

**IIT 2009/10 ASSOCIATE EXAMINATION
PAPER IV – POTENTIAL SOLUTION**

Question 1

Stamp Duty Land Tax

The SD LT consequences to be noted are:

1. The trigger date, the “effective date”, for SDLT is the date of substantial performance (s 44, FA 2003). Substantial amount of the consideration is normally taken as being 90% so the effective date 31st January 2010. The exchange rate to be taken is 1.52:1 – being that on 31st January 2010 (para 9, Sch 4, FA 2003).
2. Whilst there can be no sub-sale or assignment of the contract, HMRC accept that this comprises “other transaction) within s45, FA 2003. The “transfer of rights” means that the Raja/Maya contract is ignored and SDLT is only due on the Maya / Rani contract. SDLT due on the £1,200,000 are completed on the 31st January 2010.
3. The Partnership rules in Part 3, Schedule 15, FA 2003 apply to determining the chargeable consideration. Bett Ltd is the relevant owner, Bob and Jodie are corresponding partners and in applying para 12, Schedule 15 the SLP is 100% and as the SLP is 100, the chargeable consideration is nil. The actual consideration is not relevant for Schedule 15 purposes – para 10, Schedule 15.
4. The three properties are acquired as part of a linked transaction (s 108, FA 2003) hence the SDLT rate of tax is based on the aggregate consideration of £510,000 – s55(4) FA 2003.
5. Taking on the debt is consideration under para 8, Sch 4, FA 2003. The market value is taken if that as it is less than the debt (para 8(2)).
6. The deposit would not normally constitute substantial performance. Relief may be available under s 45, FA 2003 for the “sub-sale”. The Payment further by Sophie of the £50,000 may be indirect consideration by Michael (s 45(3)(b)(i). Alternatively, HMRC may have an argument that the transactions fall within section 75A and that SDLT is chargeable on the highest figure (£400,000).
7. Providing the conditions in para 10, Schedule 4 are met, SDLT will only be chargeable on £800,000. The works must be carried out after the effective date. There must not be a condition of the contract that the works are carried out by the vendor or a person connected with him.

Question 2

Starfleet Hotels Ltd

1	Proceeds of sale of the Enterprise	18,000,000
	Less Plant and machinery	<u>(1,000,000)</u>
		17,000,000
LESS:	Cost in 1990	7,000,000
	Less plant and machinery	<u>(1,000,000)</u>
		<u>(6,000,000)</u>
	Gain in the absence of Rollover relief	<u><u>11,000,000</u></u>

Note:	L & B	Goodwill	P & M	Total	
	Proceeds	£8M	£9M	£1M	£18M
	Cost	<u>£7M</u>	<u>£nil</u>	<u>£1M</u>	<u>£8M</u>
	Gain	£2M	£9M	Nil	£11M

2 ESC D24 allows a delay in immediate occupation if the owner intends to carry out capital expenditure and does so as soon as possible after acquisition and the works are completed within a reasonable time and on completion of the work the asset is taken into use for the purpose of the trade and no other purpose.

3	Gain as in 1 above	11,000,000
	Less gain ineligible for rollover relief s152 TCGA 1992	<u>(9,000,000)</u>
	Land & Buildings gain	2,000,000
	Less rolled over into the Bird of Prey Land & Buildings gain	<u>(2,000,000)</u> <u>Nil</u>
	Goodwill gain Chargeable	<u><u>9,000,000</u></u>

The proceeds of the Enterprise were reinvested into the Bird of Prey within the window of 12 months before and three years after the disposal of the Enterprise.

The gain on goodwill is pre 2002 goodwill and although a capital gains tax disposal is not eligible for rollover relief under TCGA but only under s 898 CTA against the acquisition of intangible property..

4	Gain as in 1 above	11,000,000
	Less gain ineligible for rollover relief under s155	<u>9,000,000</u>
	Land & Buildings gain	2,000,000
	Less rolled over into the Bird of Prey	<u>(2,000,000)</u>
	Land & Buildings gain	<u>Nil</u>
	Goodwill gain	9,000,000
	Less rolled over into Romulan Ambassador	
	Goodwill s898 CTA 2009	<u>7,000,000</u>
	Gain Chargeable	<u>2,000,000</u>

The proceeds of the Enterprise were reinvested into the Bird of Prey and the Romulan Ambassador within the window of 12 months before and three years after the disposal of the Enterprise.

5 The Bird Of Prey is not brought into use until October 2014 which is 2 years and 3 months after the three year time limit expires in July 2012. Even the receipt of planning permission is after the expiry of the three year time limit. for rollover relief.

Unless HMRC exercise their discretion to extend the time limits as envisaged in ESC D24, provided all of the other conditions of ESC D24, there will be no valid rollover and the gain will be as in 1 above. ie £11M.

If HMRC exercise their discretion and extend the three year time limit and all of the conditions of ESC D24 apply, the gain will be as in 3 above ie £9M.

6	Gain as in 1 above	11,000,000
	Less gain ineligible for rollover relief	
	s152 TCGA 1992	<u>(9,000,000)</u>
	Land & Buildings gain	2,000,000
	Less rolled over into the Romulan Ambassador	<u>(1,000,000)</u>
	Land & Buildings gain Chargeable	<u>1,000,000</u>
	Goodwill gain	9,000,000
	Less rolled over into Romulan Ambassador	
	Goodwill s898 CTA 2009	<u>(7,000,000)</u>
	Gain Chargeable	<u>2,000,000</u>

The gain on the Hotel land and buildings can not be fully rolled over as the proceeds of the Enterprise were £8M and the reinvestment in land and buildings in the Romulan Ambassador is only £7M. The amount of proceeds not reinvested is a reduction in rollover relief available.

Question 3

Calitherm

Mr Cyrill
CFO
Calitherm
Your Address

T Adviser
Institute Lane
Edinburgh

1/xx/20xx

Dear Mr Cyrill

SALE OF SHARES IN Y LTD

In answer to your query I set out the key corporate tax, VAT and stamp considerations of the sale of Y Ltd below:

Capital Gains disposal & reliefs

The sale of the shares in Y Ltd will be treated as a chargeable disposal for W Ltd for capital gains tax purposes. The gain will be calculated as the consideration received less the original cost of Y Ltd's shares. The calculation will also reflect the effect of inflation by allowing deduction of indexation allowance on the cost.

The indexed gain will be included in profits chargeable to corporation tax for W Ltd unless a relief is available. Rollover relief is not available on the gain as shares are not a qualifying asset for these purposes.

Substantial shareholding relief may apply to relieve the entire gain from tax. The exemption is designed to promote corporate activity by allowing companies to dispose of their subsidiaries without a corporation tax liability arising on any capital gains. Consequently, if various conditions are met, any gains made on the disposal of Y Ltd will be exempt from corporation tax. However if the disposal resulted in a loss this would not be allowable either.

Y Ltd is a trading company with no other activities – a requirement for the relief to apply. However, you will need to verify the position of 123 Ltd as this must also be a trading company (or member of a qualifying group both before and immediately after the acquisition).

W Ltd would seem to meet the percentage shareholding requirement which must exceed ten per cent of both the ordinary share capital and the equity holders' rights. An additional condition however is that this shareholding must have been held for a continuous period of twelve months within the two years preceding the disposal. As W Ltd has held Y Ltd for only 11 months there is a possibility of waiting to trigger the relief (to

ensure a gain is exempt from corporate tax) or triggering the disposal early (to ensure a loss is usable).

One should be careful though as there is anti-avoidance legislation which can apply where the sole or main benefit of an arrangement in relation to shares is to achieve the exemption from corporation tax.

Reducing the gain – pre-sale dividend

Should the disposal of Y Ltd give rise to a chargeable gain which is not relieved under the substantial shareholding provisions, you should consider paying a pre-sale dividend of £2m from Y Ltd to W Ltd to reduce the value of the subsidiary – and hence the gain on disposal.

This will be tax-free for W Ltd and will also reduce the stamp duty which 123 Ltd will need to pay on purchasing the shares.

Again there are anti-avoidance provisions on must be wary of and I would advise you apply to HM Revenue and Customs for a clearance under s707 ICTA 1988 if you wish to pay a pre-sale dividend.

Reducing the gain – P&M transfer

As Y Ltd has plant and machinery which 123 Ltd does not want but which can still be used elsewhere by Calitherm, you should consider transferring it intra-group to X Ltd. Such a transfer has no capital gains implication as it is deemed to give rise to neither a gain nor a loss under s171 TCGA 1992. This will also allow you to reduce the gain on disposal of Y Ltd.

Loss relief

An election can be made on the CT600 form under s171A TCGA 1992 to transfer the gain on the shares in Y Ltd to another Calitherm company. W Ltd can make a notional transfer to Z Ltd. The disposal to 123 Ltd will then be treated as made by Z Ltd which has available losses to set against the gain, thus reducing (or perhaps eliminating) any corporate tax liability.

Stamp Duty

Sales of shares in UK companies are subject to stamp duty at 0.5% of the consideration paid for the shares. This will be the responsibility of the purchaser.

Group Matters

The removal of a company from the corporate group will reduce the number of associates for corporate tax banding purposes (for future accounting periods).

The sale of Y Ltd will mean it needs to be removed from the UK VAT Group and you should notify HM Revenue and Customs within 30 days to do so, filling in forms VAT 50 and VAT 51.

Tax treatment of costs

To the extent the costs relate to the share sale, they are likely to be seen as capital rather than revenue costs and will be deducted from proceeds when calculating the capital gain on disposal of Y Ltd. No deduction will be allowed for these against W Ltd's profits.

To the extent the costs can be argued to relate to the wider group restructuring, deduction against profits for corporate tax purposes may be possible.

The work of the bank in negotiating the terms of the share sale may be VAT exempt following Sch 9 Group 5 Item 5 as intermediary services in relation to a dealing in shares.

As the contract is silent on VAT, any fee amount is deemed to be VAT-inclusive in any case so the amount W Ltd will pay should not exceed £500k in total.

Any VAT charged by FatCat Bank Ltd or Sharpsuits LLP will be argued by HMRC to relate to an exempt supply of shares (the sale of Y Ltd to a UK purchaser) and would therefore not be recoverable.

However, a recent ECJ VAT case, SKF, suggests that VAT on costs may be recoverable where such a sale takes place in the context of a group restructuring.

Please do not hesitate to contact me should you require clarification any of the matters mentioned above.

Yours sincerely

T. Adviser

Question 4

ABC Ltd

To: The Directors of ABC Ltd –

Report on the Corporation Tax, Capital Gains Tax, Stamp Duty Land Tax and VAT implications of the transfer of its trade and assets (including the land) into the LLP.

1. TOGC rules are found in Sec 49 VAT Act 1994 and Article 5 of VAT (Special Provisions) Order 1995 (SI 1995/1268) and VAT Notice 700/9
 - These provide that the transfer of business assets is not treated as a supply of goods or services subject to certain conditions – (i) the assets are to be used by the transferee in carrying on the same kind of business (whether or not as part of any existing business) as that carried on by the transferor and (ii) the transferee is already or becomes a taxable person and (iii) if only part of a business is transferred, that part is capable of separate operation

- As the assets include the grant of a fee simple (as per Item 1(a) Gp 1 Sch 9 VAT Act) – a building that has not been completed, or a new building or a civil engineering work – then the transferee must Notify HMRC that they have Opted to Tax before the date of the transfer, and they must confirm that their Option is not disapplied by Paras 12-17 of Sch 10 VAT Act 1994.
2. The LLP will have to Register for VAT (if not already registered) [1 mark], and
 - It must Notify HMRC that they have Opted to Tax before the date of the transfer, and they must confirm that their Option is not disapplied by Paras 12-17 of Sch 10 VAT Act 1994.
 3. As a result of the Option to Tax, all grants made in respect of the Opted land will be subject to VAT as per the normal rules in Sch 10 VAT Act 1994 [1 mark]
 - The freehold sale of new commercial property will be Standard Rated as per Item 1(a) Group 1 Sch 9 VAT Act 1994 regardless of any Option to Tax made by the LLP
 4. The supplies made by a dentist are exempt as per Group 7 Sch 9 VAT Act 1994, so the Dentist will be occupying the premises for “exempt purposes” as per Para 15 of Sch 10 VAT Act 1994 so the Anti-Avoidance rules may disapply the Option to Tax made by the LLP
 - The Dentist, being a member of the LLP who has contributed cash into the LLP will also be a “Financier” of the development as per Para 15(3)(c) of Sch 10 VAT Act 1994 which will also cause the Option to Tax to be disapplied
 - If the dentist’s occupation of the premises was intended or expected (Para 14(2) Sch 10), or takes place before the end of the relevant adjustment period (Para 15(2) Sch 10) then the Option to Tax made by the LLP is disapplied, and the LLP would not be able to certify that it had made a valid Option to Tax in respect of the TOGC rules (as per the conditions specified in Paras 5(2) (a) and (b) of the VAT (Special Provisions) Order 1995. Therefore the asset concerned could not form part of the TOGC from ABC Ltd to the LLP, and ABC Ltd should have charged VAT to the LLP on that asset (being a partly completed commercial building). The LLP would not be able to recover that VAT as its use of the building would be exempt (as its Option to Tax would be disapplied), so rental income from the dentist would be exempt
 5. The question is asking for an understanding of the Badges of Trade in relation to Property Development:
 - Subject matter of the transaction
 - Length of period of ownership [shorter implies trading motive]
 - Frequency or number of similar transactions [eg has ABC Ltd other properties being developed for sale]
 - Supplementary work on assets sold [renovation for sale may suggest trading]
 - Reasons for sale [selling own-use premises once surplus or if a major tenant leaves more likely to be investment]
 - Motive when acquiring assets

The main factor will be the last one (the others usually follow in property transactions).

Motive should be evidenced eg board minutes, advertising for tenants / actually having tenants, business models using rental yields vs sales price once developed. The Accounting may also be indicative of intention – held as stock or fixed assets in the accounts.

6.

- (i) The transfer would be an appropriation from trading stock for the [1/2 mark] company and so they would have to include the property transfer at market value in their computation of their trading profits. There is no election to holdover the profit.
 - (ii) The rules on partnership changes are that the assets of the partnership are not deemed to be disposed of on such a change [1 mark]. Hence there are no immediate consequences and on a subsequent disposal of the asset, ABC Ltd would be deemed to sell its share.
7. EITHER The introduction of the land to the LLP would, probably, be exempt if ABC Ltd is the initial member [1 mark] and then there would be an SDLT charge on the introduction of the new partners of $\frac{3}{4}$ of the value of the land but not any other assets
OR On the introduction of the property and assets into the LLP with the 4 equal members then there would be a charge on $\frac{3}{4}$ of the value of the land but no other assets .

Question 5

Corporate Group

Part 1)

As the vendor has opted to tax the property then this will automatically treat most supplies made by the vendor as VATable.

However, the purchaser could issue the vendor with a certificate to disapply the option to tax. This certifies that they intend to use the property as a dwelling or convert the property into a dwelling. The purchaser could use form VAT1614D issued by HMRC as a certificate. This certificate must be accepted by the purchaser if issued prior to the price for the sale is fixed. Although, by discretion, a certificate can be accepted by the vendor after the price is fixed.

If a certificate is issued to disapply the option vendor's supply would be an exempt supply which would impact on their recovery of VAT.

If the purchaser was to demolish the property then they would not be able to meet the conditions to issue the certificate. Therefore, the purchaser's option would still apply and VAT would be charged on the sale.

Stamp Duty Land Tax is chargeable on the consideration for a transaction which includes any value added tax chargeable in respect of the transaction. So the disapplication of the option would impact on the SDLT due.

Part 2)

This would realise a gain on disposal.

They would not be entitled to rollover relief on reinvestment as the property was not a trading asset.

The base cost would be the higher of original cost and market value at 31 March 1982, plus indexation since that date.

A and E could jointly elect under s171A TCGA 1992 for the gain to be treated as made by A who would then be able to set off its brought forward losses against the gain arising.

Four companies are associated. You would not include the dormant company.

Part 3)

The loan is made by a close company to a participator.

As a result the company must pay tax equal to 25% of the amount of the loan.

The tax is due to be paid to HMRC nine months and one day after the end of the accounting period in which the loan is made.

If the loan is repaid before the payment date then there is no requirement to pay the tax.

This is not the case here, so they will have to pay the tax. Once the loan is repaid, HMRC will repay the tax nine months and one day after the end of the accounting period in which the loan is repaid.

The loan could also attract a beneficial loan interest charge as it is loan at a beneficial interest rate. This could be avoided if interest is charged to the director.

Part 4)

To: Finance Director
From: Tax Advisor
Date: Today's date

I refer to your questions regarding VAT.

It is possible for two or more companies under common control to elect to form a group for VAT purposes. The trader is entitled to choose which companies are to be members of the VAT group and it need not encompass all companies which would be eligible for inclusion.

The effect of group registration is that transactions between group members are disregarded for VAT purposes. One of the member companies acts as the representative member for VAT purposes and all the inputs and outputs of the group are treated as those of the representative member.

All companies in the group registration will become jointly and severally liable for all VAT liabilities of the group.

Advantages

There will be a reduction in administration as you will only need to complete one return.

If there are exempt companies within the group who receive supplies from other companies within the group then once within a group registration there will be no VAT charged on such supplies. This will as a result reduce the irrecoverable VAT within the group.

Disadvantages

The partial exemption provisions are applied to the group as a whole. It is likely that this will lead to the de minimis limits being exceeded.

Other benefits available to traders if their turnover is below a certain limit (for example cash accounting) will now be applied to the group as a whole.

If some companies are currently repayment traders then it may be disadvantageous to include these into the group.

Question 6

EuroTax LLP

Briefing note

From: A Jones, Tax Manager

To: D Smith, Partner

Regarding: Transfer pricing and transfers to trading stock

The purpose of the transfer pricing regime is to ensure that companies which are connected to each other do not gain a tax advantage by conducting transactions with each other at non-arm's length prices.

For the transfer pricing regime to apply the first test that must be passed is that one company is participating in the management, control or capital of the other. There are different types of participation but one such is where one company controls the other.

Both Medical Equip Ltd (MEL) and Central Ltd own the entire share capital of all of their subsidiaries, so this test is met.

An exception from the rules is made for small enterprises, defined as those companies or groups of companies with less than 10m Euro turnover, less than 10m Euro balance sheet assets and less than 50 employees. Central Ltd appears to qualify for this exemption and therefore it should not need to make a transfer pricing adjustment to the services it provides to District Ltd.

In relation to MEL Ltd the next matter to consider is whether the actual provision between the companies differs from the arm's length provision. The OECD has published certain principles as to how the arm's length provision is to be determined and these should be consulted before any conclusion is reached. However, in this case we note that MEL is selling goods to both of its subsidiaries at prices significantly below the price that would be charged on an arm's length basis. Therefore it would appear that the actual provision and the arm's length provision are different.

The next consideration is whether MEL has obtained a tax advantage in relation to its transactions with its subsidiaries. A tax advantage is obtained where as a result of a non arm's length provision a smaller amount is taken into account in calculating the taxable profits of a company. In this case if MEL uses the non arm's length provision then its taxable profits will be smaller. Accordingly it appears to have obtained a tax advantage.

An exemption from the transfer pricing regime is available for medium sized enterprises. This applies where the turnover or group of companies is less than 50m Euros, the balance sheet assets less than 43m Euros and it has less than 250 employees. MEL Ltd appears to meet this definition. However, the exemption is subject to the following exceptions.

- 1) The group can elect for the exemption not to apply for a chargeable period (0.5)
- 2) The exemption does not apply where the other party to the transaction is resident in a non-qualifying territory. A non-qualifying territory is any territory other than a qualifying territory. A qualifying territory means the UK or any territory with which the UK has a Double Taxation treaty with a non-discrimination article
- 3) The exemption does not apply where HM Revenue and Customs (HMRC) have issued a transfer pricing notice.

In this case the exemption will apply to transactions between MEL and SBL since SBL is tax resident in the UK, subject to HMRC's power to issue a transfer pricing notice. It will not apply to transactions with SWL since it is resident in Ruritania which does not have a Double Taxation Treaty with the UK.

Accordingly, MEL will need to adjust its profits upwards to reflect the use of an arm's length provision. As an example if the arm's length provision is £150 then the uplift in taxable profits (the transfer pricing adjustment) will be £1m (200,000 units x (£150-£100))

Record keeping and self assessment

The company is required to keep records to justify the transfer prices used and any adjustments made in the tax return. It is also the company's responsibility to ensure that its tax return contains any necessary adjustments required by the transfer pricing rules.

Advance Pricing Agreement

In order to remove uncertainty about how what transfer pricing adjustments need to be made a company may enter into an advance pricing agreement (APA) with HMRC. An APA is not compulsory but they are binding once they are entered into.

An application for APA should be made in writing, should set out the transactions which the APA should cover, why those transactions would be subject to transfer pricing adjustments and what the company proposes to do about them.

APAs will have effect for a specific period. The company should set out what it thinks that period should be but HMRC have indicated that they envisage a minimum of three and a maximum of five years.

Once an APA is in place the assumptions laid out in the APA should be monitored and reviewed to ensure that there have not been any critical changes that lead the agreement to be obsolete.

Transfers to trading stock

The transfer of an investment property to trading stock will trigger a chargeable gain computed as the market value of the property less the base cost less indexation

The gain is calculated as follows: £

	Market value	900,000
Less	Base cost	(500,000)
	Indexation	(119,691)
	Chargeable gain	280,309
	Tax at 28%	78,486.52

Indexation is calculated as the base cost x .251 ((224.7-181.3)/181.3)

The gain is taxable in the year ended 31 December 2009. Alternatively and following a claim to HM Revenue and Customs the gain may be rolled over against the market value at the time of transfer. If this is done the gain is not chargeable now but the cost of the stock for tax purposes is now £619,691 (£900,000 – 280,309). The effect of this election is that when the property is sold the trading profit is increased.

Question 7

Garage Inc.

1.

No kink test

Shares gifted and inherited at market value

Holdover relief not available

Chargeable gain:-

Proceeds	10,000 x £100 =		1,000,000
Cost			
March 1982	500 x £10 =	5,000	
May 2000	9,500 x £40 =	<u>380,000</u>	
			<u>(385,000)</u>
Capital gain			<u><u>£615,000</u></u>

2

Domicile of origin: an individual normally acquires a domicile of origin from his father when he is born. This is not necessarily the country in which he is born. In Kirk's case although he was born in Nirvana, at Kirk's birth his father would arguably have had a domicile of Utopia and therefore Kirk's domicile would also have been Utopia.

Domicile of dependency; an individual has the legal capacity to change their domicile on reaching the age of 16. Until then it follows that of their parent or guardian. If Kirk's parents adopted a domicile of choice in Nirvana then Kirk would have acquired a similar domicile as a domicile of dependency

Domicile of choice: An individual acquires a domicile of choice by intending to settle permanently or indefinitely in another country and abandoned ties with.

There are no set of rules which determine domicile, but rather a "balance of probabilities" approach is taken. Factors to determine whether Kirk has acquired a domicile of choice in the UK:-

- Ties with home country:-
 - Property ownership
 - Location of family
 - Burial plots
 - Wills
 - Clubs, societies, etc
- Intentions for the future and an intention to return to Nirvana/Utopia
- Citizenship/nationality
- Marriage
- Long term residence

3.

- Taxable on UK source income and gains and overseas income and gains remitted to the UK
- Unless unremitted overseas income and gains < £2,000 loss of personal allowances and capital gains tax annual allowances
- As UK resident for greater than 7 out of 9 tax years will need to pay £30,000
- Election under s16 TCGA 1992 to be considered