Answers

1 Jeg Ltd group

Memorandum

For	The files
Client	Jeg Ltd group
Subject	Group matters
Prepared by	Tax senior
Date	1 September 2021

(a) Becoming tax advisers to the Jeg Ltd group of companies

Information required:

– Proof of incorporation and primary business address and registered office of each company in the group.

– The group structure, directors and shareholders of the companies.

– The identities of those persons instructing the firm on behalf of the companies and those persons who are authorised to do so.

Actions to take:

– We must give consideration to the fundamental principles of professional ethics as set out in ACCA's *Professional Code of Ethics and Conduct*. This requires us to consider whether becoming tax advisers to the Jeg Ltd group would create any threats to compliance with these principles.

In order to comply with the principle of professional competence and due care, we have an obligation to ensure that our clients receive competent, professional advice. As we have no experience of UK resident companies trading through permanent establishments situated overseas, we must obtain a thorough understanding of the relevant technical issues before we provide advice on these matters to the Jeg Ltd group of companies.

– We must assure ourselves that the companies are not involved in any form of money laundering.

– We should obtain permission to contact the group's existing tax advisers in order to ensure that there is nothing in the past which would preclude us from accepting the appointment on ethical grounds.

(b) Relieving the chargeable gain on the sale of Kod Ltd's business premises

Availability of rollover relief

– For rollover relief to be available:

  – qualifying assets, i.e. land and buildings and/or fixed plant and machinery, must be purchased;

  – in the four-year period commencing 1 July 2020 (one year prior to the sale of the premises);

  – by Kod Ltd or any company which was a member of the Jeg Ltd capital gains group at the time the replacement asset was purchased; and

  – the replacement assets must be either owned by a UK resident company for use in its trade or owned by a non-UK resident company and used to carry on a trade in the UK.

The Jeg Ltd capital gains group

– The Jeg Ltd capital gains group comprises Jeg Ltd and all of its subsidiaries, Kod Ltd, Lis Co and Mot Ltd. This is because Jeg Ltd owns at least 75% of the ordinary share capital of each of its subsidiaries.

Review of assets acquired

– The vans purchased by Kod Ltd are not qualifying assets because they are moveable as opposed to being fixed.

– The items of machinery purchased by Jeg Ltd will, however, qualify for rollover relief because they are fixed.

– Although Lis Co is a member of the Jeg Ltd capital gains group, the building, which it purchased on 1 July 2021, is not a qualifying asset for the purposes of rollover relief. This is because Lis Co is not a UK resident company and the building is not being used to carry on a trade in the UK.

Operation of rollover relief

– If the items of machinery purchased by Jeg Ltd are the only qualifying assets purchased during the qualifying period, it will not be possible to roll over the whole of the chargeable gain on the sale of Kod Ltd's business premises. The amount of proceeds not invested in qualifying assets of £195,000 (£485,000 – £290,000) will be charged to corporation tax.

– The remainder of the chargeable gain on the sale of the business premises of £52,000 (£247,000 – £195,000) could be deferred until the earliest of the following events in relation to the machinery purchased by Jeg Ltd:

- the sale of the machinery;
- the machinery no longer being used for the purposes of the trade;
- ten years after the date of purchase of the machinery (i.e. 31 January 2031).

If non-depreciating assets are purchased before the crystallisation of the deferred gain, the deferred gain need not be charged and can instead be rolled over against the base cost of the non-depreciating assets.

(c) Taxation of profits generated overseas

Lis Co

- If components were sold by Lis Co to Jeg Ltd at an inflated price, a transfer pricing adjustment would be required.

  This is because the transaction would be between Jeg Ltd and a company which it controls; and

  Lis Co would be resident in a non-qualifying territory, i.e. a territory which does not have a double tax agreement with the UK, such that the regime applies despite Jeg Ltd being a small company.

- Accordingly, the trading profit of Jeg Ltd, the company which would be gaining an advantage as a result of the inflated price, would have to be increased by the excess of the inflated price over the arm's length price. This increase would, in turn, increase the company's corporation tax payable.

Mot Ltd

Rate of corporation tax in the UK on the profits of the business

- UK resident companies are subject to UK corporation tax on their worldwide income.
- The business in Puran would be a permanent establishment (PE) of Mot Ltd as opposed to being a separate legal entity. Accordingly, the profits of the business will be subject to UK corporation tax as part of the profits of Mot Ltd.
- The rate of corporation tax suffered in the UK on the profits generated in Puran would be 6%, i.e. UK corporation tax at 19% less double tax relief of 13%.

Election to exempt the profits of the PE from UK tax

- The advantage of making such an election would be that the profits made in Puran would not be subject to UK corporation tax.

  This would save UK corporation tax at the rate of 6% as set out above.

- However, it should be recognised that it would no longer be possible to claim capital allowances in the UK in respect of assets purchased for use in the trade carried on in Puran.
- In addition, there would be no relief in the UK in the event of any losses being incurred in the trade in Puran in the future.
- Once made, the election is irrevocable and would apply to all future overseas PEs of Mot Ltd.

  Accordingly, there would be no relief in the UK for any losses incurred in any new overseas PEs operated by Mot Ltd.

(d) Value added tax (VAT)

Group VAT registration

- A company can be a member of the Jeg Ltd group VAT registration if:

  (i) it is controlled by Jeg Ltd (i.e. Jeg Ltd owns more than 50% of the company's ordinary share capital); and

  (ii) it is established in the UK (e.g. its headquarters are in the UK) or it has a fixed establishment in the UK (e.g. it has a genuine trading presence in the UK).

  Accordingly, Kod Ltd could be included within a group VAT registration, whereas Mot Ltd could not unless it satisfies (ii) above.

- Possible disadvantages
  - The members of a group VAT registration are jointly and severally liable for the group's VAT liability.

    Accordingly, the inclusion in the group of Kod Ltd must be considered particularly carefully due to its financial problems.

  - It will be necessary to obtain and collate information from the subsidiary companies in order to prepare a single VAT return, which may cause administrative difficulties.

Purchase of components from Lis Co

- Jeg Ltd would be required to pay VAT at the standard rate on the importation of the components at the same time as any other customs duties.
- The payment of the VAT could be delayed:
  - until the components are removed from a bonded warehouse; or
  - if Jeg Ltd uses the duty deferment system.

– Jeg Ltd would be able to reclaim the VAT paid as input tax on its VAT return for the period in which the components are imported.

2 Lucille

(a) Lucille's financial position for the tax year 2021/22

Cash income after tax

	£
Salary	87,800
Dividend income	18,300
Total cash income	106,100
Income tax liability (W)	46,930
Class 1 national insurance contributions (NIC) liability (W)	5,616
Total tax	52,546
Cash income after tax (£106,100 – £52,546)	53,554

Summary of the situation

Lucille's annual personal expenditure exceeds her cash income after tax by £4,046 (£57,600 – £53,554).

The tax payable by Lucille in the tax year 2021/22 will be almost half (£52,546/£106,100 = 49·52%) of the income she receives in cash. This is due to the significant non-cash benefits which she receives.

Tutorial note: *Credit was also available to candidates who identified that:*

– *on the assumption that Lucille will not receive further shares in BKB Ltd, her tax bill for the tax year 2022/23 will be reduced by £3,520 ((£8,800 x 40%).*

– *Lucille's dividend income will be lower in future years as a result of the gift of shares to the trust for her nieces.*

Working

Income tax and class 1 NIC liability

	£
Salary	87,800
Benefits	26,230
Shares in BKB Ltd (£23,200 – £14,400)	8,800
Employment income	122,830
Dividend income	18,300
Total income	141,130
Less: personal allowance	(0)
Taxable income	141,130
Employment income	
£37,500 x 20%	7,500
£85,330 (£122,830 – £37,500) x 40%	34,132
Dividend income	
£2,000 x 0%	0
£16,300 x 32·5%	5,298
Income tax liability	46,930
£40,500 (£50,000 – £9,500) x 12%	4,860
£37,800 (£87,800 – £50,000) x 2%	756
Class 1 NIC liability	5,616

Tutorial note: *The shares in BKB Ltd are not readily convertible assets, such that they will not result in a liability to class 1 NIC.*

(b) Overseas income and gain on investment property

Gain on the sale of the investment property in Tavara

The gain on the sale of the investment property will not be subject to UK capital gains tax (CGT), regardless of whether or not Lucille brings the sale proceeds into the UK. This is because, when Lucille sold the property, she was:

– neither resident in the UK;
– nor a temporary non-resident (because she was non-UK resident for a period of more than five years).

Rental income arising in Tavara

Lucille will be subject to UK income tax on her worldwide income in the tax year 2021/22 because she is resident in the UK.

The remittance basis will not be available to Lucille, because she is deemed domiciled in the UK (see below) and she will have unremitted overseas income of more than £2,000.

Accordingly, Lucille will be subject to UK income tax on the rental income in respect of her home in Tavara, even though she will not have brought it into the UK.

Lucille's deemed domicile status

Lucille will be deemed domiciled in the UK in the tax year 2021/22 because:

– she was born in the UK; and
– she has a domicile of origin in the UK; and
– she is UK resident in the tax year 2021/22.

(c) Trust to be created for the benefit of Lucille's nieces

Availability of capital gains tax gift relief

Lucille will be able to claim gift relief in respect of the chargeable gains arising on the gift of the shares to the trustees despite the shares being quoted. This is because the gift will result in an immediate charge to inheritance tax.

Availability of business property relief (BPR)

BPR will only be available to Lucille in respect of those shares where:

– the company's business does not consist wholly or mainly of dealing in financial assets and/or land and buildings or of making or holding investments; and

– Lucille controls the company concerned (this is necessary because the shares are quoted); and

– Lucille has owned the shares for at least two years; or

  these shares replaced other qualifying shares which have been sold, and the shares sold and the replacement shares have been owned for a combined period of at least two of the five years prior to the gift.

Where BPR is available, it will be given at the rate of 50%.

IHT payable

	£
Lifetime IHT payable	
Value less annual exemptions	394,000
Less: nil rate band	(325,000)
	69,000
IHT to be paid by Lucille (£69,000 x 25%)	17,250
IHT payable as a result of Lucille's death	
Gross chargeable transfer (£394,000 + £17,250)	411,250
Less: nil rate band	(325,000)
	86,250
IHT (£86,250 x 40%)	34,500
Less: taper relief at 60% (5 to 6 years)	(20,700)
	13,800
Less: lifetime tax paid (restricted)	(13,800)
IHT due	0

Tutorial note: *The lifetime tax paid reduces the IHT payable to zero, but no amount of it will be refunded.*

3 Sabin and Patan Ltd

(a) Income tax saving as a result of a terminal loss relief claim by Sabin

Terminal loss relief is available for the loss arising in the final 12 months prior to cessation.

	£
Loss 1 January 2020 to 31 December 2020:	
Loss 6 April 2020 to 31 December 2020 (£23,000 + (£4,000 x 3/12))	(24,000)
Loss 1 January 2020 to 5 April 2020 (£4,000 x 3/12)	(1,000)
Unrelieved overlap profits	(7,800)
Loss available for terminal loss relief	(32,800)

The basis period for 2020/21, the tax year of cessation, is 1 July 2019 to 31 December 2020. As this includes two loss making accounting periods, Sabin has no taxable trading income in 2020/21, such that he can claim terminal loss relief against his trading income of the three tax years prior to cessation on a LIFO basis, i.e. 2019/20, 2018/19, 2017/18, in that order.

Accordingly, the loss will be offset as follows:

	2017/18	2018/19	2019/20
	£	£	£
Trading income	44,000	32,000	21,000
Loss relief	nil	(11,800)	(21,000)

Tax relief:

2019/20: Sabin's original income tax liability was £2,900 ((£21,000 + £6,000 – £12,500) x 20%). After terminal loss relief, his liability will be £nil as his employment income (£6,000) will be covered by his personal allowance. Accordingly, the income tax saving will be £2,900.

2018/19: Sabin's original taxable income was £25,500 (£32,000 + £6,000 – £12,500). Following the terminal loss claim, this will be reduced to £13,700 (£25,500 – £11,800), such that there will be a saving of £2,360 (£11,800 x 20%).

The total income tax saving as a result of the terminal loss claim is therefore £5,260 (£2,900 + £2,360).

(b) Capital gains tax (CGT) implications of the sale of the business premises and item of specialist machinery

The sale of the business premises will give rise to a chargeable gain of £28,000 (£114,000 – £86,000).

No capital loss will arise on the sale of the specialist machine as capital allowances were claimed on this asset.

The gain on the business premises qualifies for business asset disposal relief (BADR) because Sabin carried on the business for more than two years prior to cessation, the premises were in business use at the date of cessation, and were sold within three years of the date of cessation. CGT payable is therefore £2,800 (£28,000 x 10%). After-tax proceeds are £152,200 (£114,000 + £41,000 – £2,800).

(c) Patan Ltd

(1) Tax deduction available in respect of the acquisition of the new factory

The new factory will qualify for the structures and buildings allowance (SBA) as it is a new commercial building. The cost of the land is not eligible for the allowance, so Patan Ltd may claim an annual writing down allowance of £2,580 (3% x (£142,000 – £56,000)). As Patan Ltd only brought the building in to use on 1 May 2021, the SBA available in the year ending 31 March 2022 will be £2,365 (£2,580 x 11/12).

(2) Tax deductions available in respect of the expenditure on research and development activities

As Patan Ltd is a small or medium-sized enterprise for the purposes of obtaining tax relief for expenditure on qualifying research and development activities, the revenue expenditure which relates directly to undertaking research and development activities qualifies for an additional 130% deduction from Patan Ltd's taxable trading income. This applies to the whole of the employee cost, but only 65% of the cost of the external contractor, who is provided by an unconnected company. Accordingly, the expenditure qualifying for the additional deduction is £54,300 (£40,000 + (65% x £22,000)), and the total deduction available to Patan Ltd is £132,590 (£62,000 + 130% x £54,300).

As Patan Ltd will be a loss making company in the year ending 31 March 2022, it can choose to claim a tax credit in respect of the qualifying research and development expenditure. The company can surrender to HM Revenue and Customs (HMRC) up to 230% of the qualifying expenditure of £54,300 in return for a tax credit of 14·5% of the amount surrendered.

4 Caden and Amahle

(a) (i) Capital gains tax implications of the sale of the four antique chairs

As Caden's son is a connected person to Caden, the market value of the chairs at 6 October 2021 will be used as proceeds. The capital loss on the sale will be calculated as follows:

	£
Market value of the four chairs at 6 October 2021	99,000
Less: cost (working)	(104,711)
Allowable loss	(5,711)

Caden can relieve this loss only against gains arising on further disposals to his son in 2021/22 or future tax years.

Working:

	£
Market value of the six chairs at 3 March 2019	152,000
Less: used on disposal of first two chairs £152,000 x $\frac{£42,000}{£42,000 + £93,000}$	(47,289)
Cost of remaining four chairs	104,711

(ii) Availability and effect of the instalment option for payment of inheritance tax (IHT)

Investment property

Land and buildings are qualifying assets for the instalment option for payment of IHT, so this will be available in respect of the IHT liability on the investment property, provided Nathi still owns the property on 20 March 2026, the date of his father's death. The IHT will be payable in ten equal annual instalments, commencing on 30 September 2026. However, if Nathi sells the house within the ten-year instalment period, the outstanding liability will become payable immediately.

Antique chairs

Antique chairs are not qualifying assets for the instalment option.

(b) Implications of the application of the IR35 legislation for Caden

Caden

Deemed employment payment:

	£
Budgeted fee income (all from relevant engagements)	65,000
Less: 5% deduction	(3,250)
	61,750
Less: salary (£1,500 x 12)	(18,000)
Employer's NIC ((£18,000 – £8,788) x 13·8%)	(1,271)
	42,479
Less: employer's NIC on deemed payment (£42,479 x 13·8/113·8)	(5,151)
Deemed employment payment	37,328
Total employment income (£18,000 + £37,328)	55,328
Less: personal allowance	(12,500)
Taxable income	42,828

Tutorial notes:

1. *As Caden is the only employee, and is also a director of Mandini Ltd, the employment allowance of £4,000 will not be available to deduct from the employer's NIC payable.*
2. *As all the profits of Mandini Ltd are deemed to have been paid to Caden as employment income, the dividends of £35,000 paid to Caden are treated as exempt income in order to avoid a double tax charge.*

(c) Interest arising on Amahle's bank account in Komor

As Amahle is resident in the UK, she will be assessed to UK income tax on her worldwide income, including the interest on the bank account in Komor. The remittance basis is not available to her because she is UK domiciled. Accordingly, she will be assessed on the full amount of interest income arising regardless of whether or not she remits it to the UK.

In the tax year 2021/22, Amahle will make a contribution of £3,000 (net), to her personal pension scheme, so her basic rate band will be extended by £3,750 (£3,000 x 100/80) to £41,250 (£37,500 + £3,750).

Amahle's taxable income of £40,000 (employment income of £45,000 and interest income on the Komor bank account of £7,500 (£150,000 x 5%) less the personal allowance of £12,500) will all fall into her basic rate band. As a basic rate taxpayer, a savings income nil rate band of £1,000 is available to Amahle, so her UK income tax liability in respect of the Komor interest will be £1,300 ((£1,000 x 0%) + (£6,500 x 20%)).

As the interest income will have already been taxed in Komor, double taxation relief (DTR) will be available. This will equal the lower of the UK tax and the overseas tax payable on this income. As the overseas tax payable of £1,350 (£7,500 x 18%) exceeds the UK tax of £1,300, the DTR will equal the UK tax liability. Accordingly, there will be no tax to pay in the UK.

			Available	Maximum
1	**(a)**	Information required	3	
		Actions to take	4	
			7	5
	(b)	Assets sold	2	
		Capital gains group	2	
		Assets purchased	3	
		Operation of relief	6·5	
			13·5	9
	(c)	Transfer pricing	3·5	
		UK rate of tax	2·5	
		Election to exempt profits	4	
			10	9
	(d)	Group VAT registration		
		Members of the group	3	
		Possible disadvantages	3	
		Purchase of components from Lis Co	3	
			9	8
	Problem solving		1	
	Clarity of explanations		1	
	Effectiveness of communication		1	
	Overall presentation and style		1	
			4	4
	Total			**35**
2	**(a)**	Taxable income	3·5	
		Income tax and class 1 NIC liability	3·5	
		Post-tax income and summary of findings	3·5	
			10·5	9
	(b)	Sale of investment property	2	
		Overseas rental income	3·5	
		Deemed domicile status	2	
			7·5	6
	(c)	Capital gains tax gift relief	1	
		Business property relief	6	
		Lifetime tax payable	1·5	
		Tax payable on death	3·5	
			12	10
	Total			**25**

				Available	Maximum
3	(a)	Loss available for terminal loss relief		2	
		Terminal loss relief – explanation		2·5	
		Calculation of tax relief		4·5	
				9	8
	(b)	Disposal of assets		1·5	
		Capital gains tax		3·5	
		After-tax proceeds		1	
				6	5
	(c)	New factory		3	
		Research and development	– deduction	3	
			– tax credit	2·5	
				8·5	7
	Total				**20**

				Available	Maximum
4	(a)	(i)	Calculation	2	
			Explanation	2·5	
				4·5	4
		(ii)	Availability of instalment option	1·5	
			Effect	3	
				4·5	3
	(b)	Deemed employment payment		3·5	
		Caden – taxable income		1·5	
				5	5
	(c)	Explanation of liability to UK income tax		2·5	
		Explanation and calculation of UK tax		4	
		Double tax relief		1·5	
		Conclusion		1	
				9	8
	Total				**20**