
Answers

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ABC & Co
Chartered Certified Accountants
Any Street
Any Town
16 November 2018

Tom and Susan White
Any Street
Any Town

Regarding: Tax issues arising on the disposal of your business

Dear Tom and Susan

We refer to your queries with regard to the above.

(a) Eligibility for reliefs

Entrepreneur relief

Entrepreneur relief reduces the capital gains tax (CGT) rate to 10% for qualifying disposals.

You will qualify for entrepreneur relief, provided the disposal meets the following conditions:

- You are an individual.
- You would be disposing of chargeable business assets, i.e. a holding of 5% or more of the ordinary shares in a company carrying on a qualifying trade.
- You would have been the beneficial owner of the chargeable business assets for a continuous period of three out of the five years immediately prior to disposal.
- You would have been a director or employee of the company and spent 50% or more of your working time in the service of the company in a managerial or technical capacity for a continuous period of three out of the five years immediately prior to disposal.
- Cumulative gains do not exceed the lifetime limit of €1,000,000, taking into account all disposals to date on which you have claimed entrepreneur relief.

Tutorial note: Relief can apply on the liquidation of a company, provided the company was carrying on a qualifying business up to the time the liquidator was appointed and the liquidation was completed within a reasonable period of time. For this purpose, the Revenue will regard a period of two years as being reasonable.

Eligibility

Accordingly, both of you will qualify for entrepreneur relief on the disposal of shares or liquidation of the company. In Tom's case, the entrepreneur relief will reduce the rate of taxation to 10%, prior to the application of retirement relief. In Susan's case, the entrepreneur relief will reduce the rate of taxation to 10%, however, she is not eligible for retirement relief (see below).

Tutorial note: Following this transaction, Tom and Susan's lifetime limit for entrepreneur relief will be reduced to €292,930 (€1,000,000 – €707,070) and €528,620 (€1,000,000 – €471,380) respectively (see computation 1).

Retirement relief

Retirement relief provides an exemption from CGT and will apply to the disposal of shares by you in a family trading company, provided the following criteria are met:

- You have been a working director for at least ten years during which you have been a full-time working director for more than five years.
- The relevant shares have been held during a period of at least ten years ending with the disposal.
- You have reached the minimum age of 55 on the date of disposal.
- The proceeds of disposal are less than €750,000.
- The transaction must be for *bona fide* commercial reasons and not for the avoidance of tax.

Eligibility

Tom

Tom meets the above criteria in relation to option 1.

In relation to option 2, the liquidation of Diner Ltd is a chargeable event for CGT purposes whereby the shareholders are effectively disposing of their shares and receiving a capital distribution. However, a strict interpretation of tax law indicates that retirement relief would not be available, as Tom would not be disposing of shares in a trading company, the company immediately prior to the liquidation would simply hold cash.

Marking note: The Revenue will, by concession, allow retirement relief to be claimed if the company is liquidated no more than six months after the sale of the business. An alternative answer, allowing retirement relief on that basis, is also acceptable and the calculations are included in computation 5(a).

It is important that Tom disposes of his shareholding prior to his 66th birthday, which occurs on 1 January 2019, as the proceeds limit for individuals aged 66 or over is €500,000 and on that basis Tom would no longer qualify for retirement relief.

Susan

Retirement relief will not be available to Susan as she has not been a working director for more than 10 years.

Tutorial note: *Where both entrepreneur relief and retirement relief are claimed by the same individual, the entrepreneur relief is calculated first. Please refer to computations 1 and 5(a).*

(b) Option 1

(i) Taxes arising on the sale of Vega plc shares by Diner Ltd to Tom

VAT is not chargeable on the sale of shares.

Corporation tax (CT) of €11,550 ($(€70,000 - €35,000) \times 33\%$) will be payable by Diner Ltd on the chargeable gain. This will effectively reduce the consideration payable by Roadhouse plc for the shares in Diner Ltd to €1,188,450 ($€1,200,000 - €11,550$).

In addition, Tom will be liable for stamp duty of €700 ($€70,000 \times 1\%$).

(ii) Net after-tax proceeds available on the sale of shares

The total net after-tax proceeds available to you amounts to €1,140,739 (see computations 1 and 2).

(c) Option 2

(i) VAT implications of the sale of the two properties to Roadhouse plc

'Tom's Diner' premises

The extension in April 2014 cost €150,000 which represents 36% ($€150,000/€420,000$) of the proposed consideration for the sale of the premises. As this exceeds 25%, it constitutes a development of the property. The sale is scheduled to take place on 30 November 2018 which is clearly within five years of the most recent development. Therefore the sale is subject to VAT and the transfer of a business provisions apply. The purchaser is deemed to incur VAT of €56,700 ($€420,000 \times 13.5\%$).

'Sue's Diner' premises

This is a non-new building as it has not been developed in the last five years. The proposed sale is therefore not subject to VAT. Furthermore, as no VAT was charged on the acquisition in 2009, there is no capital goods scheme (CGS) adjustment.

(ii) Net after-tax proceeds available on the liquidation of Diner Ltd

The total net after-tax proceeds available to you amounts to €1,009,754 (see computations 3–5).

(d) Recommendation

Under option 1, the gross proceeds of €1,200,000 have been reduced by the corporation tax payable by Diner Ltd in respect of the gain on the sale of the shares in Vega plc. Tom would pay nil CGT, due to the availability of retirement relief, whereas Susan would pay CGT at a 10% rate which amounts to €47,011 (as detailed in computation 1).

Under option 2, Diner Ltd must first pay tax of €212,850 on the gains arising on the sale of the relevant assets (as detailed in computation 3). Second, on the liquidator's distribution, a further €66,509 is payable by Tom and €44,297 is payable by Susan (as detailed in computation 5), being CGT at the entrepreneur relief rate of 10%. This double charge to tax is very significant, as is the fact that option 2 requires Diner Ltd to repay its liabilities, in particular the bank loan of €150,000 (which is not required under option 1).

Our calculations indicate that, even though it is a lower gross offer, the net proceeds of option 1 exceed those of option 2 by €130,945 ($€1,140,739 - €1,009,794$), and we would therefore recommend choosing option 1.

Please do not hesitate to contact us if you have any further queries.

Yours sincerely

T Consultant
Tax manager
ABC & Co

Computational appendix

Computation 1

Option 1: Capital gains tax (CGT) on disposal of shares in Diner Ltd

	Tom 60% €	Susan 40% €	Total €
Proceeds			1,200,000
Less: Corporation tax (CT) on disposal of Vega plc shares (€70,000 – €35,000) x 33%			(11,550)
Proceeds after outlay	713,070	475,380	<u>1,188,450</u>
Less: Cost	(6,000)	(4,000)	
Chargeable gain	707,070	471,380	
Annual exemption	Nil	(1,270)	
Taxable amount	<u>707,070</u>	<u>470,110</u>	
CGT on disposal of shares (10%)	70,707	47,011	
Retirement relief	(70,707)	0	
Tax payable	<u>0</u>	<u>47,011</u>	<u>47,011</u>

Note: No annual exemption for Tom as retirement relief is available.

Computation 2

Option 1: Calculation of net after-tax proceeds

	Tom €	Susan €	Total €
Net proceeds from disposal of shares in Diner Ltd	713,070	475,380	1,188,450
Less: Taxes			
Stamp duty regarding Vega plc shares	(700)		(700)
CGT on disposal of shares in Diner Ltd (computation 1)	0	(47,011)	(47,011)
Net after-tax proceeds available under option 1	<u>712,370</u>	<u>428,369</u>	<u>1,140,739</u>

Tutorial note: Under option 1, the cost of the shares in Vega plc, €70,000, has not been deducted from the net proceeds because Tom will be both paying for the shares and receiving the shares, which has a net effect of nil on the net proceeds. Under option 2 (below), Tom is also effectively paying for the shares, because he is receiving them as a distribution in specie on the liquidation (in lieu of a cash distribution).

Computation 3

Option 2: Tax at company level

	€	€	Gain/(Loss) €
'Tom's Diner' premises			
Proceeds		420,000	
Cost	400,000		
Enhancement expenditure	150,000	(550,000)	
Loss			(130,000)
'Sue's Diner' premises			
Proceeds		480,000	
Cost		(200,000)	
Gain			280,000
Goodwill			
Proceeds attributable to goodwill (Note 1)		495,000	
Cost		0	
Gain			495,000
Total taxable gains less allowable losses			<u>645,000</u>
Corporation tax at an effective rate of 33%			<u>212,850</u>

Tutorial note: Inventory is being effectively disposed of at its cost of €5,000 and there is therefore no liability to either CT or CGT.

Note 1

Proceeds attributable to goodwill

	€
Total proceeds	1,400,000
Less proceeds attributable to specific assets:	
'Tom's Diner' premises	(420,000)
'Sue's Diner' premises	(480,000)
Inventory	(5,000)
Proceeds attributable to goodwill	<u>495,000</u>

Computation 4

Option 2: Calculation of liquidator's distribution

	€	€
Assets in the company on liquidation:		
Proceeds from disposal of the properties, inventory and goodwill		1,400,000
Market value of shares in Vega plc		70,000
Proceeds from the collection of trade receivables		4,000
Cash balance		46,000
		<u>1,520,000</u>
Less: Liabilities		
Tax on disposal of the properties, inventory and goodwill (computation 3)	212,850	
Tax on deemed disposal of Vega plc shares (computation 1)	11,550	
Repayment of bank loan	150,000	
Repayment of trade payables	25,000	(399,400)
Liquidator's distribution		<u>1,120,600</u>

Computation 5

Option 2: Tax payable at shareholder level on liquidation of company (without the Revenue concession for retirement relief)

	Tom 60%	Susan 40%	Total
	€	€	€
Proceeds from deemed disposal of shares (computation 4)	672,360	448,240	1,120,600
Cost	(6,000)	(4,000)	
Gain	666,360	444,240	
Annual exemption	(1,270)	(1,270)	
Taxable	665,090	442,970	
CGT payable by shareholder (10%)	(66,509)	(44,297)	(110,806)
Net after-tax proceeds available under option 2 (without retirement relief)			<u>1,009,794</u>

Note: Stamp duty is not payable on the distribution (*in specie*) of the Vega plc shares by the liquidator.

Computation 5a

Option 2: Tax payable at shareholder level on liquidation of company (with the Revenue concession for retirement relief)

	Tom 60%	Susan 40%	Total
	€	€	€
Proceeds from deemed disposal of shares (liquidator's distribution – computation 4)	672,360	448,240	1,120,600
Cost	(6,000)	(4,000)	
Gain	666,360	444,240	
Annual exemption	0	(1,270)	
Taxable gain	666,360	442,970	
CGT at 10%	66,636	44,297	
Retirement relief	(66,636)		
CGT payable by shareholder	0	(44,297)	(44,297)
Net after-tax proceeds available under option 2 (with retirement relief)			<u>1,076,303</u>

2 (a) (i) Tax consequences of the transactions

Gothic Ltd

Gothic Ltd is a close company because it is under the control of five or fewer participators (and also is controlled by participators who are directors). It is therefore subject to the close company legislation.

Transaction 1: Sale of the warehouse at an undervalue

The warehouse was sold to Ronald Wood at €150,000 less than the market value of the property at the time.

The various tax implications are as follows:

– **Gothic Ltd: Corporation tax on capital gain**

Gothic Ltd is treated as disposing of the warehouse to Ronald Wood at market value.

	€
Sales proceeds (deemed)	500,000
Cost (2007)	(320,000)
Capital gain	<u>180,000</u>

Corporation tax of €59,400 (€180,000 x 33%) will be payable on the gain by Gothic Ltd.

– **Gothic Ltd: Dividend withholding tax (DWT)**

Ronald Wood is treated as having received a distribution of €150,000 (€500,000 – €350,000).

DWT of €30,000 (€150,000 x 20%) became payable by Gothic Ltd on the 14th of the month following the deemed date of the distribution, i.e. on 14 April 2018.

The company can seek to recover this DWT from Ronald Wood. If Ronald Wood does not repay the DWT to the company, the DWT may be treated as a further distribution.

– **Ronald Wood: Income tax, PRSI and USC**

Ronald Wood is taxable at an effective rate of 52% on the distribution received, but will receive a credit for the DWT deducted. His tax payable on the €150,000 will amount to €48,000 (€78,000 – €30,000).

– **Shareholders' base cost on future disposals**

The under-value of €150,000 will be apportioned over all of the company's issued ordinary shares and in the event of a future disposal of shares by any of the shareholders, the base cost of the shares will be reduced accordingly.

– **Stamp duty**

Stamp duty is payable by Ronald Wood on the market value of the property. A total of €30,000 (€500,000 x 6%) was payable by 17 April 2018 (within 30 days of the document being executed).

Transaction 2: Payment of the legal expenses of Anne Grant

Anne is an employee of Gothic Ltd and therefore the payment of her legal expenses will be treated as a benefit in kind.

– **Anne Grant: Income tax**

Anne will pay tax at an effective rate of 52% on this benefit.

The company will be required to operate payroll taxes on the amount of €5,000.

– **Gothic Ltd: Corporation tax**

Gothic Ltd will be allowed a corporation tax deduction for the amount of the expense (benefit), and the Case II profit will become €300,000 (€305,000 – €5,000).

(ii) Gothic Ltd: Corporation tax liability for the year ended 31 December 2018

The company's corporation tax liability on its income and chargeable gains is:

	€
Case II	300,000
Case III	60,000
Adjusted gain (€59,400/12.5%)	475,200
Total profits	<u>835,200</u>

Taxed as follows:

€775,200 at 12.5%	96,900
€60,000 at 25%	15,000
	<u>111,900</u>

Marking note: The formal CT computation is shown in the solution but a 'simple' CT computation is sufficient here for the available marks.

Gothic Ltd: Close company surcharge

Gothic Ltd is a professional service company and therefore is subject to an effective surcharge of 7.5% (15% x 50%) on its after-tax undistributed Case II income; and to a 20% surcharge on its after-tax undistributed Case III income, net of the trading company deduction.

The company's after-tax income is calculated as follows:

	€	€
Case II	300,000	
Corporation tax at 12.5%	<u>(37,500)</u>	
After-tax trading income	262,500	
50% of after-tax trading income		131,250
Case III	60,000	
Corporation tax at 25%	<u>(15,000)</u>	
After-tax investment income	45,000	
Trading company deduction at 7.5%	<u>(3,375)</u>	
		<u>41,625</u>
		<u>172,875</u>

Gothic Ltd paid no dividends in 2018 or in 2019 to date. The distribution of €150,000 will be first applied to eliminate the after-tax Case III income of €41,625 attracting the higher (20%) rate of surcharge. The balance of €108,375 (€150,000 – €41,625) will be applied to reduce the after-tax trading income to €22,875 (€131,250 – €108,375).

The professional services company surcharge for the year ended 31 December 2018 will therefore amount to €3,431 (€22,875 x 15%).

This may be reduced to nil if a dividend of at least €22,875 is paid within 18 months of the expiry of the relevant accounting period (i.e. before 30 June 2020).

(b) (i) Principal private residence (PPR) relief

The disposal of a PPR is exempt from tax, provided it has been used as a PPR throughout the period of ownership. When an individual has not occupied the property as their PPR during the entire period of ownership, the part of the gain represented by the period of non-occupation is not exempt.

In addition to actual occupation, the following periods are deemed to be periods of occupation:

- All periods of foreign employment as an employee.
 - Periods up to a maximum of four years, during which the individual resided elsewhere in Ireland as a condition of their employment.
- In order to qualify, it is necessary in the case of either of the above to actually occupy the residence at some time before and after the period of absence. It is also a requirement that the taxpayer did not own another residence eligible for PPR during the period of deemed occupation.
- The last 12 months of ownership are deemed always to be a period of occupation.

(ii) CGT liability

Rhonda – CGT computation (without reoccupation)

Sales proceeds	€	300,000
Less: Cost (€70,000 x 1.049)		<u>(73,430)</u>
Gain		226,570
Less: PPR relief (see note)		<u>(53,311)</u>
Chargeable gain		173,259
Less: Annual exemption		<u>(1,270)</u>
Taxable gain		171,989
CGT at 33%		<u>56,757</u>

Note: PPR relief

Total period of ownership (years) 17

Occupation (years)	Actual	Deemed	None
1 September 2002 to 31 August 2005	3		
1 September 2005 to 31 August 2010			5
1 September 2010 to 31 August 2015			5
1 September 2015 to 31 August 2018			3
1 September 2018 to 31 August 2019		<u>1</u>	
	<u>3</u>	<u>1</u>	<u>13</u>

Total occupation (actual plus deemed) 4

PPR relief
 €226,570 x 4/17 €53,311

If Rhonda sells the Galway house on 31 August 2019, there will be a taxable gain of €171,989 and a resulting CGT liability of €56,757.

The main reason for this liability is that she will not have re-occupied the Galway house after her periods of non-occupation in Dublin and Berlin and, therefore, these periods will not qualify as deemed periods of occupation for the purposes of PPR relief.

(iii) Recommendations

(1) Re-occupy the Galway house

It is recommended that Rhonda occupies the Galway house for a few months prior to the sale (for example, from 1 April 2019 until 31 August 2019). The taxable gain has been recalculated at €52,041 and the CGT would be €17,173.

Rhonda – CGT computation (with reoccupation)

	€
Gain (as for without reoccupation)	226,570
Less: PPR relief (see note)	(173,259)
Chargeable gain	53,311
Less: Annual exemption	(1,270)
Taxable gain	52,041
CGT at 33%	17,173

Note: PPR relief

Total period of ownership (years) 17

Occupation (years)	Actual	Deemed	None
1 September 2002 to 31 August 2005	3		
1 September 2005 to 31 August 2010		4	1
1 September 2010 to 31 August 2015		5	
1 September 2015 to 31 August 2018			3
1 September 2018 to 31 August 2019		1	
	3	10	4

Total occupation (actual plus deemed) 13

PPR relief
 €226,570 x 13/17 €173,259

This significant reduction in CGT payable arises from the periods spent in Dublin and Berlin being treated as periods of deemed occupation for PPR as a result of the re-occupation. The periods spent in Dublin after 31 August 2009 are treated as a period of non-occupation because there is a maximum allowable period of four years for employment elsewhere in Ireland.

(2) Sell and repurchase the shares in Sounds plc in 2019

There is a total latent loss in the Sounds plc shares of €60,000 (10,000 x (€10 – €4)).

If Rhonda sells her shares at this price, she can crystallise this loss in 2019. This would eliminate the €53,311 chargeable gain on the sale of the house (assuming she reoccupies it) and leave her with a nil CGT liability and a capital loss to carry forward of €6,689.

Tutorial note: *Losses must be used before the annual exemption.*

Rhonda does not wish to permanently dispose of the Sounds plc shares and after this sale she would be free to reacquire the shares. However, it is very important that there is a gap of more than four weeks between the sale and repurchase, otherwise it will not be possible to allocate the loss against anything other than a future gain on the same shares.

3 (a) Martha McDermott

Proposed lease of offices to the partnership

The leasing of property is an exempt activity for value added tax (VAT) purposes. Accordingly, Martha's friend's advice that VAT does not apply to lettings is correct but it is incomplete.

The proposal involves a change of use of the office building from a taxable activity (i.e. being used in Martha's trade) to an exempt activity (i.e. being leased to the partnership). Under the capital goods scheme, this is a 'big-swing' which would trigger a full clawback of the VAT reclaimed on the initial purchase of the office building, for the remaining years as follows:

		€
Purchase price (excluding VAT)		350,000
VAT reclaimed at 13.5%		47,250
VAT life of new building (years)	20	
Number of full intervals remaining	17	
Clawback ((17 + 1)/20 x €47,250)		42,525

However, as an alternative, it will be possible to elect to have the ongoing rents subject to VAT at the standard rate of 23%. If this election is made, there will not be a change of use to an exempt activity and so, no clawback will take place.

The option to tax the rents is available in this case, even though the letting is between connected persons. This is because the option is allowed between connected persons where the occupant is using the property for at least 90% VAT liable/deductible activities (which is the situation in this case).

If this single option to tax is made by Martha (as landlord) and VAT is charged at 23% on the monthly rent, the partnership will be able to claim an input credit for the VAT incurred.

(b) Other potential tax issues

Registration

It will be necessary to register the partnership for VAT and income tax.

It will also be necessary to de-register the sole trade for VAT and employer payroll taxes.

Income tax

Cessation: There will be a cessation of the sole trade business which may require a revision of the assessment for the penultimate year.

Commencement: The partnership will commence from 1 October 2019. Emily will cease to be an employee and will become self-employed and subject to self-assessment from 1 October 2019 onwards.

As Martha will be the precedent acting partner, she will be responsible for the submission of the partnership income tax return.

Rental income and expense: The rental income receivable by Martha will be subject to income tax under Case V and the corresponding rental expense will be a deductible expense for the partnership.

If the work in progress and receivables are being transferred to the partnership, they should be transferred at a value no greater than cost, to ensure that no income tax liabilities arise.

Interest on the loan: The interest paid by Emily on the loan borrowed to invest in the partnership will not be an allowable deduction for income tax purposes.

Tutorial note: *Tax relief is no longer available for interest on new loans obtained after 15 October 2013.*

Capital allowances

The disposal of the equipment at a value in excess of its tax written down value (TWDV) would normally generate a balancing charge. However, where a sole trader is transferring assets to a partnership and the sole trader is entitled to more than 50% of the partnership profits (as in this case), both entities may elect to transfer the relevant assets at their TWDV.

Capital gains tax (CGT)

Martha will be making a disposal of relevant assets, for CGT purposes.

The main asset of concern here is goodwill. As this will probably have a base cost of nil, CGT will apply at 33% to the full value of any goodwill recognised on the transfer.

Martha will not be able to avail of retirement relief because she is aged under 55.

Martha will also not be able to avail of entrepreneur relief, because she would not have owned the qualifying asset (goodwill) for the required three-year period in the five years immediately prior to disposal.

CGT is not likely to be an issue in relation to the transfer of the equipment because it is not valued in excess of its original cost. The work in progress and receivables are not chargeable assets for the purposes of CGT.

VAT

Where a business is disposed of and both the vendor and the purchaser are registered for VAT, the supply is not taxable under the transfer of business rules, if the business is capable of being operated on an independent basis. In the absence of this relief, VAT would need to be charged on all assets for which an input credit had been claimed (i.e. the equipment). It is therefore essential that both entities (the sole trader and the partnership) are registered for VAT at the time of the transfer of the equipment.

Stamp duty

Stamp duty will be payable on the value of the goodwill transferred to Emily, at the rate of 6%.

If the equipment can be transferred by delivery (i.e. not included in a contract), no stamp duty charge will arise.

The transfer of the work in progress and receivables to the partnership would normally give rise to a liability to stamp duty at 6%. However, if the partnership does not take ownership of the receivables but instead collects the receivables as an agent for the sole trader, then no stamp duty liability will arise on the value of the receivables.

(c) Confidentiality and potential conflict of interest

Martha is your client. You have a duty of confidentiality to her unless you have her express permission to discuss her affairs with a third party, such as Emily.

It would be advisable for Emily to obtain separate advice in relation to the various tax issues involved in setting up the partnership in order to avoid any potential conflict of interest which would arise through you personally acting for both parties. Another adviser in your firm may act for Emily provided adequate safeguards are put in place, and all parties are aware (and are in agreement) that the firm acts for both parties.

4 (a) CAT liabilities of Linda and Conor

Linda: CAT computation

	€
Encumbrance free value	300,000
Less: Right of residence (€300,000 x €10,000/€25,000)	(120,000)
	<u>180,000</u>
Class 2 threshold	(32,500)
Taxable	<u>147,500</u>
Tax at 33%	<u>48,675</u>

Marking note: *Alternatively, candidates may value the right of residence at 10% of the encumbrance free value.*

Conor: CAT computation

	€
Right of residence €120,000 x 0.3181	38,172
Class 2 threshold	(32,500)
Taxable	<u>5,672</u>
Tax at 33%	<u>1,872</u>

(b) Proposal to disclaim the inheritance from Frank in favour of Michael

If Linda disclaims the property in favour of a named beneficiary (her brother Michael), this is not a pure disclaimer and Linda is deemed first to have inherited the property from Frank and then to have made a gift of the property to Michael. This would result in a substantial CAT liability for Linda without the benefit of owning the asset.

(c) Risks associated with professional advice from a trainee accountant friend

James is a trainee accountant and is not in a position to give formal advice to Walter.

His work should be conducted for clients of his training firm who have agreed terms of engagement with that firm and should be subject to review prior to being issued to the client. It is most likely that these conditions are part of his terms of employment.

The possible risks to James associated with giving written advice in this situation could include:

- dismissal from his trainee position arising from breach of his employment contract, and
- liability for damages arising from Walter's reliance on incorrect advice.

(d) Walter's inheritance of the farm

The first issue is whether or not Walter qualifies for agricultural relief.

His total gross assets after taking the inheritance will be as follows:

	Total €	Agricultural €	Non-agricultural €
Farm and farmhouse	1,500,000	1,500,000	
Cattle	120,000	120,000	
Cash at bank	35,000		35,000
Horses	20,000	20,000	
Farm machinery	60,000	60,000	
Boat	20,000		20,000
Crops	19,000	19,000	
Car	5,000		5,000
Own PPR (€640,000 – €100,000)	540,000		540,000
	<u>2,319,000</u>	<u>1,719,000</u>	<u>600,000</u>

After taking the inheritance, his agricultural assets as a percentage of total assets is $(1,719/2,319) \times 100 = 74\%$. As this is less than the required 80%, Walter does not qualify as a 'farmer'.

Business property relief

As Walter has not qualified for agricultural relief, the feasibility of claiming business property relief can be examined.

To avoid a clawback of the relief, it is essential that the business property must be used for the purposes of carrying on a business. As Walter has stated that he will never farm the land, it is not recommended that business property relief is claimed.

Walter's CAT liability is calculated as follows:

	€
Value of assets inherited (€2,079,000 – €300,000)	1,779,000
Less: Debts and funeral expenses	(32,000)
	<u>1,747,000</u>
Class 2 threshold: €32,500 at nil	0
Balance: €1,714,500 at 33%	565,785
CAT liability	<u>565,785</u>

(e) Advice on mitigating the CAT on Walter's inheritance from Frank

Walter should seek to qualify as a farmer, as agricultural relief would effectively reduce the taxable value of the agricultural property by 90%. This should be done before the valuation date of the inheritance from Frank.

First, in relation to the 80% assets test, Walter might qualify as a farmer by taking one or a combination of the following actions:

- Moving his house into joint ownership with his wife. The value of his share in the house, after deducting 50% of the mortgage, would be €270,000 and this would reduce his percentage of non-qualifying assets and thereby increase his percentage of agricultural assets to 84% $(1,719/2,049)$, so he would then qualify as a farmer.
- Taking out a loan and buying enough agricultural property to bring his relevant percentage of agricultural assets over 80%. As the 'farmer' test is a gross assets test, the loan (liability) will not be counted in the assessment of assets.

Tutorial note: *In general, no deduction is made for loans in calculating the gross value of property for the purposes of the 80% test. The only exception is that the value of an 'off-farm' principal private residence, which is a non-qualifying asset, is to be determined after deducting any borrowings which have been used to purchase, repair or improve the residence.*

In addition to the above, as Walter does not intend to personally farm the land, he must lease the land for a period of six years commencing on the valuation date to an individual who either:

- Has an approved agricultural qualification: or
- Farms the agricultural property for not less than 50% of his or her normal working time.

It is crucial that the property subject to agricultural relief be retained for a minimum period of six years, to avoid a clawback of the relief for Walter.

This marking scheme is given as a guide to markers in the context of the suggested answer. Scope is given to markers to award marks for alternative approaches to a question, including relevant comment, and where well-reasoned conclusions are provided. This is particularly the case for essay-based questions where there will often be more than one definitive solution.

	<i>Available</i>	<i>Maximum</i>
1 (a) Eligibility for relief(s)		
Entrepreneur relief (ER) and rate	1.0	
Conditions for ER which are met by Susan and Tom	2.5	
Tom and Susan qualify for ER	1.0	
Conditions for retirement relief (RR)	2.5	
Tom qualifies for RR regarding option 1	0.5	
Conclusion regarding option 2 not qualifying for RR under the strict rules (see marking note)	0.5	
Importance of disposal taking place before 1 January 2019	1.0	
RR not available to Susan	0.5	
	<hr/> 9.5	7.0
(b) (i) Tax on sale of Vega plc shares		
No value added tax (VAT) on the sale of shares	0.5	
Corporation tax (CT) on gain	1.0	
Stamp duty	1.0	
	<hr/> 2.5	2.0
(ii) Net after-tax proceeds: option 1 (computations 1 and 2)		
Tom: Capital gains tax (CGT) calculation including RR and no annual exemption	2.5	
Susan: CGT calculation including ER	2.0	
Calculation of net after-tax proceeds (computation 2)	1.0	
	<hr/> 5.5	5.0
(c) (i) VAT implications of Diner Ltd selling the two properties to Roadhouse plc		
‘Tom’s Diner’ property		
Cost of extension was more than 25% of sales price and therefore constitutes development	1.0	
Development was within five years of scheduled sale	0.5	
VAT calculation	0.5	
Transfer of business provisions apply	1.0	
‘Sue’s Diner’ property		
Non-new building not subject to VAT	0.5	
Non-new building not subject to capital goods scheme adjustment	0.5	
	<hr/> 4.0	3.0

	<i>Available</i>	<i>Maximum</i>
(ii) Net after-tax proceeds: option 2 (computations 3–5)		
Calculation of tax at company level (computation 3)		
Gain/loss on ‘Tom’s Diner’ property	1.0	
Gain/loss on ‘Sue’s Diner’ property	1.0	
Proceeds attributable to goodwill (Note 1)	1.0	
Gain/loss on goodwill	0.5	
CT at 33%	0.5	
Calculation of liquidator’s distribution (computation 4)		
Disposal proceeds	0.5	
Market value of Vega plc shares	0.5	
Proceeds from trade receivables	0.5	
Cash	0.5	
Tax liability on disposal	0.5	
Tax on deemed disposal of Vega plc shares	0.5	
Repayment of bank loan	0.5	
Repayment of trade payables	0.5	
Tax payable at shareholder level (computation 5)		
CGT: Tom	1.5	
CGT: Susan	1.5	
Stamp duty not payable on distribution (<i>in specie</i>) of Vega plc shares	0.5	
	11.5	10.0
 (d) Explanation of taxes under both options and recommendation		
Explanation of taxes arising under option 1	1.5	
Explanation of the double tax charge arising under option 2	1.0	
Reference to the requirement to pay company liabilities under option 2	1.0	
Recommendation of best option	1.0	
	4.5	4.0
 Professional marks		
Format and presentation of letter	1.0	
Effectiveness of written communication	1.0	
Appropriate use of support schedules/appendix	1.0	
Logical flow of calculations	1.0	
	4.0	4.0
		35

	<i>Available</i>	<i>Maximum</i>
2 (a) (i) Tax consequences of the transactions		
Close company: identify and explain	1.0	
Sale of warehouse at undervalue		
Gothic Ltd: CT on disposal at market value	1.0	
Identification of distribution €150,000	1.0	
Gothic Ltd: dividend withholding tax (DWT) calculation and payment date	1.0	
Right to recover DWT from Ronald Wood	0.5	
Potential further distribution if not repaid	0.5	
Ronald Wood: personal tax	1.0	
Reduction in shareholders' base cost on future disposal of shares	1.0	
Stamp duty calculation on market value and payment date	1.0	
Payment of expenses of Anne Grant		
Benefit in kind taxable at 52% and subject to payroll taxes	1.0	
Valid CT deduction for the company and adjustment to Case II profits	1.0	
	<u>10.0</u>	9.0
(ii) CT liability and surcharges		
CT liability	2.0	
Surcharge		
Identification of two potential surcharges	1.0	
Calculation of after-tax income subject to surcharge	2.0	
Use of distribution against higher surchargeable income first	0.5	
Calculation of final surcharge amount	0.5	
Effect of payment of dividend within 18 months	0.5	
	<u>6.5</u>	5.0
(b) (i) Explanation of principal private residence (PPR) relief	1.0	
Periods of deemed occupation		
Foreign employment	0.5	
Ireland up to four years	0.5	
Requirement to occupy before and after	0.5	
Requirement not to own another residence eligible for PPR	0.5	
Last 12 months	0.5	
	<u>3.5</u>	3.0
(ii) Calculation of CGT liability		
PPR relief calculation	2.0	
CGT computation	2.0	
	<u>4.0</u>	4.0
(iii) Recommendations		
(1) Re-occupy the Galway house	1.0	
Calculation of CGT liability with re-occupation	2.0	
(2) Sell and repurchase the Sounds plc shares	1.0	
Calculation of saving arising from loss relief	0.5	
Four-week gap required between sale and repurchase	1.0	
	<u>5.5</u>	4.0
		<u>25</u>

	<i>Available</i>	<i>Maximum</i>
3 (a) Explanation of transfer to an exempt activity	1.0	
Calculation of potential clawback	1.5	
Election to tax the rents	1.0	
Restrictions regarding connected parties not applicable	1.5	
Martha charges VAT and partnership reclaims	1.0	
	<u>6.0</u>	5.0
(b) Registration and de-registration for various taxes	1.0	
Income tax (IT)		
Cessation of sole trade, potential revision of penultimate year of assessment	1.0	
Commencement of partnership, Emily becomes subject to self-assessment, Martha will be responsible for IT return	1.5	
Tax treatment of rental income and expense	0.5	
Transfer work in progress and receivables at cost	0.5	
No interest relief on loan	1.0	
Capital allowances, ability to elect to avoid balancing charge	1.5	
CGT		
Identification of goodwill disposal	0.5	
Explanation of potential liability	0.5	
RR and ER not available (2 x 0.5)	1.0	
CGT not applicable to the equipment, receivables or work in progress	1.0	
VAT		
Exemption if both parties are registered	1.0	
Stamp duty		
Applicable to goodwill	0.5	
Not applicable to transfer of equipment if by delivery	0.5	
Applicable to receivables and work in progress	1.0	
Receivables collected as agent	0.5	
	<u>13.5</u>	13.0
(c) Emily to obtain separate tax advice – potential conflict of interest	1.0	
Confidentiality – permission to discuss with third party	1.0	2.0
		<u>2.0</u>
4 (a) Linda: Capital acquisitions tax (CAT) computation	2.0	
Conor: CAT computation	2.0	4.0
	<u>2.0</u>	
(b) Effect of disclaimer	2.0	2.0
(c) Position of James as a trainee accountant	1.5	
Risks arising to James from giving advice	1.0	
	<u>2.5</u>	2.0
(d) Deductibility of mortgage from value of PPR	1.0	
Calculation of farmer percentage	2.5	
Consideration of business property relief	0.5	
Non-eligibility for business property relief	1.0	
Calculation of CAT payable (without agricultural relief)	1.5	
	<u>6.5</u>	6.0
(e) Seek to qualify for agricultural relief	1.0	
Suggested actions to pass the 80% test (2 x 1.5)	3.0	
Conditions in relation to the lease and the lessee	1.5	
Retain for six years	0.5	6.0
	<u>0.5</u>	<u>6.0</u>
		20