Answers

1 Grand Ltd group

(a) Memorandum

Client	Grand Ltd group
Subject	Sale of Colca Ltd
Prepared by	Tax senior
Date	4 September 2018

(i) **Offer A – in respect of a sale of the company's shares**

Tax relief available in respect of the capital loss on the sale of the shares

– The capital loss on the sale of the shares will not be allowable for tax purposes due to the automatic application of the substantial shareholding exemption (SSE).

– The SSE applies because:

  – Grand Ltd and Colca Ltd are both trading companies; and

  – Grand Ltd will have owned at least 10% of the ordinary share capital of Colca Ltd for at least 12 months in the two years prior to the sale of the company.

The tax implications of Colca Ltd leaving the Grand Ltd group whilst owning the Atuel building

Degrouping charge

– The sale of the Atuel building by Sautso Ltd to Colca Ltd took place at no gain, no loss because the two companies were members of a capital gains group. This resulted in a base cost in the building for Colca Ltd equal to Sautso Ltd's cost plus indexation allowance up to the date of the sale (1 April 2016).

– Colca Ltd will leave the Grand Ltd group within six years of purchasing the building from Sautso Ltd, such that a degrouping charge will arise. Colca Ltd will be deemed to have sold the building for £255,000, its market value as at 1 April 2016.

  This deemed disposal results in a capital loss. However, this loss merely increases Grand Ltd's cost of the shares in Colca Ltd. This in turn will increase the capital loss on the sale of the shares, which is exempt due to the SSE (as noted above).

Tutorial notes:

1. *There was no need to calculate the capital loss in respect of the degrouping charge because it merely increases the capital loss on the sale of Colca Ltd, which is exempt under the SSE.*

2. *Colca Ltd will also be deemed to have purchased the building for £255,000, such that this will be its base cost in the building when calculating the chargeable gain or allowable loss arising on any future disposal of the building.*

Stamp duty land tax (SDLT)

– There was no SDLT liability when Colca Ltd purchased the Atuel building from Sautso Ltd because both companies were 75% subsidiaries of Grand Ltd.

– However, Colca Ltd will leave the Grand Ltd group within three years of purchasing the building, such that it will have to pay the SDLT which would have been due at the time of purchase if the group exemption had not been available.

Post-tax proceeds

	£
Sale proceeds	730,000
Less: SDLT payable by Colca Ltd in respect of the Atuel building	(2,250)
Post-tax proceeds	727,750

Working

SDLT payable by Colca Ltd in respect of the Atuel building

£		£
150,000	x 0%	0
100,000	x 2%	2,000
5,000	x 5%	250
255,000		2,250

(ii) Offer B – in respect of a sale of the company's trade and assets

Post-tax proceeds

	£
Sale proceeds	
Trade and assets	695,000
Tax liability/credit in respect of:	
Chargeable gain on the Oribi building (£70,337 (W1) x 19%)	(13,364)
Plant and machinery balancing charge (£12,100 x 19%)	(2,299)
Allowable loss on the Atuel building (£110,000 (W2) x 19%)	20,900
Post-tax proceeds	700,237

Workings

1. Sale of the Oribi building

	£
Proceeds	410,000
Less: cost (£320,000 – £17,000)	(303,000)
Less: indexation allowance (£303,000 x 0·121)	(36,663)
Chargeable gain	70,337

2. Sale of the Atuel building

	£
Proceeds	230,000
Less: cost (original cost to Sautso Ltd)	(340,000)
Allowable loss	(110,000)

Tutorial note: *Colca Ltd has a base cost in the Atuel building equal to the cost of the building to Sautso Ltd plus indexation allowance up to the date of sale (1 April 2016). However, the indexation allowance has to be excluded from the base cost when calculating a capital loss because indexation allowance cannot be used to increase the allowable loss.*

Chargeable gains and allowable capital losses on the sale of the machinery

– The items of machinery will not be exempt under the wasting chattels rule because they qualify for capital allowances.

– However, any item where both the cost and the proceeds are less than £6,000 will be exempt.

– In respect of the chargeable items of machinery (where the cost or the proceeds is at least £6,000):

  – An item sold at a loss will not result in an allowable capital loss. This is because Colca Ltd will have received capital allowances equal to the fall in value of the item.

  – An item sold at a profit will result in a chargeable gain. Rollover relief will not be available because the items are moveable as opposed to fixed.

Transfer of capital losses to group members

– The whole or part of any capital loss can be transferred to Grand Ltd, Sautso Ltd and any other member of the Grand Ltd capital gains group.

  – this group consists of Grand Ltd, its directly held 75% subsidiaries, their directly held 75% subsidiaries and so on;

  – where each company is an effective 51% subsidiary of Grand Ltd.

(iii) Offer B – value added tax (VAT)

Colca Ltd should not charge VAT on the sale of its business if the sale is a transfer of a going concern (TOGC). This requires all of the following conditions to be satisfied:

– the business of Colca Ltd is transferred as a going concern;
– the purchaser will use the assets to carry on the same kind of business as Colca Ltd;
– there is no significant break in trading;
– the purchaser is VAT registered or will become registrable as a result of the purchase.

However, even where the sale of the business qualifies as a TOGC, VAT must still be charged on the sale of any building included as part of the sale if either:

– an option to tax has been made in respect of the building; or
– the building is a commercial building which is less than three years old.

No option to tax has been made in respect of either of the buildings to be sold by Colca Ltd.

However, the Atuel building is a commercial building which will be less than three years old on 1 December 2018, such that the sale of this building will be a standard rated supply and VAT must be charged unless the purchaser opts to tax the building.

(b) Tax evasion and tax avoidance

Tax evasion, tax avoidance, and the purpose of the general anti-abuse rule (GAAR)

Tax evasion is unlawful. It involves the provision of false information or the withholding of information in order to evade tax.

Tax avoidance involves the use of legal methods in order to reduce the amount of tax payable.

The GAAR is intended to counteract tax advantages, obtained via what would otherwise be legal tax avoidance methods, where the arrangements can be considered to be abusive.

Why the GAAR is likely to apply to the plan drawn up by Bryce and his daughter

- the tax advantage obtained would be a tax deduction in excess of the cost of the machinery;
- the tax arrangements would be the formation of the subsidiary and the series of leasing contracts which are intended to obtain the tax advantage;
- the arrangements are likely to be regarded as abusive because they appear to have been designed to give rise to additional tax deductions rather than for genuine commercial reasons.

2 Dee

(a) Minimising income tax on investment income

Gift of £150,000 to Cam – income tax saving

	£
Total income tax	
If Dee invests the whole of the £450,000	3,342
If Dee gives £150,000 to Cam (£1,593 + £0) (below)	(1,593)
Income tax saving	1,749
Dee – investing £300,000	
Interest income	
(£1,000 (£300,000 x 1/3 x 1%) x 45%)	450
Dividend income	
((£8,000 (£300,000 x 2/3 x 4%) – £5,000) x 38·1%)	1,143
	1,593
Cam – investing £150,000	
Interest income	
(£500 (£150,000 x 1/3 x 1%) x 0%) (savings income nil rate band)	0
Dividend income	
(£4,000 (£150,000 x 2/3 x 4%) x 0%) (dividend nil rate band)	0
	0

Tutorial note: *The interest and dividends in respect of funds held within ISAs are exempt from income tax. Accordingly, they do not reduce the savings income nil rate band or the dividend nil rate band.*

Factors relevant to obtaining a more income tax-efficient split of the total investment

Tax allowances

Cam has £500 (£1,000 – £500) of the savings income nil rate band and £1,000 (£5,000 – £4,000) of the dividend nil rate band remaining.

Income tax rates

Even if he were to have to pay income tax on his investment income, Cam's tax rates would be considerably lower than those of Dee.

Accordingly, it makes sense for Cam's income to be maximised and Dee's income to be minimised.

Yields on the investments

The greatest change in their income levels would be achieved by Cam investing more in shares and Dee investing less in shares. This is because the yield from shares is four times the yield on cash deposits.

Gift to Oder

The interest income in respect of Dee's proposed gift to Oder would exceed £100 (£20,000 x 1% = £200). Accordingly, until Oder is 18 years old, all of the interest income (i.e. not just the excess over £100) would be taxed as if it were Dee's income. Accordingly, no tax saving would arise.

Once Oder is 18, the interest income would be treated as his income. Oder is unlikely to be an additional rate taxpayer, such that the interest income would be taxed at a lower rate than if it were received by Dee. This would then reduce the total income tax liability of the family.

(b) Gift to Cam

Inheritance tax

Cam is non-UK domiciled, such that the spouse exemption, which applies to gifts between spouses, is limited to a lifetime maximum of £325,000. This limit has already been exceeded due to the gift made by Dee to Cam on 1 August 2014, which was valued at £600,000.

Accordingly, Dee's gift of £150,000 to Cam would be a potentially exempt transfer, which could give rise to an inheritance tax liability if Dee were to die within seven years of the gift.

This potential liability could be avoided in either of the following ways:

- The terms of Dee's father's will could be altered via a deed of variation, such that one-third of the London house is left directly to Cam. This would avoid the need for Dee to make a potentially exempt transfer to Cam.
- Cam could elect to be treated as UK domiciled for the purposes of inheritance tax. This would mean that all gifts from Dee would be exempt under the spouse exemption with no upper limit.

Tutorial notes:

1. *The deed of variation would have to be signed by Dee and be executed within two years of Dee's father's death. It should state that it is intended to be effective for both inheritance tax and capital gains tax purposes.*
2. *The downside of Cam electing to be treated as UK domiciled would be that any non-UK assets owned by Cam would cease to be outside UK inheritance tax and so would become taxable.*

Capital gains tax (CGT) saving if Dee were to give Cam a one-third interest in the London house

	Dee	Cam
	£	£
Sale of the house by Dee as planned		
Chargeable gain £450,000 – £390,000)	60,000	
Less: annual exempt amount	(11,300)	
	48,700	
CGT at 28%	13,636	
Gift of one-third of the house to Cam		
Chargeable gain 2/3:1/3	40,000	20,000
Less: annual exempt amount	(11,300)	(11,300)
	28,700	8,700
CGT at 28%/18%	8,036	1,566

CGT saving of £4,034 (£13,636 – (£8,036 + £1,566)).

Tutorial note: *The gift of one-third of the house to Cam would take place at no gain, no loss because Dee and Cam are married. As a result, the gain of £60,000 would be split between them in the ratio 2/3:1/3.*

(c) Tax-efficient investments

Income tax relief

Dee's income tax liability would be reduced by 30% of the amount invested in venture capital trust (VCT) shares, i.e. £15,000 (£50,000 x 30%).

The tax relief in respect of an investment in enterprise investment scheme (EIS) shares would be the same.

Withdrawal of income tax relief

The relief would be withdrawn if Dee were to sell the VCT shares within five years.

Dee would only need to retain the EIS shares for three years for the relief not to be withdrawn.

Dividends received in respect of the investments

Dividend income in respect of VCT shares is not subject to income tax.

Dividend income in respect of EIS shares is taxable.

3 Enid

(a) Reliefs available for the trading losses brought forward at 6 April 2018

Trading losses brought forward are automatically offset against the first available future profits from the same trade. Enid will therefore offset £42,000 of the trading losses brought forward against the profit of her unincorporated business prior to its transfer to Niche Ltd. £9,000 (£51,000 – £42,000) remains unrelieved.

However, as her business has been transferred to a company, Enid can relieve the remainder of the loss against her income from the company. The loss will be relieved against the first-available income from the company, earned before unearned, which will be her salary of £37,500 (£75,000 x 6/12) in the tax year 2018/19. Enid qualifies for this relief as at least 80% of the consideration for the transfer of her business will be in the form of shares. She must retain these shares until the end of 2018/19 in order to make this claim.

(b) Availability of incorporation relief and the balance on Enid's loan account

Availability of incorporation relief

Incorporation relief will be available because:

– the business will be transferred as a going concern;
– all the assets will be transferred; and
– the consideration includes shares.

Amount to be withdrawn from the loan account

	£
Gain on goodwill	80,000
Gain on workshop (£122,000 – £55,000)	67,000
Total gains before relief	147,000
Less: incorporation relief: 85% x £147,000	(124,950)
Chargeable gains	22,050

	Gain eligible for entrepreneurs' relief £	Gain not eligible for entrepreneurs' relief £
Gain attributable to workshop (67/147)	10,050	
Gain attributable to goodwill (80/147)		12,000
Less: annual exempt amount (best use)	0	(11,300)
Taxable gains	10,050	700

Enid's capital gains tax (CGT) liability is £1,145 ((£10,050 x 10%) + (£700 x 20%)).

The funds left on loan account initially will be £30,000 (15% x £200,000 (£80,000 + £122,000 + £8,000 – £10,000)).

The balance on Enid's loan account after deducting the cash to be withdrawn to pay the CGT liability will be £28,855 (£30,000 – £1,145)

Tutorial note: *Goodwill is not a relevant business asset for entrepreneurs' relief where it is transferred by an individual to a close company, and that individual is a related party to the close company, as is the case in this scenario.*

(c) Replacement of Enid's dividend with increased salary or withdrawal from her loan account

Enid is a higher rate taxpayer. She currently receives dividends of £4,000 each year, so the income tax payable on the dividend of £15,000 from Niche Ltd will be £4,550 (((£5,000 – £4,000) x 0%) + ((£15,000 – £1,000) x 32·5%)).

There are no tax implications for Niche Ltd of payment of a dividend.

Neither Niche Ltd nor Enid would pay national insurance contributions (NIC) on the payment of a dividend.

(1) Increased salary

Enid will pay income tax at the rate of 40% and class 1 employees' national insurance contributions (NIC) at the rate of 2% on the increased salary.

Niche Ltd will pay class 1 employers' NIC at the rate of 13·8%, but the increased salary and the NIC are deductible for corporation tax, providing a saving at the rate of 19%.

	£	£
Amount payable by Enid:		
Income tax (£15,000 x 40%)		6,000
NIC (£15,000 x 2%)		300
		6,300
Amount payable by Niche Ltd:		
NIC (£15,000 x 13·8%)	2,070	
Corporation tax saving ((£15,000 + £2,070) x 19%)	(3,243)	
Net corporation tax saving	(1,173)	(1,173)
Total tax payable		5,127

Therefore there will be additional tax of £577 (£5,127 – £4,550) if Niche Ltd pays Enid an increased salary instead of the dividend.

(2) **Withdrawal of £15,000 from Enid's loan account**

This will have no tax implications for either Enid or Niche Ltd.

Therefore there will be a tax saving of £4,550.

(d) The change in legal status of the business from an unincorporated business to a company means that Enid is required to cancel the business's value added tax (VAT) registration. Niche Ltd is required to register for VAT. The VAT registration number may be transferred from the business to Niche Ltd, in which case Niche Ltd will take over the rights and liabilities of the business in respect of VAT at the date of transfer.

4 Aqil

(a) (i) The availability of gift relief on the gift of the warehouse

Gift relief is available because:

(1) The warehouse is a business asset, which has been used throughout Aqil's period of ownership by Spidera Ltd, which is Aqil's personal trading company (as he can exercise at least 5% of the voting rights).

(2) The donee, Damia, is resident in the UK.

(ii) Effect of making a gift relief claim

The effect of making a gift relief claim is that the gain of £133,000 (£195,000 – £62,000) arising on the gift by Aqil on 1 October 2018 will be deferred and will be deducted from the base cost of the warehouse for Damia. Accordingly, Aqil's chargeable gain will be reduced to nil.

If the gift relief claim had not been made, Aqil's capital gain of £133,000 would have been liable to capital gains tax (CGT) at the rate of 20%. Aqil has already used his annual exempt amount for the tax year 2018/19. Entrepreneurs' relief is not available as Aqil will not be selling his shares in Spidera Ltd, so the disposal of the warehouse will not qualify as an 'associated disposal'.

Therefore, the CGT saved will be £26,600 (£133,000 x 20%).

When Damia sells her business in five years' time, she will realise a gain on the warehouse. This gain will be effectively increased by the amount of the gift relief, due to the reduction in the base cost in respect of the deferred gain. However, provided the sale takes place within three years of cessation, Damia will qualify for entrepreneurs' relief as she will be disposing of the whole of her business, which she has carried on throughout the year preceding the date of the transfer.

Therefore, Damia's CGT will increase by £13,300 (£133,000 x 10%).

The total tax saved as a result of the claim will therefore be £13,300 (£26,600 – £13,300).

(iii) The availability of business property relief

The gift of the warehouse will qualify for business property relief at the rate of 50% because Aqil will have owned it for at least two years prior to the date of the gift, and, immediately prior to the transfer, it will have been used by Spidera Ltd, a company controlled by Aqil.

However, it is also necessary that Damia still owns the warehouse at the date of Aqil's death, or, if not, that it has been replaced by another qualifying asset. Accordingly, if Aqil dies within the next five years, while Damia is still in business, business property relief will be available. But business property relief will only be available after this if Damia reinvests the proceeds from the sale of the warehouse in a further qualifying asset within three years of the date of sale.

(b) Spidera Ltd

As the tax written down value of Spidera Ltd's main pool is £nil, the disposal of the machine will give rise to a balancing charge of £20,000. This will increase Spidera Ltd's taxable trading profit.

A capital loss will not arise on the disposal of the equipment because it qualified for capital allowances. As the equipment is a depreciating asset for capital gains tax purposes, the chargeable gain of £38,000 which was deferred against the purchase of the equipment will become chargeable on its disposal, which will also increase Spidera Ltd's taxable total profits.

The additional corporation tax arising as a result of this transaction will be £11,020 ((£20,000 + £38,000) x 19%). The after-tax proceeds available to purchase the motorcycle will be £8,980 (£20,000 – £11,020).

Spidera Ltd is a close company as all of its share capital is owned by Aqil and Basir who are therefore participators in the company. As Basir is not a director or employee of Spidera Ltd, the gift to him of the motorcycle will be treated as a distribution so that Basir will be treated as if he had received a dividend equal to the market value of the motorcycle in 2018/19. Accordingly, Spidera Ltd cannot deduct capital allowances, or any other amount in respect of the motorcycle, for corporation tax purposes.

				Available	*Maximum*
1	**(a)**	**(i)**	Offer A		
			Calculation of post-tax proceeds	1	
			Loss on the sale of the shares	3	
			Leaving the Grand Ltd group		
			Degrouping charge	2·5	
			Stamp duty land tax	3·5	
				10	8
		(ii)	Offer B		
			Calculation of post-tax proceeds	1·5	
			Oribi building chargeable gain	2	
			Plant and machinery balancing charge	1	
			Atuel building allowable loss	1·5	
			Plant and machinery chargeable gains/allowable losses	4	
			Capital gains group	2	
				12	11
		(iii)	Transfer of a going concern	4	
			Rules in relation to buildings	4	
				8	7
	(b)		Tax evasion, tax avoidance and the purpose of the GAAR	4	
			Application to plan	3	
				7	5
	Problem solving			1	
	Clarity of explanations and calculations			1	
	Effectiveness of communication			1	
	Overall presentation and style			1	
				4	4
	Total				**35**
2	**(a)**		Income tax saving if gift made to Cam	5·5	
			Factors relevant to obtaining a more income tax-efficient split of the total investment	4	
			Gift to Oder	3	
				12·5	11
	(b)		Inheritance tax		
			Potential liability	3	
			Advice	3	
			Capital gains tax		
			Dee owns the whole of the house	2	
			Transfer of one-third of the house to Cam	2	
				10	9
	(c)		EIS versus VCT investment	6	5
			Total		**25**

				Available	Maximum
3	**(a)**	Relief against future trading profit		1·5	
		Relief against income from Niche Ltd		3·5	
				5	4
	(b)	Availability of incorporation relief		1·5	
		Calculation of chargeable gain		2	
		Calculation of capital gains tax liability		3	
		Balance on loan account		2	
				8·5	7
	(c)	Tax on dividend		2·5	
		Tax payable on increased salary		3	
		Increased total tax liability		0·5	
		Tax on withdrawal from loan account		1	
		Tax saving from loan account withdrawal		0·5	
				7·5	6
	(d)	Administrative requirements for VAT		3	3
		Total			**20**
4	**(a)**	**(i)**	Reasons why gift relief is available	2	2
		(ii)	Impact on Aqil	3	
			Impact on Damia	3·5	
			Tax saved	0·5	
				7	5
		(iii)	Qualifying asset for business property relief	3	
			Still held by Damia	3	
				6	5
	(b)	Disposal of equipment	– implications for capital allowances	2	
			– implications for capital gains tax	3	
		After-tax proceeds		1·5	
		Provision of motorcycle for Basir		3	
				9·5	8
		Total			**20**