Answers

1 To: Taxation Manager
From: Taxation Junior

Subject: Leo and Fiona Graham and W&D Manufacturing Limited.
Date: xx June 2009

This report considers the taxation issues that may arise on the proposed liquidation of W&D Manufacturing Limited by Leo and Fiona Graham.

(a) Capital gains tax

The liquidation of W&D Manufacturing Limited is a disposal for capital gains tax purposes. In the first instance, the company will need to dispose of or encash its assets to facilitate a payment to the shareholders. To the extent that this encashment results in the sale or disposal of chargeable assets, capital gains tax will arise. In addition, a second charge to capital gains tax will arise on the distribution of the resultant share value to the shareholders on liquidation.

The company owns two chargeable assets, the property and the quoted shares. The remaining cash assets are not liable to capital gains tax. A distribution of the property, either by sale or transfer to the shareholders will result in a capital gains tax liability arising on the company calculated on the difference between the original site cost plus construction cost of the property and its market value at the date of liquidation. Based on a market value of €1,250,000, this liability will be €100,095 (Appendix 1). The disposal of the quoted shares will result in a capital loss and this loss has been offset against the gain on the property in arriving at this liability.

A further capital gains tax liability will arise on Leo and Fiona personally on the capital distribution on liquidation of the company. This distribution represents the share value remaining after capital gains tax has been paid. This capital value is €1,699,905 (€1,800,000 – €100,095). This gain is calculated on the difference between the value of the shares at the date of inheritance and the net value of assets available for distribution. In the absence of any relief, the capital gains tax liability arising will be €231,420 and €99,035 on Leo and Fiona respectively (Appendix 2).

(b) Property transfer

Leo and Fiona have stated that they wish to retain the property as an investment. To this end, the property can be distributed to the shareholders by either:

(i) a 'sale' prior to liquidation, or
(ii) as a distribution '*in specie*'.

(1) Distribution by sale

The property could be sold to Leo and Fiona at market value prior to liquidation and the proceeds subsequently distributed on liquidation. This will result in the capital gain as calculated in Appendix 1 arising in the company. Stamp duty would be payable at a rate of 9% giving a liability of €112,500 and this would be payable by Leo and Fiona proportionately.

It may be possible to alleviate some of this capital gain by claiming retirement relief. This relief is available where all the following conditions are met:

1. The claimant is 55 years old or more.
2. The shares being disposed of are shares in a family company, i.e. the claimant can exercise not less than 25% of the voting rights or not less than 10% where at least 75% of the voting rights are exercisable by members of their family.
3. The claimant has owned the shares for at least ten years ending with the date of disposal.
4. The claimant has been a working director for a period of at least ten years and a full-time working director for at least five of those years.

Fiona will not qualify for relief as she is not yet 55 years of age, but it would appear that Leo will qualify. Retirement relief provides that the disposal of shares in a family company as defined at point 2 above will be exempt where the consideration does not exceed €750,000 and marginal relief arises where the consideration does not greatly exceed this limit. The relief applies to the consideration received for chargeable business assets only. Therefore that element of the property that is not used for business purposes in addition to the cash assets of the company are not chargeable business assets for the purpose of this relief.

If Leo claims the relief, the capital gains tax which he is liable to pay reduces from €231,420 (Appendix 2) to €95,388 (Appendix 3), resulting in a saving of €136,032.

The net position of the shareholders, assuming that the property is distributed by sale prior to liquidation, would be:

	Leo	Fiona	Total
	€	€	€
Capital distribution	1,189,934	509,971	1,699,905
Less:			
Capital gains tax	(95,388)	(99,035)	(194,423)
Stamp duty	(78,750)	(33,750)	(112,500)
Net proceeds	1,015,796	377,186	1,392,982

As a result of the sale of the property, the assets of the company at the date of liquidation will be comprised mainly of cash and technically would not qualify for retirement relief as there are no chargeable business assets. However, a Revenue concession provides that where the proceeds are distributed within six months from the sale of the property, the proceeds of this sale can be included as chargeable business assets for the purpose of calculating retirement relief.

(2) Distribution *in specie*

On liquidation, the premises can be transferred to the shareholders as part of their capital distribution. Stamp duty will not arise on this distribution. The capital gains tax exposure remains the same. However, retirement relief will not apply to the distribution of chargeable business assets. Consequently, where the property is distributed '*in specie*' on liquidation it will not qualify for relief. The net position of Leo and Fiona assuming a distribution *in specie* would be:

	Leo	Fiona	Total
	€	€	€
Capital distribution	1,189,934	509,971	1,699,905
Less:			
Capital gains tax	(231,420)	(99,035)	(330,455)
Net proceeds	958,514	410,936	1,369,450

It would appear therefore that the best results can be achieved if the property is sold to the shareholders prior to liquidation and distributing the proceeds on liquidation.

Appendix 1
Capital gains tax on liquidation of company

				€	€
Market value of property at date of liquidation					1,250,000
Less original cost					
1993–94	Site cost	83,000	indexed at 1·331	110,473	
1994–95	Construction cost	450,000	indexed at 1·309	589,050	(699,523)
Taxable gain					550,477
Less loss on disposal of shares					(50,000)
Net taxable gain					500,477
Tax at 20%					100,095

		€
Market value of quoted shares at date of liquidation		200,000
Less original cost	2004	250,000
Capital loss		(50,000)

Appendix 2
Capital gains tax on liquidation of company

	Leo	Fiona	Total
	70%	30%	
	€	€	€
Net value of assets at date of liquidation			
(1,800,000 – 100,095)	1,189,934	509,971	1,699,905
Less original cost			
1989–90 Share value at date of inheritance			
30,000 indexed at 1·503	(31,563)	(13,527)	(45,090)
Taxable gain	1,158,371	496,444	1,654,815
Annual exemption	(1,270)	(1,270)	(2,540)
Net taxable gain	1,157,101	495,174	1,652,275
Tax at 20%	231,420	99,035	330,455

Appendix 3
Retirement relief for Leo assuming the 'sale' of the premises to the shareholders

		Leo
Leo's capital distribution on liquidation	€	€
Comprised of:		1,189,934
Chargeable business assets (80% of premises) (1,250,000 x 70% x 80%)	700,000	
Chargeable non-business assets (20% of premises) (1,250,000 x 70% x 20%)	175,000	
Non-chargeable assets (€350,000 + €200,000 – €100,095) x 70%	314,934	

As the consideration received for the chargeable business assets exceeds 750,000, marginal relief will apply.

Element qualifying for retirement relief $1,189,934 \times \frac{700,000}{1,015,000^*} = 820,644$

	€
Leo's taxable gain	1,158,371
Tax:	
Marginal relief on chargeable business assets (820,644 – 750,000) x 50%	35,322
Balance of gain taxed at 20% (1,158,371 – 820,644 x 20%)	67,545
Total tax payable	102,867

Note: No annual allowance is available where retirement relief is claimed.
** 700,000 + 175,000 + (200,000 x 70%) = 1,015,000*

(c) Reduction of capital gains tax

While the cash balance remaining in the company is not liable to capital gains tax within the company, it does form part of the distribution for capital gains tax purposes on liquidation. It may be possible to reduce the shareholders exposure to capital gains tax by utilising this cash balance prior to liquidation. The cash balance can be utilised in a tax efficient manner by either:

(1) Prior to liquidation, the company could pay some of this amount as a pension contribution into the company pension plan on behalf of Leo and Fiona. This contribution is deductible for corporation tax purposes and is not liable to income tax on Leo and Fiona. As Leo is 58 years old, he would be able to withdraw 25% of this amount tax free within two years.
(2) Make a termination payment to both Leo and Fiona. As Leo and Fiona have worked in the company for a large number of years it is likely, subject to the information on salaries for the five years prior to termination being received, that this payment could be made tax free.

This would have the effect of reducing the overall capital gains tax liability by 20% of the utilised cash balance.

(d) VAT implications of the property transfer

As this property was developed before 1 July 2008 and VAT was reclaimed on its original development, it is considered a transitional property. The new VAT rules provide that as this property is no longer considered new (more than five years from date of development) the supply of this property is VAT exempt. Therefore W&D Manufacturing Limited need not charge VAT on the sale of the property to the shareholders.

However, as this property is being supplied within its tax life, i.e. within 20 years from the date of construction, a capital goods scheme adjustment will be required. This results in a clawback of a proportion of the input credits originally refunded to the company as follows:

Clawback of VAT input credits

		€
VAT reclaimed	450,000 x 13·5%	60,750
Annual CGS amount		3,038
Number of years to date of sale		15
Clawback of five years input credits		15,190

This clawback is a real cost to the company that cannot be reclaimed.

The new rules provide an option to elect to have the sale of the property VATable where both the supplier and the purchaser are engaged in business. Where this election is made, the purchaser is required to self-account for the VAT due and take an input credit as appropriate. This will result in a new tax life of 20 years for the building under the Capital Goods Scheme.

2 (a) Memorandum

To Taxation Manager
From Tax Senior
Date 10 June 2009
Subject Gerry Butler

Further to your memorandum, I have set out the principal issues based on the queries raised as follows:

(i) Income tax on property development trade

The profits on the sale of the apartments will be taxable under Schedule D Case I. The first year of trading will be from 1 July 2009 to 31 December 2009. While under normal commencement rules, the second year of trading would be the 12 months ending 30 June 2010, s.68 TCA 1997 specifies that where a business permanently discontinues within the second year of assessment, taxable profits will be the actual profits earned in that period. Therefore Case I will be based on the actual profits for each of the two years as follows: 2009 tax year – 1 July 2009 to 31 December 2009 and 2010 tax year – 1 January 2010 to 1 October 2010.

The house and lands will transfer into the Case I trade as trading stock. To the extent that Gerry intends to retain the apartments for his personal use (the penthouse and the apartment to be gifted to Brian), that proportionate part of Gerry's original house and site will not form part of the trading stock.

The Case I profits will be taxable in the normal manner; however, special rules apply to the sale of residential development land. To the extent that profits arise from the sale of the residential development land, the profits will be taxed at 20% and will be exempt from PRSI and health levies. Personal tax credits cannot be used against these residential development profits. The proportion of profits relating to the construction of the apartments is taxable at Gerry's marginal rate – likely to be 41%. PRSI and levies will apply.

In computing the profits or gains from dealing in residential development land, no account is to be taken of profits attributable to construction operations on the land. However, profits arising from the following activities can be included for the purpose of the 20% rate:

(a) the demolition or dismantling of any building or structure on the land;
(b) the construction or demolition of any works forming part of the land, being road-works, water mains, wells, sewers or installations for the purpose of land drainage; or
(c) any other operations which are preparatory to residential development on the land other than the laying of foundations for such development.

Gerry should ensure that in preparing his accounts for this trade, the above elements are clearly identified so that the profits can be appropriately apportioned between construction and non-construction activities.

Pre-trading expenses

The expenditure incurred by Gerry on obtaining planning permission is allowable as a trading expense as it was incurred within three years of the commencement of the trade. It will be deemed to be incurred at the time when the trade commences. This expense will be apportioned between the private and business element of the development.

(ii) Capital gains tax (CGT) arising on the transfer of house and lands to trading stock

At the date of commencement of the development, Gerry will be deemed to have disposed of a part of his principal residence and lands to the trade of property development. However, as it is Gerry's intention to personally retain two apartments, accounting for 48% of the overall development (35% and 13% respectively), he will only dispose of an appropriate part of his original house and lands to stock in trade. This will cause a part disposal to arise for CGT purposes and this will be based on the market value at 1 July 2009. As the property has been occupied by Gerry as his principal private residence since 1964, the disposal of the house and up to one acre will qualify for principal private property relief. The second acre of land will however, give rise to a capital gain as set out in Appendix 1.

Gerry may elect to reduce the stock cost by the amount of the gain, thereby deferring the gain until the property is developed and sold. However, this would have the effect of increasing the Case I profit on the development and, as the profits are apportioned between the 20% and 41% rates, may have the effect of taxing a portion of the deferred gain at 41% plus PRSI and levies.

(iii) Capital acquisitions tax (CAT)

Brian will receive a gift of an apartment from Gerry. This gift is taxable subject to the Class 1 tax free threshold of €521,208 (benefits from parent to child). The gift tax will be based on the market value of the property at the date of transfer, in this case €650,000. Brian will be liable to CAT of €25,158 (Appendix 2). In addition, the transfer will attract stamp duty of 9%; however, due to the relationship between Brian and his parents, consanguinity relief will apply to reduce the exposure to 4·5%. This results in a stamp duty liability of €29,250 (650,000 x 4·5%) and is payable by Brian.

Gerry will be liable to CGT on the disposal of the apartment to Brian. This gain will be calculated on the difference between the market value of the property at the date of transfer and the part-disposal of his original property holding and construction costs as set out in Appendix 3. As two capital taxes arise on the one event, an offset will arise for Brian's CAT liability of €25,158 against the CGT paid by Gerry of €11,407 resulting in a net CAT liability payable by Brian of €13,751.

(iv) Relevant contract tax and value added tax

Relevant Contract Tax (RCT)

Gerry needs to be aware of the RCT provisions. RCT applies where a principal contractor, carrying on a business of building or the erection of buildings, takes on a subcontractor to carry out specific construction activities. Under this definition, Gerry is a principal contractor on that part of the building that is to be sold. However, where he is constructing the building for his own use, RCT will not apply. RCT is calculated at 35% of the VAT exclusive amount invoiced by the subcontractor.

Where a subcontractor provides a C2 Certificate of Authorisation to the principal, and the principal applies for and receives a relevant payments card, the principal is not required to withhold RCT and the invoice can be paid gross. Where a subcontractor does not provide a C2 certificate Gerry, as principal contractor must withhold RCT at 35%.

Value added tax (VAT)

Gerry must register for VAT as a property developer on that part of the development that is to be sold. VAT incurred on the input costs of construction for this part of the development can be reclaimed. As Gerry intends to retain both the penthouse and one apartment, only 52% of the VAT element incurred can be reclaimed. VAT must be charged on the sale of the apartments at 13·5%.

With effect from 1 September 2008, Gerry as a principal contractor must account for VAT payable on subcontractors' invoices on a reverse-charge basis. This means that the VAT-registered subcontractor issues an invoice to the principal but does not charge VAT. Gerry must include this VAT on his return as VAT on sales for the period in which the supply is made. Gerry can simultaneously claim an input credit for this VAT in the same return but only on the proportion that is related to the trade. That part of the costs relating to the personal properties must be paid and cannot be reclaimed.

As Gerry was not VAT registered at the time of payment of the pre-trading planning expenses, the VAT element cannot be reclaimed.

Appendix 1

Capital gains tax on the part-disposal of the property to trading stock

		€
Market value at the date of transfer (€2,500,000 x 52%)		1,300,000
Less original cost (current use value)		
Part-disposal:		
$61,500 \times \frac{1,300,000}{2,500,000}$	31,980	
Indexed at	7·528	(240,745)
Gain		1,059,255
Less principal private property relief (below)		(803,169)
Taxable gain		256,086
Less annual exemption		(1,270)
		254,816
Tax at 20%		50,963

Principal private residence relief

		€
Market value of residence and one acre		2,000,000
Original cost of residence	60,500 x 7·528	(455,444)
Residence gain		1,544,556
Restricted to part disposal (52%)		803,169

Appendix 2

Capital acquisitions tax arising on Brian

	€
Market value of apartment	650,000
Less stamp duty paid	(29,250)
	620,750
Less threshold amount	(521,208)
	99,542
Less small gift exemption	(3,000)
Taxable benefit	96,542
Tax at 20%	19,308

Appendix 3
Capital gains tax arising on Gerry on disposal of apartment to Brian

		€
Market value at date of gift		650,000
Less cost:		
Construction cost of apartment	€2,250,000 + 13·5% VAT x 13%	(331,988)
Site cost	61,500 x 13% x 7·528	(60,186)
Gain		257,826
Less principal private residence relief		
– per Appendix 1	1,544,556 x 13%	(200,792)
Taxable gain		57,034
Tax at 20%		11,407

(b) Implications of a successful Revenue challenge to the property valuation

In the event that the Revenue were to successfully argue for the alternative valuation of the original principal private residence, then the principal private residence relief would be restricted to €595,169 resulting in an additional tax liability of €41,600.

Principal private residence relief

		€
Market value of residence and one acre		1,600,000
Original cost of residence (as in (a))	60,500 x 7·528	(455,444)
Residence gain		1,144,556
Restricted to part disposal (52%)		595,169

	€
Original relief given	803,169
Restricted relief	(595,169)
Additional gain	208,000
Taxed at 20%	41,600

Capital gains tax is returned and paid through the self-assessment process. Interest and surcharges will be levied where the Revenue argue that an incorrect return has been filed. In addition, interest will be charged on the underpaid CGT.

3 (a) Karen and John Murray

Karen and John have lived in Ireland since 2006. Their exposure to Irish taxation depends on their residence and domicile status. In order to be considered Irish resident, the following conditions must be met:

(i) an individual must be in the State for a period of 183 days in one tax year, or
(ii) 280 days taking into account the current and preceding tax year.

Where an individual is in the State for a period of 30 days or less in any one year, they will not be considered resident and these days are excluded for the purposes of the 280 day test.

On this basis, Karen is not considered Irish resident for 2006 as she was in Ireland for only 122 days. However, she will be considered resident from 2007 onwards. John will be considered resident from 2006 onwards.

Domicile is not defined but is generally accepted to mean an individual's place of natural birth, or place of origin, thus Karen will be considered Irish domiciled. While it is possible to acquire a domicile of choice, there is no evidence to suggest that John has changed his US domicile. Neither Karen nor John will be considered ordinarily resident until they are individually Irish resident for three consecutive tax years. Based on their individual status, they will be taxable in Ireland as follows:

Karen

For the 2006 tax year, Karen is taxable on her Irish and UK source income only. Her only UK income for 2006 is the UK deposit interest. Under the terms of the UK/Ireland double taxation agreement the interest is only liable to Irish tax where the recipient is resident in Ireland. As she is not considered resident for this year, no Irish tax exposure arises.

For the 2007 tax year, Karen will be taxable in Ireland on the following:

- UK deposit interest under Schedule D Case III. Any UK tax deducted at source is recoverable from the UK Revenue where a relevant claim is made.
- remittance of US dividend source income of €20,000 from the US deposit account.
- US funds used to repay credit cards are deemed remitted funds to the State under s.72 TCA 1997 anti-avoidance legislation.

For the 2008 and 2009 tax years, Karen is taxable on the same income sources as for 2007. However, UK source income is taxed on a remittance basis with effect from 1 January 2008 (FA 2008). From 2010 onwards, Karen will be treated as ordinarily resident and therefore taxable on her worldwide income whether remitted or not.

John

As a non-domiciled, Irish resident, John will be taxed on the same basis as Karen for all years up to 2009 in respect of his non-employment income. From 2009 onwards, John will be ordinarily resident. However, he retains his non-domiciled status and therefore can continue on a remittance basis in respect of foreign non-employment income only.

The Finance Act 2006 amended the treatment of employment income and provided that where an Irish resident, non-domiciled individual has foreign employment income, this income is taxable in Ireland under Schedule E to the extent that the employment is exercised here. It is necessary for his employer to distinguish that part of his income attributable to the performance of his duties in the State and that part outside of the State. Eglan International Corporation is obliged to register and account for Irish PAYE in respect of any remuneration, including any benefit-in-kind paid to John. This treatment applies from the date of taking up employment in Ireland and is not dependent on his residence status and is regardless of the fact that some of this income may not be remitted to the Irish state. John's non-employment income, such as US deposit interest and US dividends continues to be taxable on a remittance basis.

(b) Tax on the Eglan International Corporation shares

(i) Exercise of options

The exercise of John's share option is partially taxable in Ireland. The proportion that is taxable is based on the part of John's employment carried out in Ireland during the vesting period of the option relative to that part carried out in the USA. The option has a four-year vesting period from 1 January 2004 to 31 December 2007. John spent one year seven months out of the four-year vesting period in Ireland. Accordingly, Ireland may tax the gain as follows:

	€
Market value of shares at date of exercise	
10,000 x €6·00	60,000
Option price paid	
10,000 x €1·50	(15,000)
Gain	45,000

	€
Taxable portion in Ireland	
$45{,}000 \times \frac{19}{48}$ months =	17,813

This gain of €17,813 will be liable to income tax under Schedule E in Ireland at John's effective rate. The tax on this gain must be paid within 30 days of the exercise of the option together with a completed Form RTSO1. The balance of the gain, €27,187 (€45,000 – €17,813) will be taxable in the USA.

(ii) Sale of shares

John will be liable to capital gains tax in Ireland under the terms of the Ireland/US double taxation agreement. The capital gain will be:

	€
Sale proceeds (10,000 x €10)	100,000
Less cost:	
Consideration deemed paid*	(60,000)
Gain	40,000
Less annual exemption	(1,270)
Taxable gain	38,730
Tax at 20%	7,746

* The Revenue will allow the full amount of consideration as the base cost, including that element that is only taxed in the US. (Revenue statement of practice SP IT/1/07)

(c) Capital gains tax on disposal of Murray Secretarial Corporation shares

The disposal of shares in Murray Secretarial Corporation will give rise to a capital gain. As Karen is Irish resident and domiciled she will be taxable in Ireland on this gain whether the income is remitted to the State or not. The tax payable will be as follows:

		€
Sale proceeds		424,000
Less:		
Original cost	1,000 x 1·232	(1,232)
Gain		422,768
Less annual exemption		(1,270)
		421,498
Tax at 20%		84,300

4 Keegan Architectural Services Limited (KASL)

(a) Disposal of shares in Grogan Limited (GL)

The disposal of shares by KASL in GL is liable to capital gains tax. As KASL owned more than 75% of the issued shares of GL, a group structure existed and consideration can therefore be given to the application of 'holding company relief' to this sale.

In order to qualify for this relief a number of conditions must be met (see tutorial note below), one of which is that the greater part of the value of the shares cannot be represented by Irish land or buildings. GL does not satisfy this condition and therefore does not qualify for the relief.

At the date of sale of the shares, the property represented 54% of the share value (945,000/1,750,000). Therefore capital gains tax is payable by KASL on this disposal. The chargeable gain is €1,652,560 calculated as follows:

		€
Sale proceeds		1,400,000
Less cost	350,000	
Indexed by	1·049	(367,150)
Taxable gain		1,032,850
Chargeable gain		
1,032,850 x	$\frac{20}{12 \cdot 5}$	1,652,560

As a result of the sale of GL the original group structure no longer exists. Where capital gains tax relief was claimed on the transfer of property between group companies and the group is dissolved within ten years, the deferred gain crystallises. Consequently, the gain deferred on the property transferred between KASL and GL in 2006 is now payable and is calculated based on the date the company received the asset, i.e. July 2006 and not the date GL leaves the group.

The deferred gain now due and payable by GL is therefore:

		€
Market value at date of transfer		1,150,000
Cost – January 1997	450,000	
Indexed by	1·251	(562,950)
Gain		587,050

Tutorial note: The full conditions for 'holding company relief' are as follows:
1. *the parent company must own at least 5% of the investee company;*
2. *the investee company must be wholly or mainly a trading company;*
3. *the greater part of the value of the shares cannot be represented by Irish land or buildings;*
4. *the investee company must be resident in the EU; and*
5. *the shares must be owned by the parent company for at least 12 months ending on the date of disposal.*

(b) Corporation tax liability for the year ended 31 December 2008

			€	€
Net profit before taxation				8,493,900
Deduct:				
Irish distributions received			578,500	
Rents received from let properties			985,900	
Profit on sale of investments			1,050,000	(2,614,400)
Case II income				5,879,500
Case II Interior Design current year loss				(114,200)
				5,765,300
Case V income				985,900
Total income				6,751,200
Chargeable gains (from (a))				1,652,560
Total profit				8,403,760
Tax liability				
5,765,300	at	12·5%	720,663	
1,652,560	at	12·5%	206,570	
985,900	at	25%	246,475	1,173,708

(c) Close company surcharge liability year ending 31 December 2008

		€	€
Income for surcharge purposes			
Case II trading income		5,879,500	
Case V income		985,900	
		6,865,400	
Less current year loss		(114,200)	
Income		6,751,200	
Case II trading income		5,879,500	
Less current year loss on Interior Design trade		(114,200)	
		5,765,300	
Corporation tax at 12·5%		(720,663)	
Distributable trading income		5,044,637	
Surchargeable amount at 50%		2,522,319	
Surcharge at 15%			378,348
Estate income		€	
6,751,200 x	985,900 / 6,865,400	969,500	
Plus franked investment income		178,500	
Investment income		1,148,000	
Less corporation tax at 25% on €969,500		(242,375)	
		905,625	
Less 7·5% discount		(67,922)	
Distributable estate income		837,703	
Less dividend paid		(250,000)	
Net distributable estate income		587,703	
Surcharge at 20%			117,541
Total surcharge			495,889

Note: the distributions received from Grogan Ltd are ignored as both companies have so elected.

5 Sheila Mulholland (Deceased)

(a) (i) Margaret

Margaret inherits the shares in Cotton Prints Ltd from her mother, Sheila. She will be liable to capital acquisitions tax on the market value of this benefit. As she is receiving the benefit from a parent, she will be entitled to claim a lifetime tax free threshold of €521,208 (Class 1).

Where a benefit is comprised of shares in a private company, the market value attributed to those shares depends on whether the beneficiary has control of the company after taking the benefit or not. Where control is present after the benefit, the shares are valued on a market value basis as a majority holding. Where control is not present, the shares are valued on a minority valuation basis. A private company is defined as one which is under the control of five or fewer persons. In determining the number of persons who control the company, a relative of a person is included as a person for this test. Control includes having more than 50% of the voting power, entitlement to dividends or shares in the company. Under s.27 CATCA, Margaret will not be considered a majority shareholder after receiving this benefit as she is not a relative of Jennifer. Therefore the shares will be valued at the minority value of €20,000 per share. The total value of the shares will be €900,000 (€20,000 x 45 shares).

Business relief provides for the reduction in the taxable value of a benefit by 90% where the benefit is comprised of business assets or shares in a trading company. In order to qualify, the disponer must have owned the shares for a minimum period of two years prior to death (or five years in the case of a gift). In addition, the beneficiary must, after taking the gift of inheritance, either:

- own more than 25% of the voting rights in relation to all questions affecting the company as a whole, or
- control the company (50% control where relatives' shares are included), or
- own at least 10% of all the issued shares and securities of the company and have worked full-time in the company throughout the period of five years prior to the date of the gift or inheritance.

As Sheila had owned these shares for the minimum period of two years prior to her death and Margaret will meet the first of the control tests (25% of the voting rights), the shares will qualify for business relief. Therefore Margaret's capital acquisitions tax liability will be:

	€
Market value of shares	900,000
Less business relief at 90%	(810,000)
Taxable benefit	90,000
50% of bank savings	92,500
Total benefits	182,500
Less threshold amount (Class 1)	(521,208)
Taxable benefit	Nil

(ii) Barry

Barry receives the principal residence from Sheila subject to the right of residence, support and maintenance in the property for his uncle, Jack. The value of Barry's benefit will be reduced by the value of Jack's right to use the property. As he is receiving the benefit from a parent, like Margaret, he will be entitled to claim a lifetime tax free threshold of €521,208 (Class 1).

Therefore, Barry's capital acquisitions tax liability will be:

	€
Market value of principal residence	650,000
Less value of right of residence	
$650{,}000 \times \frac{3{,}000}{10{,}000}$	(195,000)
Taxable benefit	455,000
50% of bank savings	92,500
	547,500
Less threshold amount (Class 1)	(521,208)
Taxable benefit	26,292
Tax at 20%	5,258

(iii) Jack

Jack has lived in this house as his principal residence for the past 10 years. Consequently, this benefit will qualify for relief under the tax exemption of dwelling houses under s.86 CATCA 2003.

(b) Gift of bank savings to Margaret

If Barry accepts the benefit of 50% of the bank savings under the terms of his mother's will and subsequently gifts this money to Margaret, it will be treated as a gift from Barry to Margaret. Margaret will be taxable on this benefit subject to the Class 2 tax free threshold of €52,121. This will result in gift tax being paid as follows:

	€
Benefit from Barry	92,500
Less small gift exemption	(3,000)
	89,500
Less threshold amount	(52,121)
Taxable benefit	37,379
Tax at 20%	7,476

Recommendation

Barry should consider disclaiming the specific benefit of the bank savings. This will result in these funds falling into the residue of the estate and being redistributed accordingly. Sheila has specifically named Margaret and Barry as beneficiaries of the residue and therefore Barry needs to also disclaim his entitlement from the residue. The effect of this is that Margaret, as the only beneficiary of the residuary estate, will take the remaining 50% of the bank account from her mother, Sheila, rather than from Barry. As Margaret has not utilised her full threshold under Class I, she will take this benefit tax free:

	€
Additional benefit from Sheila	92,500
Plus prior benefits	182,500
Total benefits	275,000
Less threshold amount	(521,208)
Taxable benefit	Nil

(c) **Gift from Jennifer of undervalued shares**

If Barry purchases the shares at an undervalue from Jennifer, Barry will be deemed to have received a gift of the amount deemed undervalued. The shares in this instance will be valued as a majority holding on the basis that Barry has 'control' of the company after the benefit as he and his relatives (Margaret) own more than 50% of the shares. Barry will also qualify for business relief on this gift. This will result in the following liability:

	€
Market value of shares at date of gift	
55 x €35,000	1,925,000
Less consideration paid	
55 x €20,000	(1,100,000)
Value of gift	825,000
Less business relief (90%)	(742,500)
Less small gift exemption	(3,000)
Taxable value	79,500
Less threshold amount (Class 3)	(26,060)
Taxable benefit	53,440
Tax at 20%	10,688

This liability may be offset by any capital gains tax paid by Jennifer on the same benefit.
Barry will also be liable to stamp duty on the market value of the shares of €19,250 (1,925,000 x 1%).

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.

				Marks
1	**(a)**		Liquidation liable to CGT	$^1/_2$
			Second charge on disposal of property within company	1
			Calculation of CGT on property	1
			Calculation of CGT on shares and offset	1
			Calculation of capital value of liquidation	$^1/_2$
			CGT liability of Leo and Fiona on liquidation	2
				6
	(b)	**(i)**	Distribution of property by sale	
			Stamp duty on sale	2
			Retirement relief – conditions	$1^1/_2$
			Fiona does not qualify	1
			Leo will qualify	$^1/_2$
			Computation of relief available to Leo	3
			Net position of shareholders assuming a property sale	$1^1/_2$
			Revenue concession on cash assets for retirement relief purposes	2
		(ii)	Distribution of property *in specie*	
			Stamp duty not payable	1
			Retirement relief not applicable to transfer of chargeable assets	2
			Net position of shareholders assuming distribution *in specie*	$1^1/_2$
			Conclusion	1
				17
	(c)		Reduce cash balance prior to liquidation	1
			Use of pension contribution	1
			Termination payment	1
				3
	(d)		Transitional property for VAT	1
			More than five years old so not 'new' property	1
			Property sale exempt for VAT purposes	1
			Capital goods scheme adjustment required	1
			Computation of clawback	1
			Option to tax can be claimed	1
				6
	Format and presentation of report			1
	Effectiveness of written communication			1
	Appropriate use of support schedules			1
				3
				35

				Marks
2	**(a)**	**(i)**	Income tax on property development	
			Accounting periods for short trade	$1\frac{1}{2}$
			Transfer into trading stock	1
			20% rate for development land	$1\frac{1}{2}$
			No credit usable	$\frac{1}{2}$
			Exempt from PRSI and levies	1
			Construction operations included for 20%	$1\frac{1}{2}$
			Pre-trading expenses	1
				8
		(ii)	Transfer of property to trading stock	
			Part disposal for CGT purposes	1
			Principal private residence relief	1
			Calculation of PPR	1
			Calculation of CGT	1
			Reduce stock value by tax	1
				5
		(iii)	Capital acquisitions tax	
			CAT on gift, including computation	2
			Stamp duty exposure, including consanguinity relief	$1\frac{1}{2}$
			CGT on gift, including computation	2
			Offset of CGT against CAT	$1\frac{1}{2}$
				7
		(iv)	RCT and VAT	
			Principal contractors	1
			Requirement for C2 and relevant payment card	1
			Withholding tax of 35%	1
			VAT registration and partial reclaim	$1\frac{1}{2}$
			Reverse charge basis for VAT payment	$1\frac{1}{2}$
			No reclaim on pre-registration invoices	1
				7
		Format and presentation of the memorandum		1
		Effectiveness of written communication		1
		Appropriate use of support schedules		1
				3
	(b)	Revenue challenge to valuation		
		Withdrawal of PPR relief		1
		Interest and charges re incorrect return		1
		Interest on underpaid tax		1
				3
				33

			Marks
3	**(a)**	General rules re residence	1
		Application to Karen and John	$^1/_2$
		General rules re domicile	$^1/_2$
		Application to Karen and John	$^1/_2$
		General rule re ordinary residence	$^1/_2$
		Karen – 2006 exclusion of UK deposit interest	$^1/_2$
		– 2007 UK deposit interest under Case III	$^1/_2$
		US remittances – credit cards and US dividends	1
		– 2008 UK on remittance basis	$^1/_2$
		– 2009 onwards on worldwide income	$^1/_2$
		John – non-employment income	1
		Employment income taxable in Ireland	1
		Employer required to operate PAYE	$^1/_2$
		Remittance basis for balance	$^1/_2$
			9
	(b)	Exercise of option partially taxable in Ireland	1
		Calculation of taxable portion	1
		Payment of tax	1
		Liability to capital gains tax on sale of share	$^1/_2$
		Calculation of taxable gain	1
		Allowability of full consideration against gain	$^1/_2$
			5
	(c)	Karen's exposure to Irish capital gains tax	1
		Computation of gain	1
			2
			16
4	**(a)**	Group structure	1
		Holding company relief does not apply	$1^1/_2$
		Computation of gain	1
		Deferred gain crystallised	$1^1/_2$
		Computation of gain	1
			6
	(b)	Corporation tax liability	
		Computation of Case II income	1
		Use of losses	1
		Case V income	$^1/_2$
		Chargeable gain	$^1/_2$
		Tax liability	1
			4
	(c)	Close company surcharge	
		Income for surcharge purposes	1
		Case II trading income surcharge	2
		Estate income surcharge	3
			6
			16

				Marks
5	**(a)**	**(i)**	Margaret	
			Private company	$^1/_2$
			Minority holding	$^1/_2$
			Business relief entitlement	1
			CAT calculation	1
		(ii)	Barry	
			Value reduced by right of use	1
			Calculation of slice of property	1
			CAT calculation	1
		(iii)	Jack	
			S.86 exemption	1
				7
	(b)		CAT on gift from Barry to Margaret	1
			Disclaim specific benefit	1
			Disclaim residue	1
			Benefit tax free – calculation	1
				4
	(c)		Gift at undervalue	1
			Majority share valuation	1
			CAT calculation	2
			Offset for CGT	$^1/_2$
			Stamp duty on share transfer	$^1/_2$
				5
				16