
Answers

1 Jane Moneypenny

(a) Letter

ABC & Co
Chartered Certified Accountants
Any Street
Any Town
6 November 2013

Ms Jane Moneypenny
Skyfall View
Any Town

Re: Tax issues in relation to your proposed investment

Dear Ms Moneypenny,

We refer to our recent meeting and the issues raised.

(i) Tax issues regarding Option 1: Purchase of shares in Style Dublin Ltd (SDL)

Current tax costs and benefits

(1) Stamp duty

The rate of stamp duty applicable to the purchase of shares is 1%. The stamp duty payable by you will amount to €12,000.

(2) Company chargeable gains (clawback of group relief)

If you pursue this option, it will involve SDL leaving the Style Ireland group of companies. There will be a clawback of the group relief, previously claimed by the company on the transfer of the Northbank Boutique premises in 2004. SDL will be deemed to have sold and reacquired the property at market value. Our calculations (see Schedule 1) indicate that corporation tax of €22,209 will be payable by SDL on this company chargeable gain. This tax will become payable in 2013.

(3) Value added tax (VAT)

VAT is not chargeable on the sale of shares.

(4) Corporation tax losses brought forward

There are two restrictions in relation to the buying of losses brought forward for subsequent use.

- The first restriction refers to situations where, within three years of the purchase of the shares, there is a major change in the trade, for example, in the products or customers of the business. It is our view that the changes proposed by you would not constitute a major change in the trade.
- The second restriction refers to a situation where the trade had ceased or been negligible at the time of sale and was followed by a revival of the trade. This is clearly not the case in this situation.

The losses brought forward of €100,000 will therefore be available to shelter future profits of the company and (at the current corporation tax rate of 12.5%) the use of these losses will result in a benefit to the company to the value of €12,500.

Potential future tax costs

(5) Company chargeable gains (latent gains)

When shares in a company are purchased, some of the assets of the company will have increased in value since they were acquired by the company. By purchasing the shares rather than the assets, these gains lie dormant and will not crystallise until the assets are subsequently sold by the company. These are referred to as latent gains.

Tax computations have been prepared based on a notional disposal of chargeable assets by SDL at their current market values (see Schedule 2) and the following latent gains will arise in this case:

(i) Southbank Boutique premises

There is a latent gain of €264,730 arising on this disposal.
The potential tax cost is €87,361.

(ii) Goodwill

The proceeds attributable to goodwill amount to €275,000 and in the event of SDL selling this asset, it would have a nil base cost and so tax of €90,750 would be payable.

In summary, there is a potential corporation tax liability of €178,111 in relation to the latent gains at current value. It is probable that these gains will increase further over the next ten years. However, this liability may not materialise if the company does not sell the assets in the future.

If you sell the shares in SDL in the future, these liabilities will not crystallise, but a future purchaser will probably seek a discount from you in relation to these latent gains. It appears that the current vendor is not offering you such a discount and this should be addressed.

(ii) Tax issues regarding Option 2: Purchase of assets from SDL and subsequent operation of the business as a sole trader

Current tax costs and benefits

(1) Stamp duty

Stamp duty at the rate of 2% will apply to the purchase of both premises and goodwill and this will amount to €22,700 (see Schedule 3).

It is assumed that it will be possible to transfer the equipment and stock by delivery, thereby avoiding stamp duty.

(2) Company chargeable gains (clawback of group relief)

The tax liabilities arising for SDL on the clawback of group relief will not be relevant to you under this option, as you are not buying SDL.

(3) VAT

The general rule is that VAT must be charged on all assets for which an input credit has been claimed. However, the transfer of the assets of a business is not subject to VAT where the assets constitute an undertaking or part of an undertaking capable of being operated on an independent basis and both parties are registered for VAT. In this case, the assets being transferred would clearly constitute an undertaking according to the above definition and you can therefore avail of this provision, provided the entity acquiring the assets (company or sole trader) is registered for VAT at the time of the transfer. Provided this is the case, no VAT will be payable.

Tutorial note: *Even if the above were not to apply, as the Southbank boutique was bought more than 20 years ago and was not developed within the last five years, no VAT liability will arise on its sale, as the building is classified as an 'old' building. The sale of the Northbank boutique building will be exempt from VAT for the same reasons.*

In neither case will there be a deductibility adjustment because both buildings are outside the 20-year period.

(4) Corporation tax losses brought forward

Unfortunately, under option 2 the trading losses brought forward of SDL cannot be transferred to yourself and their benefit will be lost.

(5) Capital allowances

There are no significant capital allowances issues for you with this option as the market value of the equipment is very close to the tax written down value.

Potential future tax costs and savings

(6) Restricted scope for tax planning arising from a sole trader structure (compared to a company)

If you operate as a sole trader, you will be subject to income tax at your marginal rate on all profits earned, regardless of your level of drawings. This will result in high income tax liabilities as profits increase. In addition, you will be subject to age and income related restrictions on your tax deductible pension contributions.

(7) Company chargeable gains (latent gains)

Under option 2, you will buy the relevant assets at their current market value, which will become their base cost in the event of a future disposal. The taxes payable by SDL on the disposal of the relevant assets will be the responsibility of SDL and not you.

(8) Seven year capital gains tax (CGT) exemption

If the properties are bought by you prior to 31 December 2013 (which is the plan) and owned by you for at least seven years, any gain arising in that seven year period will be exempt from CGT. If the properties are held for more than seven years, then partial relief is available (e.g. if a property is held for ten years, then 70% of the gain will be exempt).

(iii) Tax treatment of the interest payable on the bank loan

Under option 1, the bank loan would be applied towards the purchase of the ordinary shares of SDL. The interest on loans used to purchase ordinary shares in companies is not allowed as a deduction in calculating your income tax.

Tutorial note: *Interest relief on loans to acquire shares in a company, taken out prior to 8 December 2010 is being tapered out and will be completely abolished in 2014.*

Under option 2, the bank loan would be applied towards the purchase of business assets and it will be possible for you to claim the full amount of the interest as a deduction in calculating your income tax.

(iv) Summary of tax costs and recommendation

Summary of tax costs

	Option 1	Option 2
	€	€
Stamp duty	12,000	22,700
Corporation tax (CT) chargeable gains (clawback)	22,209	–
VAT	–	–
Less: Benefit of CT losses forward	(12,500)	–
Total current tax costs	21,709	22,700
Potential tax costs		
CT on latent gains	178,111	–
Total tax costs	199,820	22,700

Recommendation

The current tax costs of both options are similar. However, option 2 has the following advantages:

- A potential tax liability of €178,111 arising in respect of latent gains in the event of a subsequent sale of the business is avoided.
- The seven year CGT exemption can be availed of in respect of the properties.
- The costly due diligence process and the possibility of taking over undisclosed liabilities are avoided.
- The interest on bank borrowings will be allowable as a deduction for income tax purposes.

Option 2 is therefore recommended.

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

Yours sincerely,

T Consultant
Tax manager
ABC & Co

Appendix 1: Computations

Schedule 1

Calculation of clawback of group relief on the transfer of the Northbank boutique premises in 2004

	€	€
Deemed proceeds		460,000
Cost	300,000	
Indexation (1994/95)	1,309	(392,700)
Taxable gain		67,300
CGT at 33%		22,209

Tutorial note: The (correct) CGT rate applicable in 2004 was 20%. Historical CGT rates are not given on the exam paper. Marks were awarded to candidates who calculated the clawback using either 20% or the current rate of 33%.

Schedule 2

Calculation of potential corporation tax (CT) on latent chargeable gains based on disposals at current market value

	€	€	€
Southbank Boutique premises			
Proceeds		400,000	
Cost	90,000		
Indexation (1989/90)	1,503	(135,270)	
Taxable gain		264,730	
CT at 33%			87,361
Northbank Boutique premises			
No latent gain, following clawback of group relief.			
Goodwill			
Proceeds attributable to goodwill (Note)		275,000	
Cost		0	
Taxable gain		275,000	
CT at 33%			90,750
			178,111

Note: Proceeds attributable to goodwill

	€
Total proceeds	1,200,000
Less: Proceeds attributable to specific assets	
Southbank Boutique premises	(400,000)
Northbank Boutique premises	(460,000)
Equipment	(40,000)
Inventory	(25,000)
Proceeds attributable to goodwill	<u>275,000</u>

Schedule 3**Stamp duty on purchase of assets**

	Value €	Rate	Stamp duty €
Premises	860,000	2%	17,200
Goodwill	275,000	2%	5,500
			<u>22,700</u>

(b) Alternative tax efficient structure for option 2

In view of Jane's intention to sell the business after ten years and pursue other investments, the following structure is likely to prove the most tax efficient:

- Both properties should be purchased by Jane in a personal capacity.
- The bank loan should be applied towards the purchase of the properties.
- The goodwill, equipment and stock of the company should be bought by a new company (Newco) which will carry on the trade.
- Newco will rent the boutique premises from Jane.
- Jane should invest in Newco through a holding company (Holdco).

Tax implications**(1) Stamp duty**

The stamp duty cost will be €22,700 (i.e. as for option 2 above).

(2) Reduced corporation tax rate on profits retained

The corporation tax rate of 12.5% will apply to the profits retained in the company, Newco (i.e. not paid out to Jane as salary or director's fees), whereas all the profits of a sole trader are taxable at the trader's marginal rate, which in Jane's case is 52%. This is important in the current context, as the increasing level of profits may exceed Jane's immediate salary requirements.

(3) Holding company exemption

The presence of the holding company (Holdco) in the structure will enable Jane to avail of the holding company exemption, so making the future gain on a disposal of the shares in Newco exempt. At that point Holdco could use the entire proceeds of the exempt sale to make further investments as desired.

The conditions of the holding company exemption are:

- (i) The parent company (Holdco) must hold at least 5% of the share capital of the investee company (Newco).
- (ii) The investee company must be wholly or mainly a trading company.
- (iii) The greater part of the value of the shares cannot be represented by Irish land or buildings.
- (iv) The investee company must be resident in an EU member state or a country with which Ireland has a double tax treaty and the shares must be owned for more than 12 months.

All of these conditions are likely to be fulfilled if, as suggested, Jane owns both properties personally.

(4) Seven year capital gains tax (CGT) exemption

Jane will be eligible for the seven year CGT exemption (as for option 2 above) as both boutique premises will be held by her personally.

(5) Rental income and expense

The interest payable on the bank loan will be an allowable expense against the rental income received by Jane from Newco. The rental profit will be taxed at her marginal tax rate of 52%. Newco will receive a corporation tax deduction for the rentals paid.

(6) Value added tax (VAT)

Even though the premises are being sold to Jane personally, the transfer of the goodwill, equipment and stock to Newco is still likely to qualify for relief as the transfer of an undertaking (on the grounds that the assets being transferred constitute an undertaking or part of an undertaking capable of being operated on an independent basis) so (as for option 2 above), no VAT will apply.

Even if VAT were to arise on the equipment or goodwill, there would be no VAT cost provided Newco is registered for VAT.

VAT will not apply to the sale of the two properties to Jane as they are both 'old' properties (as for option 2 above).

The lease of the premises from Jane to Newco will be exempt from VAT.

(7) Pension planning

The incorporation of the business will allow for the setup of a company pension plan, which will allow a greater level of contributions and greater flexibility when compared to the (age and income related) restriction on the pension options available to sole traders.

2 Mary Kennedy

(a) The books and records which are required to be kept are those relating to:

- all sums of monies received and expended in the course of business;
- all sales and purchases of goods and services;
- all assets and liabilities; and
- all transactions which constitute an acquisition or disposal of an asset for capital gains tax purposes.

The taxpayer must also retain linking documents, which are the working papers which link the books and records to the financial statements.

Records must be retained for six years.

(b) Strategy for minimising penalties arising from the revenue audit

The strategy recommended in this case is a prompted qualifying disclosure, and cooperation.

(i) Prior to the commencement of the audit, the taxpayer has an opportunity to make a complete qualifying disclosure of irregular tax issues to the Revenue. In this case the disclosure would be a 'prompted' disclosure, as the business has been notified of a revenue audit.

It is important that the disclosure is complete insofar as it must state the amounts of all liabilities to tax and interest in respect of the relevant tax heads and periods within the scope of the proposed audit. In this case the audit notification is in relation to VAT for the 2012 year. However, it is likely that in this case, one or more disclosures will be in the category of deliberate behaviour, in which case the scope of the disclosure is extended to include all tax heads and periods where liabilities arise.

The qualifying disclosure must be in writing, signed by or on behalf of the taxpayer, and accompanied by a settlement of the tax and interest due, but not the penalties.

If notice is given to the Revenue of the intention to make a prompted qualifying disclosure within 14 days of the taxpayer receiving notification of the audit, a 60-day period is available in which to make the qualifying disclosure.

(ii) Cooperation includes having all the books and records and linking papers ready at the start of the audit, responding promptly to all requests for information, and making prompt payment of the audit settlement liability.

(iii) The benefits to the taxpayer of making a qualifying disclosure and cooperating are:

- Reduced rates of penalty as follows:
 - Careless behaviour 10% (otherwise 20%)
 - Careless behaviour with significant consequences 20% (otherwise 40%)
 - Deliberate behaviour 50% (otherwise 100%)
- Non-publication of the default. This is particularly relevant in this case.
- No prosecution.

(c) Calculation of under-declared sales

(1) Review of mark-up percentage

Cost of goods sold	€ 45,000
Correct mark-up percentage	300%
Correct gross profit (€45,000 x 300%)	135,000
Correct sales figure (net) (€45,000 + €135,000)	180,000
Under-declaration of sales (€180,000 – €130,000)	<u>50,000</u>
Gross sales understated (x 1.09)	54,500

(2) Comparison of declared drawings to lifestyle expenditure

	€
Declared drawings (€500 x 52)	26,000
Add: Proceeds on disposal of shares	2,100
	<hr/>
	28,100
Personal expenditure (€5,500 x 12)	66,000
Shortfall in funding of personal expenditure	37,900
Add: cash paid to employee (€300 x 52)	15,600
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Gross sales understated	53,500

Mary has not increased her borrowings during the year and is up to date in relation to the payment of her bills, so the obvious conclusion is that she has withdrawn additional amounts from the business.

Since there is a relatively small difference (€1,000) between the above two calculations, it is reasonable to assume that both calculations of under-declared sales are materially correct.

(d) Calculation of tax underpaid

	€	Tax underpaid €
(1) Undeclared cash sales	50,000	
Value added tax (VAT):		
Tax underpayment (€50,000 x 9%)		4,500
<i>Note: The above was based on the industry mark-up percentage.</i>		
(2) Cash wages		
Net wages paid (€300 x 52)	15,600	
Marginal tax rate	52%	
	<hr/>	
Grossed up wages (x 100/48)	32,500	
Tax underpayment:		
Employee payroll taxes (€32,500 x 52%)	16,900	
Employers PRSI (10.75%)	3,494	20,394
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(3) VAT over-claimed on electricity		
Electricity (including VAT)	3,405	
VAT input reclaimed (€3,405 x 23/123)	637	
Correct VAT input (€3,405 x 13.5/113.5)	(405)	
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Over-claimed VAT		232
(4) Capital gains tax (CGT) on share disposal		
Proceeds	2,100	
Less: Cost (€300 x 300/400)	(225)	
	<hr/>	
Gain	1,875	
Less: Annual exemption	(1,270)	
	<hr/>	
Taxable gain	605	
Capital gains tax at 33%		200

Tutorial note: The disposal of the 300 shares is deemed to come from the first holding which was acquired on 30 June 2007 (as increased by the bonus issue).

Original holding	200
Bonus	200
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Subtotal	400
Disposal	(300)
	<hr/>
Balance	100

	€	Tax underpaid €
(5) Income tax, PRSI and USC understatement		
Adjustments		
Sales under-declared	50,000	
Less: Additional wages (total cost) (€32,500 + €3,494)	(35,994)	
Less: Credit for VAT input over-claimed	(232)	
Total under-declaration of profit	<u>13,774</u>	
Income tax, PRSI and USC (52%)		7,162

Summary of the tax and penalties payable

	Tax underpaid €	Reduced rate of penalty	Amount of penalty €	€
(i) VAT	4,500	50%	2,250	
(ii) Income tax, PRSI and USC (payroll)	20,394	50%	10,197	
(iii) VAT	232	20%	46	
(iv) CGT	200	20%	40	
(v) Income tax, PRSI and USC (Mary)	7,162	50%	3,581	
	<u>32,488</u>		<u>16,114</u>	48,602

From the above, the expected total liability for tax and penalties is €48,602.

Deliberate behaviour (Items (i), (ii) and (v))

The under-declaration of sales for VAT and income tax and the payment of cash wages without the deduction of payroll taxes are clearly in the above category. Where the taxpayer makes a prompted qualifying disclosure, the reduced rate of penalty is 50%.

Careless behaviour with significant consequences (Items (iii), (iv))

The underpayment of VAT arising from the incorrect rate being applied to the electricity expense (€232) when combined with the underpayment of VAT arising from the sales under-declaration (€4,500) amounts to more than 15% of the tax due under the VAT tax head for 2012 and therefore qualifies for the penalty of 20% applicable on disclosure.

The CGT underpayment amounts to 100% of the tax payable under the CGT tax head for 2012 and therefore qualifies for the penalty of 20% applicable on disclosure.

Tutorial note: *An argument could possibly be made to the Revenue that the 10% penalty rate applicable to careless behaviour without significant consequences applies to the electricity expense issue and the CGT underpayment, given the small overall size of these errors.*

3 (a) Mark Reilly

(i) Additional taxes on projected income

	€
Increase in taxable profit (€100,000 – €60,000)	40,000
Increase in tax at 52%	20,800
Less: Pension relief €20,000 x 41%	(8,200)
Additional taxes	<u>12,600</u>

On the basis that Mark will be aged between 30 and 40 in 2014, his maximum allowable pension contribution is €20,000 (being net relevant earnings of €100,000 x 20%).

Income tax relief will apply at his marginal income tax rate of 41% as personal pension contributions do not relieve PRSI and USC. The tax savings amount to €8,200.

(ii) Taxes payable as a corporate business

The taxes payable on a salary of €60,000 (income tax, PRSI and USC) will amount to €18,441 (as given in the question).

Tutorial note: *There will be no employer's PRSI as Mark is a proprietary director.*

Corporation tax liabilities (including surcharge):

	€
Corporation tax	
Net profit before director's remuneration	105,000
Less: Director's remuneration	(60,000)
Capital allowances	(5,000)
Taxable profit	<u>40,000</u>
Corporation tax at 12.5%	<u>5,000</u>
Close service company surcharge	
Case II income	40,000
Less: Corporation tax	(5,000)
Distributable income	<u>35,000</u>
Surchargeable income (50%)	<u>17,500</u>
Surcharge at 15%	<u>2,625</u>
Total tax payable by the company	<u>7,625</u>
Total tax borne on profits (€18,441 + €7,625)	<u>€26,066</u>

- (iii) It is most likely that the €40,000 company contribution to the occupational pension scheme will be fully allowable as an expense for corporation tax (CT) purposes. Consequently, the net profit of the company will be reduced to zero and there will be a nil liability for CT and the surcharge. There will therefore be a tax saving of €7,625 arising from the pension contribution.

The contribution by the company is not a benefit in kind for Mark.

(iv) Summary of tax costs under the two alternatives

	€
Tax payable as a sole trader (€18,441 + €12,600)	31,041
Tax payable as a company	<u>18,441</u>
Tax saving	<u>12,600</u>

The above schedule indicates that a tax saving of €12,600 will arise if the incorporation and occupational pension scheme option is chosen. This saving arises because:

- There is effectively no limit on the amount of contributions which a company can contribute to an occupational scheme (unless the pension fund is being overfunded), whereas (as demonstrated in (i) above) there are age-related limits and income-related limits to the amount which can be paid into a personal pension plan.
- PRSI and USC (amounting to 11%) are not sheltered in the case of the personal pension scheme.

These differences will increase as profits and proposed pension investments increase (and vice versa). However, in relation to the sole trader option, as Mark gets older a higher amount of his pension contribution will qualify for tax relief, which would reduce the difference between the two options.

A further advantage of an occupational pension scheme is that in certain circumstances it may be possible to take the entire occupational pension fund by way of a tax-free lump sum.

Disadvantages of the incorporation/occupational pension scheme option include:

- The compliance costs (accounting, taxation, etc) will be higher.
- There will also be accounting, taxation and possibly legal costs associated with setting up the company and transferring the trade.

Recommendation

The incorporation/occupational pension scheme option is recommended as being the more tax efficient based on the expected 2014 figures. Also, the tax benefits of this option could be even greater if there were to be further increases in profits in future years and a higher amount became available for retention in the business or for further pension investment.

(b) Kathleen Fleming**(i) Relief available**

The employment and investment incentive scheme (EIS) gives qualifying individuals a tax deduction for investment in new shares of qualifying companies.

Conditions of the EIS:

- Investors must purchase new ordinary share capital in the company. The shares must be issued on or before 31 December 2013.
- The shares must carry no preferential rights and there can be no condition which would eliminate risk for the investor.
- The company must be an unquoted company incorporated and resident in Ireland or an EU state and must carry on a qualifying trade (which is generally an activity taxable under Schedule D Case I).
- The maximum amount a company can raise under the scheme is €10 million and no more than €2.5 million in any one period of 12 months.
- An individual will qualify for relief if they subscribe on their own behalf for eligible shares in a qualifying company and if they are not at any time in the specified period connected with that company. An individual is connected with a company if they directly or indirectly possess or are entitled to acquire more than 30% of the share capital of the company.
- The investor must retain the shares for at least three years.
- The maximum investment is €150,000 and the minimum investment is €250.

(ii) Restrictions on tax relief

On the assumption that the company and Kathleen meet the above criteria, Kathleen will be able to claim tax relief on her investment. The amount of tax relief and the restrictions thereon are:

- The tax deduction is in respect of income tax only (not PRSI and USC).
- Relief cannot be claimed until the company commences trading.
- Income tax relief at an effective rate of 30% of the amount invested is allowed in the year of investment. Further tax relief of 11% (to bring the effective rate of tax relief to 41%) is deferred until the third anniversary of the investment and is subject to the company being able to demonstrate that either it has increased employment or expenditure on research and development over the term of the investment.
- In order to avail of the tax relief at the 30% (or 41%) rate, the investor must have paid income tax on an amount of income equal to or exceeding the amount of the investment. This would be the position in 2013 in Kathleen's case.
- The high income earners restriction will apply where the specified relief sought is more than €80,000 and the individual's income is more than €125,000. Kathleen's EIS relief for 2013 amounts to €62,195 (€85,000 x 30/41). As this is less than €80,000, she will not be affected by the high earners restriction.

Note: This assumes that Kathleen does not have any other claims for the specified restricted reliefs in 2013.

- The high earners restriction does not apply to the balance of 11% tax relief which may be available after the third year.

Tutorial note: With effect from 16 October 2013, subscriptions for EIS shares will not be subject to the high earners restriction.

4 James O'Neill

(a) Capital acquisitions tax (CAT) liabilities of the beneficiaries

(1) Alison (wife)

There is no CAT arising on this inheritance as it is from husband to wife.

(2) Kenneth (brother)

Kenneth's assets after taking the inheritance are categorised as follows to determine whether he qualifies as a 'farmer' for agricultural relief:

	Agricultural €	Non-agricultural €
Land	560,000	
Farmhouse	400,000	
Farm machinery	250,000	
Home (€360,000 – €80,000)		280,000
Car		8,000
Cash		5,000
	1,210,000	293,000

As 81% of Kenneth's assets are agricultural property, he qualifies as a farmer.

CAT computation

		€
Agricultural property		1,210,000
Agricultural relief	90%	(1,089,000)
Taxable value		121,000
Less: Class 2 threshold		(30,150)
		<u>90,850</u>
Tax at 33%		29,981

Tutorial note: *The prior inheritance received from his mother is not aggregated as it is not a Class 2 disposition.*

(3) Eva (niece – child of brother)

Eva qualifies for business property relief on the inheritance of the entire shareholding of Agrideal Ltd, because:

- she will own more than 25% of the company's shares after taking the inheritance; and
- James had owned the shares for more than two years prior to his death.

The relevant and non-relevant business assets are separated for the purpose of calculating the relief.

	Relevant business assets €	Non-relevant business assets €	Total €
Non-current assets	650,000	350,000	1,000,000
Current assets	150,000	100,000	250,000
	<u>800,000</u>	<u>450,000</u>	<u>1,250,000</u>

Business property relief is calculated as: $(€1,250,000 \times €800,000/€1,250,000) \times 90\% = €720,000$.

CAT computation

	€
Value of the business	1,250,000
Business property relief	(720,000)
Taxable value	530,000
Less: Class 2 threshold	(30,150)
	<u>499,850</u>
Tax at 33%	164,951

Tutorial note: *Eva does not qualify for the Class 1 threshold applicable to a favourite niece because she did not work in the business for the five-year period ending on the date of the inheritance.*

(4) Patricia (friend)

CAT computation

	€
Investment property	270,000
Less: Value of right of residence	(101,250)
	<u>168,750</u>
Less: Class 3 threshold	(15,075)
	<u>153,675</u>
Tax at 33%	50,713

The value of the right of residence is calculated as:

$(€270,000 \times €6,000/€16,000)$ 101,250

Tutorial note: *Revenue use 10% of the market value of the dwelling when valuing a right of residence. This approach is equally acceptable.*

(5) Anne (cousin)

CAT computation

	€
Right of residence (€101,250 x .7791)	78,884
Less: Class 3 threshold	(15,075)
	<u>63,809</u>
Tax at 33%	21,057

(b) Eva – sale of Agrideal Ltd shareholding

Capital acquisitions tax (CAT)

There will be a clawback of the business property relief if Eva disposes of the shares within six years of receipt and does not purchase other qualifying business property within one year.

The value of this clawback (at current tax rates) amounts to €237,600 (€720,000 x 33%).

Capital gains tax (CGT)

Eva will be liable to CGT at the rate of 33% on any appreciation in the value of the shares during her ownership.

(c) Kenneth – sale/letting out of farming assets

Capital acquisitions tax (CAT)

There will be a clawback of the agricultural relief granted in relation to the farmhouse if Kenneth does not reinvest the proceeds in other agricultural property within one year (as he is selling the property within six years).

The value of this clawback (at current rates) amounts to €118,800 (€400,000 x 90% x 33%).

It is not a requirement of agricultural relief that Kenneth actually farms the land, so the letting of the farm will not trigger a clawback of the agricultural relief granted in relation to the land and other farming assets let out.

Capital gains tax (CGT)

The farmhouse will not be Kenneth's principal private residence and therefore any gain arising will be subject to CGT at a rate of 33%. The gain is calculated as the difference between the net sales proceeds and €400,000 (being the value of the farmhouse on the date of the inheritance).

Income taxes

Kenneth will be liable to income tax, PRSI and USC on the rental income (after deduction of relevant expenses).

5 John Lannigan

(a) The Lannigan group

Formation:

John should form a company which he wishes to be the holding company (H Ltd). John would own all of the initial share capital in this company.

H Ltd would make an offer to John to acquire his share capital in the existing companies.

The terms of the offer would be that additional shares in H Ltd would be issued to John in return for the shares he already holds in Alarm Ltd and Components Ltd.

Tax consequences

Capital gains tax (CGT)

A share for share exchange (as proposed) does not give rise to a charge to CGT, provided it is shown that the exchange was effected for *bona fide* commercial reasons and did not form part of an arrangement or scheme of which the main purpose or one of the main purposes was the avoidance of tax. Arranging a group structure so as to facilitate the availability of group loss reliefs is not considered to have an avoidance purpose.

The new shares received in H Ltd take the same date of acquisition and cost incurred as in the target companies of Alarm Ltd and Components Ltd.

It is a condition of the relief that H Ltd acquires control of both Alarm Ltd and Components Ltd.

Stamp duty

There is also a similar share for share exemption from stamp duty. To avail of this exemption, H Ltd must acquire at least 90% of the share capital of Alarm Ltd and Components Ltd.

This exemption will be clawed back if Alarm Ltd and Components Ltd leave the group within two years.

Corporation tax (CT)

The three companies will form a group for the purposes of group loss relief, as both trading companies will be more than 75% subsidiaries of the third company (H Ltd). Therefore, from the date of formation of the group, current trading losses and excess charges can be surrendered between group members. This will enable the profitable company (Components Ltd) to utilise the losses of Alarm Ltd to shelter its future CT liabilities on a current year basis.

(b) Value added tax (VAT)

VAT Section 56 authorisation

Components Ltd should apply for a s.56 authorisation. This allows authorised persons to purchase goods and services, import goods and services and make intra-EU acquisitions at the zero rate of VAT.

Tutorial note: *Prior to the VAT Consolidation Act 2010, s.56 authorisation was referred to as s.13B authorisation.*

A qualifying person is an accountable person whose turnover from:

- supplies of goods to either VAT registered persons in other EU Member States or persons outside the EU; and/ or
- certain contract work services in relation to movable goods where the goods are dispatched from Ireland to another country after the work is carried out amounts to 75% or more of their total turnover from the supply of goods and services.

Based on the information supplied, Components Ltd will meet the above criteria.

When the authorisation letter is received from the Revenue, copies should be sent to the respective suppliers who will quote the reference on their invoices to Components Ltd and charge VAT at the zero rate.

VAT group

The Revenue, at their discretion, are allowed to treat two or more accountable persons as one accountable person, if they are satisfied that it is in the interest of the efficient administration of the VAT system. Unlike corporation tax and capital gains tax, there is no requirement that a certain minimum shareholding relationship exist between group members.

Tutorial note: *In practice, the Revenue normally require a minimum 50% shareholding relationship.*

The current situation, whereby VAT is being charged on inter-company transfers of goods, can be avoided if authorisation is received to treat the companies as a VAT group. With group registration, there would also be an automatic right of set-off of the repayments due to one group member against the payments of another group member.

An application must be made by all the companies requiring to be treated as a group. The group members have joint and several liability for the VAT obligations of the group.

Group registration for VAT does not apply to inter-group property sales.

(c) Income tax relief for foreign travel

Foreign earnings deduction (FED) relief applies to individuals on assignment in Brazil, Russia, India, China and South Africa (known as the 'BRICS' countries).

The main features of this relief are as follows:

- Relief is granted from income tax but not for PRSI or USC.
- The individual must be present in the relevant state for at least four consecutive qualifying days for the performance of the duties of the office or employment in order to qualify. Weekends and/or public holidays will be counted towards qualifying days.
- In any year or 12-month period the individual must have spent at least 60 qualifying days in BRICS countries.
- The relief is reduced by any double taxation credits and restricted by the higher earners' restriction.

Where FED is claimed, the employee may not claim other reliefs relating to employment income in the same year, such as split year residence relief, cross border workers relief, remittance basis on employment income, special assignee relief programme (SARP) or the surrender of R & D credit relief for key employees.

The amount of the deduction is the lesser of €35,000 and the proportion of employment income relating to the number of qualifying days worked in a relevant state in the tax year (the specified amount). For this purpose, income from employment includes any taxable share options derived from the employment, less any qualifying pension premium but excludes any tax deductible expense payments, benefits in kind, termination payments and payments under restrictive covenants.

Therefore, Julia will be entitled to a tax refund on a specified amount of €22,260 ($€125,000 \times 65/365$), being €9,127 ($€22,260 \times 41\%$).

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) (i) Tax issues associated with option 1		
Stamp duty, including calculation	0.5	
Clawback of group relief, explanation and calculation	2.5	
VAT not chargeable on shares	0.5	
CT losses forward explanation and calculation	2.5	
Latent gains, explanation of concept and significance	1.5	
Latent gains tax calculation re Southbank Boutique	1.0	
No latent gains re Northbank Boutique	0.5	
Latent gains tax calculation, goodwill	0.5	
Calculation of proceeds attributable to goodwill	0.5	
	<u>10.0</u>	9.0
(ii) Tax issues associated with option 2		
Stamp duty, including calculation	1.0	
Transfer of stock and equipment by delivery	0.5	
Clawback of group relief not relevant to Jane	0.5	
VAT avoided by transfer of undertaking	1.5	
Requirement for both parties to be VAT registered	0.5	
<i>Note: Candidates will alternatively be awarded a maximum of 1.5 marks for explaining that VAT does not apply to the transfer of the buildings because they are 'old' and exempt.</i>		
CT losses forward cannot be utilised	1.0	
Capital allowances, no significant issues	0.5	
Sole trader status: tax on future profits subject to income tax in full and limited planning options	1.0	
No latent gains risk to Jane	0.5	
Seven year CGT exemption	1.0	
	<u>8.0</u>	6.0
(iii) Income tax treatment of bank interest under option 1	1.0	
Income tax treatment of bank interest under option 2	1.0	2.0
	<u>2.0</u>	
(iv) Summary of tax costs	1.0	
Recommendation of option 2 with supporting arguments	2.0	3.0
	<u>3.0</u>	
Professional marks		
Format and presentation of the 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
	<u>4.0</u>	

	<i>Available</i>	<i>Maximum</i>
(b) Tax efficient alternative to option 2: Recommended structure		
Purchase properties in a personal capacity	1.0	
Bank loan to be applied to purchase of property	0.5	
Newco purchases goodwill, stock and equipment and carries on the trade	1.0	
Newco rents the boutique premises	0.5	
Investment in Newco through a holding company	1.0	
Tax implications		
Stamp duty cost remains the same	0.5	
Reduced tax on retained profits	1.0	
Holding company exemption (availability)	1.0	
Holding company structure (conditions)	2.0	
Importance of holding properties personally (re the above)	0.5	
Seven year CGT exemption still available	0.5	
Rental income and expense	1.0	
VAT: applicability of transfer of undertaking	1.0	
<i>Alternatively 1 mark will be awarded for stating that there will be no VAT cost if Newco is registered for VAT</i>		
VAT: will not apply to premises transfers	0.5	
VAT: will not apply to premises lease	0.5	
Pension planning opportunities	0.5	
	<u>13.0</u>	<u>11.0</u>
		<u>35</u>
2 (a) Books and records	1.5	
Linking documents	0.5	
Six year retention period	0.5	
	<u>2.5</u>	2.0
(b) Opportunity to make a qualifying disclosure	0.5	
Explanation of nature and process for qualifying disclosure	1.5	
Inclusion of other taxes due to deliberate behaviour items	1.0	
60 days to prepare disclosure if notified within 14 days	0.5	
Explanation of cooperation	1.0	
Benefits of making a qualifying disclosure		
Reduced penalties	0.5	
Non-publication	0.5	
No prosecution	0.5	
	<u>6.0</u>	5.0
(c) Calculation of under-declared sales using mark-up percentage	2.0	
Calculation of under-declared sales based on the shortfall in funding of personal expenditure	2.0	
Comparison and conclusion	1.0	
	<u>5.0</u>	4.0
(d) Tax underpaid		
Item 1 VAT on sales	1.0	
Note: <i>The mark will also be awarded where candidates base their VAT underpayment on an alternative calculation.</i>		
Item 2 IT, PRSI, USC re Tim	2.5	
Item 3 VAT on electricity	1.5	
Item 4 CGT on share disposal	2.0	
Item 5 IT, PRSI, USC re Mary	3.0	
Explanation of the three categories of default	3.5	
Penalties for each scenario	1.5	
	<u>15.0</u>	<u>14.0</u>
		<u>25</u>

	<i>Available</i>	<i>Maximum</i>
3 (a) (i) Explanation and calculation of additional taxes	<u>2.0</u>	2.0
(ii) Tax on director's remuneration	0.5	
Corporation tax computation	1.5	
Surcharge computation	<u>2.0</u>	4.0
(iii) Explanation and calculation of tax saving	1.5	
Pension contribution not a BIK	<u>0.5</u>	2.0
(iv) Summary of tax costs and identification of savings	1.0	
Explanation of savings	2.0	
Benefit of occupational scheme (tax free lump sum)	0.5	
Disadvantages of incorporation (higher compliance costs, etc)	1.0	
Recommendation	<u>0.5</u>	
	5.0	4.0
(b) (i) Employment and investment incentive scheme (EIS)	0.5	
New ordinary share capital issued before 31 December 2013	0.5	
No preferential rights or elimination of risk	0.5	
Unquoted company in Ireland or EU carrying on qualifying trade	1.0	
Maxima which can be raised €10 million/€2.5 million	0.5	
Individual must not be connected with the company (>30%)	1.0	
Three year retention period	0.5	
Maximum investment €150,000, minimum €250	<u>0.5</u>	
	5.0	4.0
(ii) Tax deduction for income tax only (not PRSI or USC)	0.5	
Relief cannot be claimed until the company starts trading	0.5	
30% initially and 11% in three years, subject to conditions	1.5	
Investor must have paid income tax at 41% on an amount equal to the amount of the investment	0.5	
High earners restriction, explanation and calculation re 30/41 EIS relief	1.5	
Higher earners restriction does not apply to 11% relief	<u>0.5</u>	
	5.0	4.0
		<u>20</u>

		<i>Available</i>	<i>Maximum</i>	
4 (a)	Alison	Husband to wife, nil CAT liability	1.0	
	Kenneth	Categorisation of assets	1.0	
		Deduction of mortgage from PPR	1.0	
		Eligible for agricultural relief	1.0	
		CAT computation	1.5	
		Non-aggregation of prior inheritance	0.5	
	Eva	Qualifies for business property relief as shares owned for more than two years by James	0.5	
		Her shareholding will exceed 25%	0.5	
		Categorisation of assets	1.0	
		Calculation of business property relief	1.0	
		CAT computation	1.0	
	Patricia	Non-applicability of favoured niece relief	0.5	
		Value of right of residence	1.5	
		CAT computation	1.0	
		Note: <i>It is also acceptable to value the right of residence at 10% of the market value.</i>		
	Anne	CAT computation	1.5	
			<hr/> 14.5	13.0
(b)	Business property relief clawback explanation			
		Six year holding period	1.0	
		No replacement within one year	0.5	
		Calculation of value of clawback	0.5	
		CGT liability on appreciation in value	1.0	
		<hr/> 3.0		
(c)	Agricultural relief clawback explanation			
		Six year holding period	1.0	
		No replacement within one year	0.5	
		Calculation of value of clawback	0.5	
		Not a requirement that Kenneth actually farms the land	1.0	
		CGT applies to sale of farmhouse as it is not his PPR	0.5	
		Explanation of the calculation of CGT on farmhouse disposal	0.5	
		Income tax on rental	0.5	
			<hr/> 4.5	4.0
			<hr/> 20	
5 (a)	Formation of the group		3.0	
	Tax consequences			
	CGT	Exempt, provided scheme is for <i>bona fide</i> reasons	1.0	
		Comment on application to this scenario	0.5	
		New shares take same date of acquisition and cost	1.0	
		H Ltd must acquire control of both trading companies	1.0	
	Stamp duty	Exempt provided 90% of share capital is acquired	1.0	
		Clawback if they leave the group within two years	1.0	
	Ongoing CT	Qualifies as a loss group (75% test)	1.0	
		Losses of Alarm Ltd available for set off on current year basis	1.0	
			<hr/> 10.5	9.0
	(b)	VAT Section 56	Explanation and application	2.5
		VAT group registration	Explanation and application	2.5
		<hr/> 5.0		
(c)	Identification of foreign earnings deduction		1.0	
		Explanation of main features	3.5	
		Explanation and calculation of rebate	2.0	
			<hr/> 6.5	6.0
			<hr/> 20	