCES

The following rates, credits, formulae and allowances are based on the Finance Act 2006 and are to be used for all questions in this paper.

Rates of income tax 2006

	Tax
	€
Single/Widow(er)	
€32,000 at 20%	6,400
Balance at 42%	
Married couple (one income)	
€41,000 at 20%	8,200
Balance at 42%	
Married couple (dual income)	
€64,000 at 20%	12,800
Balance at 42%	
One parent family	
€36,000 at 20%	7,200
Balance at 42%	

Abbreviated list of personal tax credits for the income tax year 2006

	€
Single person's credit	1,630
Married couple credit	3,260
Widowed person's credit (without dependent children)	2,130
Home carer credit (maximum)	770
Single parent credit	1,630
Dependent relative credit	80
Age credit – single/widowed	250
– married	500
Employee/PAYE credit	1,490

Rates of PRSI/levies 2006
Self-employed

PRSI	
Rate	3%
Note: No PRSI where income is below €3,174 per annum	
Health contribution	
Lower exemption limit	€22,880
Rate	2%
Note: No upper limit for PRSI or health contribution	

Rates of PRSI/levies 2006
Employee – Class A1

PRSI

Upper limit	€46,600
Rate	4%

The first €127 per week (non-cumulative) is exempt from PRSI
Note: No PRSI on income up to €15,600 per annum (€300 per week)

Health contribution

Lower exemption limit (€440 per week)	€22,880
Rate	2%

Note: No upper limit for health contribution

Rates of PRSI/levies 2006
Employer (for employees – Class A1)

PRSI

Rate:	10·75%

For salaries less than €18,512 (€356 per week) the rate is 8·5% per annum
Note: No upper limit for employer's contribution.

Retirement annuities

Age	**Percentage of net relevant earnings** %
Up to 30 years	15
30 years but less than 40 years	20
40 years but less than 50 years	25
50 years but less than 55 years	30
55 years but less than 60 years	35
60 years and over	40

Cap on earnings of €254,000

Corporation tax

Standard rate	12·5%
Higher rate	25%
Manufacturing rate	10%

Capital gains tax

Rate	20%
Annual exemption	€1,270

Rural/Urban renewal allowances

Industrial and commercial buildings	
Owner occupier	**%**
Free depreciation	50
or	
Initial allowance	50
Annual allowance	4
Maximum	100
Lessor	
Initial allowance	50
Annual allowance	4
Maximum	100
Residential property	
Owner occupier	
Construction	5% per annum (10 years)
Refurbishment	10% per annum (10 years)
Lessor (Section 23 relief)	
Construction	100
Conversion	100
Refurbishment	100

Motor cars – limits on capital costs

	To 31 December 2005	1 January 2006 onwards
	€	€
Capital allowances	22,000	23,000
Leasing charges	22,000	23,000
Running cost	No limit	No limit

Capital allowances

Plant and machinery	
including motor vehicles	**Rate (straight line)**
Expenditure incurred	**%**
1 January 2001 to 3 December 2002	20
4 December 2002 onwards	12·5

Motor cars – benefit-in-kind rates

Lower limit miles	Upper limit miles	Percentage of original market value of car
		%
15,000 or less		30
15,001	20,000	24
20,001	25,000	18
25,001	30,000	12
30,001	upwards	6

Indexation factors for capital gains tax

Year Expenditure Incurred	Multipliers for disposals in year ending
	2004 et seq
1974-75	7.528
1975-76	6.080
1976-77	5.238
1977-78	4.490
1978-79	4.148
1979-80	3.742
1980-81	3.240
1981-82	2.678
1982-83	2.253
1983-84	2.003
1984-85	1.819
1985-86	1.713
1986-87	1.637
1987-88	1.583
1988-89	1.553
1989-90	1.503
1990-91	1.442
1991-92	1.406
1992-93	1.356
1993-94	1.331
1994-95	1.309
1995-96	1.277
1996-97	1.251
1997-98	1.232
1998-99	1.212
1999-2000	1.193
2000-2001	1.144
2001	1.087
2002	1.049
2003 et seq	1.000

Capital acquisition tax – 2006

Class threshold		€
Class 1:	Child or minor child of deceased child (or inheritance taken by parent):	478,155
Class 2:	Lineal ancestor (other than inheritance taken by parent) Lineal descendent (other than a child or a minor child of a deceased child) Brother, sister, child of brother or sister	47,815
Class 3:	Any other person	23,908
Rate		20%

Rates of stamp duty

Non residential property

Value	Rate %
Up to €10,000	0
€10,001 – €20,000	1
€20,001 – €30,000	2
€30,001 – €40,000	3
€40,001 – €70,000	4
€70,001 – €80,000	5
€80,001 – €100,000	6
€100,001 – €120,000	7
€120,001 – €150,000	8
Over €150,000	9

Residential property

Value	Owner occupiers & investors %	First time buyers who are owner occupiers of second-hand property %
Up to €127,000	0%	Exempt
€127,001 – €190,500	3%	Exempt
€190,501 – €254,000	4%	Exempt
€254,001 – €317,500	5%	Exempt
€317,501 – €381,000	6%	3%
€381,001 – €635,000	7·5%	6%
Over €635,000	9%	9%

New houses

First time buyers who are owner occupiers of new houses with a floor area under 125 square metres are exempt from stamp duty provided a Floor Area Compliance Certificate has been issued by the Minister for the Environment, Heritage & Local Government.

Partial relief under Section 92 SDCA applies based on the rate structure outlined above, to first time buyers who are owner occupiers of new houses where the floor area of such houses exceeds 125 square metres.

Note: Where applicable VAT should be excluded from the chargeable consideration.

Stocks and marketable securities	1%

Section A – BOTH questions are compulsory and MUST be attempted

1 Your client, Mr Cullen Senior, carries on a pharmacy business as a sole trader. He is nearing retirement age and wishes to consider passing the business on to the next generation. Both his own son, John Cullen, and their general manager Mark O'Shea, work fulltime in the business. Mr Cullen Senior's desire is to transfer the business to his son and Mark O'Shea in the following proportions:

– John Cullen 75%
– Mark O'Shea 25%.

Mr Cullen Senior intends that they should pay him the full market value for the business which is estimated to be €2·0m. This is made up of goodwill – €1·0m; shop premises – €0·5m and current assets – €0·5m.

Mr Cullen Senior is also concerned about another issue. He is conscious that because his business has been very successful and quite profitable, it would probably be more tax efficient to carry it on through the medium of a company. For this reason, he feels that it might be appropriate to use the opportunity of his retirement to incorporate the business and has asked for advice in relation to this matter.

Required:

(a) Draft a letter to Mr Cullen Senior setting out the advice that he has requested. Marks will be awarded for the components of the letter as follows:

(i) The tax implications of the transfer of the business as a sole trader. You should consider the potential liabilities to and any reliefs that may be claimed in connection with capital gains tax, gift tax and stamp duty (13 marks)

(ii) The issues that arise in connection with the intention to incorporate the business in the context of the proposed transfers to John Cullen and Mark O'Shea. (6 marks)

(iii) Assuming that Mr Cullen Senior wishes to proceed with both the incorporation of the business and the transfers, outline an approach which will meet his objectives in the most tax efficient manner. You should clearly identify any taxes that are payable and/or reliefs to be claimed. You are not required to compute the actual tax liabilities. (10 marks)

Additional marks will be awarded for the appropriateness of the format and presentation of the letter and the effectiveness with which the information is communicated. (2 marks)

(b) Briefly identify the tax issues John Cullen and Mark O'Shea should consider in relation to financing the acquisition of the business/shares. (2 marks)

(33 marks)

2 Holland Ltd is a holding company, the sole activity of which is the holding of shares in two wholly owned subsidiary companies. The two subsidiary companies are:

– Amsterdam Ltd, a manufacturer of jewellery, 100% of the share capital of which was acquired for €150,000 on 1 April 1997.

– Hague Ltd, a dealer in precious metals, 60% of the share capital of which was acquired for €100,000 on 1 April 1998 and the remaining 40% for €150,000 on 31 May 2002.

All three companies are Irish incorporated and resident; make up their accounts to 31 December each year; and are subject to corporation tax at $12^1/_2$% on their profits.

The group is currently profitable. However, both Amsterdam Ltd and Hague Ltd have substantial unrelieved trading losses brought forward from earlier years and these are unlikely to be fully utilised in the near future.

The directors wish to expand the group's manufacturing activities and are considering methods by which funds might be released from existing resources to finance this expansion. The two options are:

(1) An offer of €1·5m has been received for the shares in Hague Ltd. This valuation is made up as follows:

	€
Showroom	960,000
Office	450,000
Net current assets	90,000
	1,500,000

Both the showroom and the office were originally acquired by Holland Ltd on 1 July 1997 for €128,000 and €60,000 respectively. The showroom was sold to Hague Ltd on 1 April 2002 for €400,000, and the office was sold to Hague Ltd on 1 April 2004 for €300,000. Both sales were at market value and all available reliefs were claimed.

(2) An unrelated property investment company is prepared to enter into a 'sale and leaseback' arrangement for a factory owned by Amsterdam Ltd. Under the arrangement the factory would be sold to the property investment company for its current market value of €1·76m, and leased back to Amsterdam Ltd for a period of ten years at an annual rent of €90,000. The rent is at the current market rate. The factory cost €960,000 on 1 January 2000 as follows:

	€
Land	256,000
Construction costs:	
Factory	480,000
Canteen	64,000
General offices	160,000
	960,000

The factory qualified for industrial buildings annual allowances of 4% per annum.

You should assume that any transactions will take place during the year ended 31 December 2007 and that the tax rates and allowances for the tax year 2006 will continue to apply.

Required:

(a) **Prepare a memorandum for the directors of Holland Ltd, advising on the taxation implications of each of the two alternatives. You should consider the implications for each of the companies concerned, including the effects of any reliefs potentially available. Support your advice with computations of any tax liabilities arising.** (16 marks)

Additional marks will be awarded for the appropriateness of the format and presentation of the memorandum and the effectiveness with which the information is communicated. (2 marks)

(b) **Comment briefly on the non-tax factors which the directors of Holland Ltd should take into account in deciding between the two alternative methods of financing.** (4 marks)

(c) **Explain whether the purchaser of Hague Ltd would be able to derive any benefit from the existing unrelieved trading losses of that company.** (3 marks)

(25 marks)

Section B – TWO questions ONLY to be attempted

3 Oldbridge Ltd is an Irish incorporated and resident company which operates a retail convenience shop. It also has a number of other sources of income. The share capital of the company comprises 10,000 ordinary shares of €1 each owned as follows:

		€
William Browne		3,000
James Browne	(William's brother)	3,000
Mary Browne	(William's wife)	2,000
Anne Browne	(William's and James' sister)	2,000
		10,000

William and James Browne are directors of the company and work full-time for it. Mary Browne is not a director but she works three mornings a week in the shop. Anne Browne is a full-time teacher, she is not a director and she does not work at all in the business of the company.

The following information has been extracted from the financial statements of Oldbridge Ltd for the year ended 31 December 2006:

	€
Trading income	152,400
Capital allowances	(19,000)
Net rental income	15,250
Interest income: gross (DIRT not withheld)	13,800
Dividends from Irish companies (gross)	7,800
Chargeable gain – as adjusted for corporation tax purposes	12,600

The following additional information is available:

Notes:

1. On 1 January 2006 William and James made loans to the company of €40,000 each to finance working capital for its trading operations. These loans have no specific repayment date and the company paid €2,000 interest to each director in the year ended 31 December 2006. This interest cost has been deducted in arriving at the trading income.
2. On 1 June 2006 the company made an interest free loan of €35,000 to Mary Browne to enable her to refurbish her family home.
3. The company rents an apartment for use by Anne Browne at an annual cost of €15,000. This cost has also been deducted in arriving at the trading income.

Required:

(a) State, giving reasons, why Oldbridge Ltd is a close company. (2 marks)

(b) Compute the corporation tax, close company surcharge and income tax payable by Oldbridge Ltd in respect of the year ended 31 December 2006, giving explanations of your treatment of the items referred to in the additional information notes 1 to 3. (13 marks)

(c) Advise the directors on what actions could be taken to reduce or eliminate the liabilities which arise in consequence of Oldbridge Ltd being a close company. (6 marks)

(21 marks)

4 Lexer Ltd is an Irish incorporated and resident trading company. The shareholders in the company are:

	Number of ordinary shares
Patrick McGrath	10,000
Bernadette McGrath	10,000
Phillip O'Sullivan	10,000
	30,000

Patrick McGrath is engaged fulltime in the business of the company.

Bernadette McGrath also works for the company having succeeded her late husband, Patrick's brother John McGrath, who died approximately two years ago, as a shareholder and director.

Phillip O'Sullivan, who originally provided part of the capital for the company is a non-executive director. He does not play an active part in the day to day running of the business of the company and restricts his role to attending quarterly board meetings. He has substantial interests in other companies engaged in similar businesses.

The relationship between Phillip O'Sullivan and the other two shareholders has become somewhat strained recently in light of the commitment of the other shareholders who work in the business, compared with his contribution. In addition, there is a perception that Phillip O'Sullivan's involvement in other companies in the same or similar businesses gives rise to a potential conflict of interest, which is detrimental to the trade of the company.

After a period of negotiation, an agreement has been reached where the company will buy back Phillip O'Sullivan's shares for €750,000 and he will resign as a director. Following the purchase, Phillip O'Sullivan will hold no shares in the company and will have no further role in its affairs.

The purchase will be financed from the company's own resources. At 31 December 2006 the company had distributable reserves of €1·3m.

The directors have been working on the assumption that the profit realised by Phillip O'Sullivan on the disposal of his shares will be subject to capital gains tax. However, they are no longer certain that capital gains tax treatment will apply and they have sought your advice.

Required:

(a) Explain the alternative tax treatments (income tax and capital gains tax) that might apply to a purchase or redemption by a company of its own shares, stating the conditions, if any, which must be satisfied in order to avail of capital gains tax treatment. (16 marks)

(b) Explain which stamp duty liabilities arise in connection with a purchase or redemption by a company of its own shares and advise how these might be minimised in the case of Lexer Ltd. (3 marks)

(c) Briefly identify any other issues that Lexer Ltd will need to consider with regard to its ability to buy back its own shares. (2 marks)

(21 marks)

5 Acme Inc is a large multi-national group, based in the United States. The group comprises both trading and manufacturing companies. Acme Inc has subsidiaries in several countries worldwide.

Acme Inc's directors are considering setting up a European holding company. The role of this company will be to hold the shares in the group's operating companies throughout the European Union (EU). The directors wish to be advised as to whether it would be appropriate to locate this company in Ireland.

In addition, Acme Inc wishes to centralise a number of trading activities which are currently carried on in several different countries. The directors have read that the $12^1/_2\%$ corporation tax rate may be of benefit in this regard and wish to be advised as to whether it would be appropriate to locate a trading company in Ireland which would carry on trading activities outside of Ireland.

Required:

(a) Explain the tax treatment of a holding company based in Ireland in respect of:

(i) capital gains tax; (4 marks)

(ii) dividend income; and (5 marks)

(iii) relief for interest paid in respect of money borrowed to acquire shares in subsidiary companies. (8 marks)

(b) Set out the circumstances in which a trading company, based in Ireland but carrying on its trading activities outside of Ireland, can avail of the $12^1/_2\%$ rate of corporation tax. (4 marks)

(21 marks)

End of Question Paper