

Chartered Tax Consultant

Stage 3 Integrated Tax: Sample Paper 1 & 2



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This sample paper is designed to provide accurate and authoritative information in regard to the assessment of Stage 3 of Chartered Tax Consultant. It is provided on the understanding that the Institute of Chartered Accountants in Ireland is not engaged in rendering professional services. The Institute of Chartered Accountants in Ireland disclaims all liability for any reliance placed on the information contained within this publication and recommends that if professional advice or other expert assistance is required, the services of a competent professional should be sought.

Introduction to Stage 3 Integrated Tax: Sample Paper 1 & 2

These papers have been written as a sample examination for **Chartered Tax Consultant, Stage 3 Integrated Tax**.

Time Allowed

Four hours is the time permitted for each of the two papers examined under Stage 3, Integrated Tax. The first 30 minutes of each paper is designated as “reading time” during which the examination paper will be distributed to all candidates. Notes may be made on the examination paper. Once the reading time has elapsed, the Invigilator will distribute the answer books and will announce the start of the examination proper.

Layout

The layout of these sample papers is indicative of the layout for the Chartered Tax Consultant, Stage 3 Integrated Tax Examination:

Paper 1 consists of two independent case studies.

Paper 2 consists of two independent case studies.

It is expected that candidates will dedicate a reasonable amount of time to reading and assimilating the information contained in each of the case studies.

“Requirements” are a mixture of implied requirements built into the narrative and also explicit requirements testing a specified issue. Therefore candidates must be alert for less directive “requirements” which require them to identify the relevant tax issues across a possible number of tax heads and provide advice based on the requirement outlined in the body of the case study. Candidates wishing to do well will need to pay close attention to the skills of assimilation and analysis of the material presented.

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The responses to the case studies must be written in a professional manner, and marks will be awarded for providing the report, email, letter etc., as set out in the requirements.

Open Book

This paper is an open book exam. Candidates are permitted to bring any reference material into the examination hall. Candidates are reminded that it is important to be very selective with regard to the material taken into the exam hall, as attempting to look up a lot of material in the examination is likely to be time-consuming and unproductive. The value of material is as a referencing tool. The emphasis in the examination will be on application of knowledge and skills, and interpreting the tax legislation and marks will **not** be awarded for direct transcription or close paraphrase of reference material. The marking schemes will reflect this.

Assessment Architecture

The assessment structure, including marks for assignments, is as follows:

Form of Exam	Mark	Topic Tested
Assignment 1	10%	M2, M3, M4
Assignment 2	10%	M5, M6, M7
Assignment 3	10%	M8, M9, M10
Exam-Paper 1		
Section 1 Case Study A	17.50%	M2/M3/M4
Section 2 Case Study B	17.50%	M5/M6/M7
Exam-Paper 2		
Section 1 Case Study A	17.50%	M8/M9/M10
Section 2 Case Study B	17.50%	M11/M2/M4/M5/M6
	100%	
<i>Core Modules 1&12 to feature in all exam case studies</i>		

All assessments will examine tax law up to and including FA2010.

Paper 1

Section 1

Case Study A: Casco Group

60 Marks

Casco is a world leading internet search engine provider. It has announced that it intends to expand its Irish operations by locating its European head office in Dublin. The firm of Chartered Accountants you work for has been engaged by Casco to provide professional tax advice on the Irish tax issues arising from the Irish expansion project.

The Irish operation currently trades through a company called Casco Ireland Ltd, set up in 1998, and is 100% owned by the UK-based parent company, Casco Plc. While Casco Plc is a publicly traded company, 86% of the voting rights are held by the founders of the company, Harry Smith, David Jones and Tim Mills.

Humphrey O'Neill will head up the Irish expansion project. Humphrey is a UK citizen and has worked for Casco Plc for 12 years and is contracted to work in Ireland for the next 24 months starting on 6 January 2010. His contract of employment is with Casco Plc, which will continue to pay Humphrey's salary into his UK bank account. Casco Plc will bear the cost of Humphrey's salary package, a breakdown of which is as follows:

- Gross salary of €550,000 (as converted from Sterling)
- Company car with a market value of €150,000 (business mileage will be 10,000 p/a)
- Private school fees of €15,000 p/a for Humphrey's daughter (Humphrey's wife and daughter will relocate to Ireland with him)

Humphrey must visit the European group operations for 1 month in each year he is located in Ireland. Approximately €50,000 of his annual €550,000 salary is attributable to his work for the local European functions.

While he is happy to locate to Ireland, Humphrey has every intention of returning to the UK on completion of his 24-month contract. He has leased his UK home for €4,000 per month for the duration of his time in Ireland and plans to use rental income from the UK property to pay for the cost of renting a house in Ireland. All going to budget, Humphrey will live on €5,000 per month while in Ireland if the rental income from the UK property can be used to fund the Irish rental costs. Therefore a transfer of €9,000 per month will be

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made from Humphrey's UK bank account to his Irish bank account. Mrs O'Neill will not have any earnings while resident in Ireland.

The current CEO of Casco Ireland Ltd, George Aspen, will retire from the company in February 2010. George has worked for Casco since September 1998. He is a director of Casco Ireland Ltd and has a 5% shareholding in Casco Plc which he intends to retain after retiring. His contract of employment entitles him to pay in lieu of notice and holiday pay but he has no contractual rights to a termination payment. George is due to be paid a performance bonus of €50,000 as provided for under the terms of his contract but he would like to take this bonus either as a tax-exempt termination payment or exchange the bonus for his company car which has a current market value of approximately €50,000. Casco Ireland Ltd values George's contribution to the success of the company over the years and would like to accommodate George's request in as tax efficient a manner as possible.

Casco Ireland Ltd operates an occupational pension scheme in favour of its employees and directors. George will reach retirement age in June 2010. His pension fund is currently valued at €7,560,000 and Casco Ireland Ltd wants your firm to provide George with independent tax advice on how exactly his pension fund will be taxed on his retirement. He intends to withdraw the maximum tax-free lump sum possible on retirement and then use 75% of the remaining fund to purchase an annuity and the balance will be transferred to an ARF. George's gross salary (including bonuses and BIK) for the last three years was €800,000, €850,000 and €980,000.

Management is keen to sort out a lingering Revenue Audit issue before the changeover of CEO. A consultant who provides services to Casco over the years has been ruled by the Revenue Commissioners to be an employee of Casco Ireland rather than a consultant. Up to now, Revenue's enquiries into the matter have been on an informal basis but a recent letter from Revenue states that the enquiry is now a Revenue Audit covering PAYE for the tax years 2006 and 2007. Casco Ireland Ltd accepts that the consultant should have been treated as an employee and wishes to reach a settlement with Revenue for the purposes of keeping its good name out of the media as a tax defaulter and minimising exposure to interest and penalties. Gross payments of €150,000 were paid to the consultant in 2006 and 2007. He actually paid tax on these payments through the self-assessment system (€71,250 for 2006 and €69,750 for 2007) and is willing to provide copies of his tax returns and notices of assessment to assist Casco in reaching a settlement with Revenue. Preliminary

reviews of Casco's tax affairs for the years in question indicate that PAYE was correctly operated other than on payments to the consultant and other company taxes are also in order. The irregularity arising on the payments to the consultant amounts to less than 5% of PAYE paid by Casco for each year in question.

The expansion project in Ireland also involves the proposed development of a cloud computing operation. Cash of approximately €15,000,000 will be transferred by Casco Plc to Ireland to fund the new business and will be held on a high earning DIRT-free interest account which will generate gross interest of €900,000 per annum. For UK tax purposes, the group would prefer that the new business be run as a branch operation rather than as a subsidiary for at least three years. Casco Ireland Ltd operates a 12-month accounting period which runs to a 31 December year end. The following projections are relevant for the first 12 months of the new trade due to commence on 6 January 2010:

Cloud computing trading loss	€5,000,000
Depreciation	€300,000
Capital Allowances	€200,000
Casco Ireland Ltd's trading profits	€14,100,000
Depreciation	€500,000
Capital Allowances	€600,000

As Casco Ireland Ltd has significant trading profits arising in the same period in which the new cloud computing business will be generating a loss, the group would like these losses to be offset against Casco Ireland Ltd's trading profit to minimise overall tax payments in Ireland for 2010. The group also has a policy of not declaring intercompany dividends.

Your firm has been asked to provide preliminary tax advice on the most tax efficient structure for the new branch assuming that the deposit interest is taxable in Ireland. The new cloud computing business structure analysis must be supported with computations but should not deal with double taxation issues which will be reviewed at a more advanced stage.

Using tax legislation and rates in place under Finance Act 2010, the tax partner in charge of the engagement with Casco has asked that you provide him with a memo detailing the tax consequences of the various issues outlined by Casco, in particular:

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Requirements:

1. Discuss the Irish tax treatment of Humphrey O'Neill's remuneration package.
15 Marks
 2. What are the tax consequences of the proposed bonus arrangement with George?
10 Marks
 3. Explain how George will be taxed on his pension fund.
5 Marks
 4. Advise Casco Ireland Ltd how it should deal with the Revenue Audit issue.
13 Marks
 5. Detail how the proposed new cloud computing business should be structured from a tax perspective.
15 Marks
- Commercial awareness **2 Marks**
Total Marks **60 Marks**

Section 2

Case Study B: Peter and Brian Barry

60 Marks

You are the tax advisor to Peter Barry. Peter is 60 years of age and is married to Deirdre. They have one child, a son named Brian who is 25 years of age. Peter is considering passing some of his business onto Brian now in the hope that Brian will be experienced enough to take over the entire business on Peter's death or retirement. Peter comes equipped with all relevant information when he meets you on 20 June 2010.

Peter holds 100% of the shares in FarmCo Ltd ("FarmCo"), a company carrying on a successful farming business. FarmCo rents the land (100 acres in total) which it farms from Peter.

Peter has been a full-time working director of the company since establishing it 25 years ago and has owned the land rented to FarmCo for 25 years also. The land is currently valued at €3,000,000. A professional valuer recently advised that the entire share capital in FarmCo is worth €600,000, while the value of a 50% shareholding is €300,000 on a net asset basis as appropriate in this case. The base cost of Peter's shares in FarmCo is €2. The base cost of Peter's farm land is €500,000.

FarmCo's assets are as follows:

Plant & Machinery	€500,000
Cash	€100,000
Stock	€300,000
Debtors	€50,000
*Quoted Shares	€50,000
*Government Stock	€20,000

**A 50% shareholding in FarmCo would be worth approximately €230,000 if the quoted shares and government stock are excluded from the valuation.*

Peter wants to immediately gift 50% of the shares in FarmCo to Brian along with 50 acres of his farm but is not yet ready to retire and would like to continue on as a director of the company and continue to work on the farm.

Brian's principal private residence is worth €300,000 with a mortgage of €275,000. He also owns a rental property valued at €330,000 with a mortgage of €363,000 and his car is worth €22,000. Currently Brian works as an agricultural advisor having graduated from UCD with a degree in Agricultural Science but plans to work for the company on a full-time basis on taking the gift of the shares and land.

Peter sold a number of sites with road frontage in 2008 to a local property developer for €600,000 and did not pay any CGT on the disposal on claiming retirement relief. The balance of the land remaining has no development potential.

Both father and son are aware that tax costs will be triggered on the transfer and want to avail of any reliefs or exemptions to minimise tax. Brian received a gift of €400,000 cash from his mother in 2007.

While considering what assets to gift to Brian now, Peter mentions to you that he is also thinking about making a will which leaves all of his assets to Brian. Peter reckons that Deirdre will be financially secure as she has her own investments and Peter dearly wishes that Brian should inherit his property assets in addition to the family home, the remaining balance of the farm land and company. Before he discusses this matter with the family solicitor, Peter is interested in your views on the proposed structure of his will.

Peter wants to extract the cash reserves in FarmCo but he doesn't want to pay the top rate of income tax or sell any of the shares in the company. During the meeting he mentions

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to you that he has been approached by an advisor offering a scheme to extract the cash of €100,000 from FarmCo. The advisor claims that the funds can be extracted at the lower CGT rate and Peter will not have to reduce his shares in the company. The scheme as described by Peter does not provide any commercial benefit to the company. Of course Peter is very interested in this scheme but asks you to highlight any issues he should be aware of before he progresses.

Peter also owns a number of commercial properties in Rathmines which he rents as 12-month lettings. He reclaimed the VAT on the purchase of these properties in 2005 having put a waiver of exemption in place and charges VAT on the rents. Peter acquired another commercial property in Rathgar in late 2007 which he intended to lease on a 12-month basis, and reclaimed the VAT incurred on the acquisition of the property. However the property required extensive renovations which were on-going throughout all of 2008 and 2009 before completion in May 2010. VAT was reclaimed on all costs arising on the renovation works. Pete is now about to let the property to a tenant under a 12-month lease but is unsure as to how he should account for VAT, if any. One thing he is sure of is that he doesn't want to repay any VAT already reclaimed.

FarmCo's office was damaged by a burst pipe during the winter freeze. This forced Peter to look into proper storage for FarmCo's books and records which date back to 1985. The front room in Peter's house is also swamped by paper work relating to his own rental properties. He asks your advice on what files he really needs to retain and what can be shredded.

Requirements:

Prepare a letter to Peter addressing the tax issues relevant to the information discussed during the meeting. Peter would like your advice to be supported by appropriate tax legislation, case law references and calculations. Your file note from the meeting summarises the issues which Peter wants addressed as follows:

1. Provide a tax efficient plan to Peter (15 marks) and Brian (15 marks) on the proposed transfer of assets which meets their objectives.

30 Marks

2. Advise Peter of your views on the cash extraction scheme based on the information provided.

10 Marks

Sample Paper 1

3. Explain the VAT treatment of the 12-month lease of the Rathgar property. **6 Marks**
4. What books and records do you recommend that Peter should retain for tax purposes? **6 Marks**
5. What are the legal implications of Peter's plans to leave all his assets to Brian? **6 Marks**
- Commercial awareness **2 Marks**
- Total Marks **60 Marks**

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Paper 2

Section 1

Case Study A: Holdco Group

60 Marks

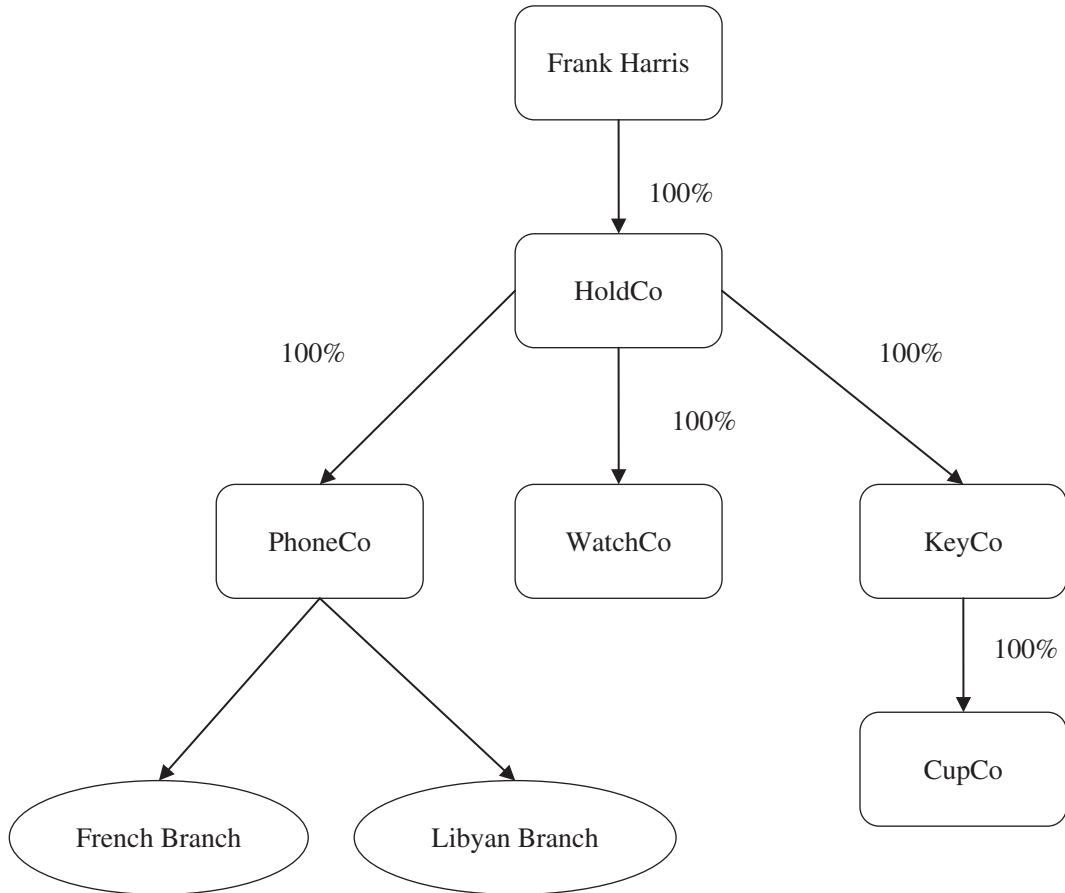
Frank Harris and his group of companies are long-standing clients of your firm. Frank is a director of all of the companies in the group along with his wife.

You meet with the tax partner, Ken Coleman, who is also the engagement partner, on 15 September 2010 for a briefing as Ken wants you to take over the tax compliance and consultancy work that the firm is engaged to handle. He begins by briefing you on the background to Frank and his companies.

Frank owns 100% of HoldCo, which is an Irish incorporated and tax resident company. It does not trade or hold assets other than holding 100% shares in the group as follows:

- Watchco is an Irish incorporated and tax resident company carrying on a manufacturing trade.
- PhoneCo is an Irish incorporated and tax resident company and carries on a trade of retailing phones. PhoneCo has branch operations in France and Libya both of which are profitable.
- KeyCo is an Irish incorporated and tax resident company carrying on a manufacturing trade.
- CupCo is a UK incorporated and tax resident company that holds a valuable investment property in the UK. It is owned 100% by KeyCo.

All of the companies operate a 31 December 2010 year end. The diagram below illustrates the current organisational chart:



Holdco acquired the shares in WatchCo for €10m 13 months ago. The reserves of WatchCo at the date of acquisition were approximately €9m. The reserves have not fluctuated materially since the acquisition. Ken mentions that, during the course of the recent audit, the audit team uncovered irregular transactions by the previous owner of WatchCo which take the form of understated sales and cash payments to employees on which PAYE was not operated.

KeyCo has just entered into an agreement to license a patented invention for an annual royalty of €80,000. The invention is owned by a UK tax resident individual and KeyCo is due to commence making payments to him on 30 November 2010.

The financial controller of PhoneCo wants to ensure that optimal tax relief is reflected in the corporation tax calculation of PhoneCo for the year ended 31 December 2010. The

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financial performance of the foreign branch operations can be summarised as follows (assume all income arises in the branches):

	€ France	€ Libya
Adjusted profits for Irish tax	240,000	300,000
Foreign tax payable	120,000	15,000

Ken also provides you with the following financial overview of the group (*extract from most recently audited accounts – 31 August 2009*):

	WatchCo €	KeyCo €	PhoneCo €	CupCo €
Net trading profits	1,000,000	100,000	500,000	Nil
Net rental income	Nil	Nil	Nil	€150,000
Net trading assets	9,000,000	300,000	4,000,000	Nil
Net investment assets	Nil	Nil	Nil	2,000,000
Turnover	25,000,000	1,000,000	15,000,000	500,000 (rents)
Staff	100	20	50	1

KeyCo has received an offer of €2,000,000 for its 100% shareholding in CupCo; this represents a significant gain for KeyCo as it originally acquired the shares in CupCo for €500,000 in 2004. UK tax advice already taken by the Group indicates that no UK tax will arise on the proposed disposal but the Irish tax issues on the disposal must be established.

While the HoldCo group is doing well, Frank has run into some personal financial difficulties. He purchased a green-field development site in 2005 for €4,000,000 of which €3,500,000 was borrowed by Frank to fund the purchase. He intended to hold the land as a long-term investment. However as Frank is coming under pressure to repay his debts, he decides to arrange for HoldCo to purchase the land from him and the company will assume Frank's debt (€3,500,000) in consideration for the transfer. The property has recently been valued at €1,000,000 but Frank is sure that HoldCo will get its money back as soon as the economy picks up. Ken has identified the CGT, stamp duty and VAT consequences of the proposed transaction but wants you to take another look at the proposal and identify any other tax issues he has not considered.

Frank also intends taking a dividend from the group. HoldCo's reserves will be depleted on proceeding with the plan to purchase Frank's site. Therefore, Frank proposes that WatchCo pay a dividend of €1,000,000 to HoldCo so that HoldCo can pay a matching dividend to Frank.

Requirements:

Prepare a memo to Ken addressing the tax issues relevant to the information discussed during the meeting. Ken has indicated to you that your memo should be supported by appropriate tax legislation, case law references and calculations. Your file note from the meeting summarises the issues which Ken wants addressed as follows:

1. How will tax paid at branch level be treated in the calculation of PhoneCo's corporation tax liability for the year ended 31 December 2010?
10 Marks
 2. What are KeyCo's obligations, if any, in respect of the royalty payments to the UK patent holder?
6 Marks
 3. Provide a tax plan for KeyCo regarding the proposed disposal of shares in CupCo if it accepts the offer of €2,000,000.
20 Marks
 4. Identify and discuss tax issues (6 marks) not already considered by Ken and company law issues (5 marks) on the proposed transfer of the green field site from Frank to Holdco.
11 Marks
 5. What are the key company law considerations in relation to the proposed dividend payment by HoldCo to Frank?
5 Marks
 6. Explain the firm's obligations under the Taxes Acts with regard to the irregularities identified by the audit team while working on WatchCo's audit.
5 Marks
- Commercial awareness **3 Marks**
Total Marks **60 Marks**

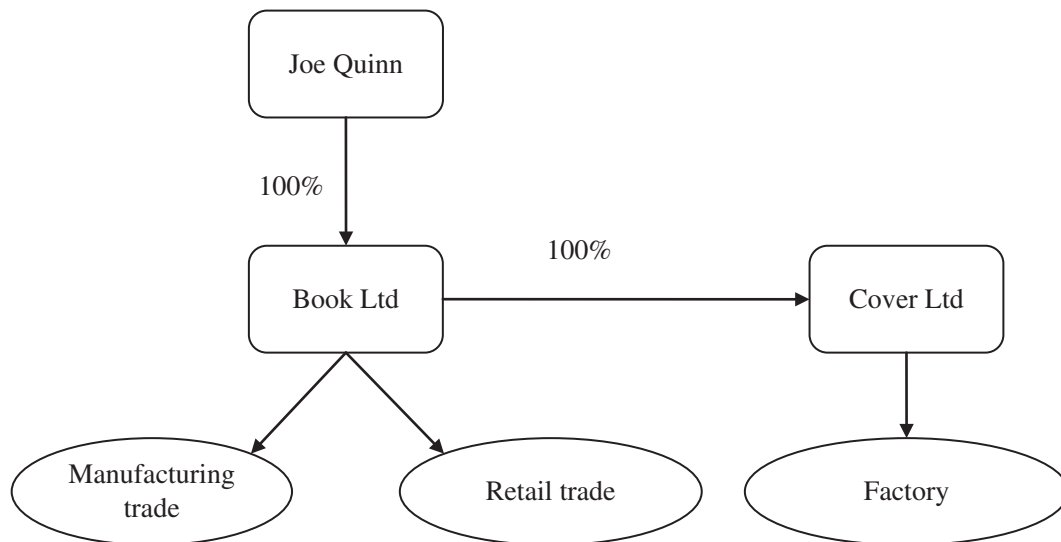
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Section 2

Case Study B: Joe Quinn and Book Ltd Group

60 Marks

You are a tax senior and accompany your tax partner, Mary O'Leary, to meet Joe Quinn, a client of your firm. Joe holds 100% of the shares in Book Ltd, a company that carries on two separate trades, one of manufacturing textiles and the other of retailing clothes. Book Ltd also holds 100% of the shares of Cover Ltd which holds a freehold interest in the factory premises from which Book Ltd carries on its manufacturing trade. The diagram below illustrates the current organisational structure:



Joe has been approached by a large multinational company seeking to purchase the retail trade carried on by Book Ltd. However, the potential purchaser will only undertake a share purchase rather than a purchase of the retail trade from Book Ltd.

Joe is willing to consider a plan of restructuring to accommodate the potential purchaser if it can be done in a tax efficient manner. If restructuring goes ahead, then all of the assets and liabilities of the retail trade along with the employees will be transferred with the retail trade. The net value (assets less liabilities) of the retail trade is €2m, with goodwill making up €650,000 of this value. The distributable reserves of Book Ltd amount to €6m in the company's most recent set of accounts.

Joe wants to receive the proceeds from the sale of the retail trade directly rather than having the funds tied up in a corporate structure.

Following the sale Joe wishes to simplify the corporate structure; he would like to transfer the factory property held by Cover Ltd to Book Ltd. Cover Ltd purchased the factory for €400,000 in 2004. The factory property is currently worth €2m. The consideration for the transfer will be €2m satisfied by way of inter-company debt. Mary has identified the VAT consequences of the proposed transaction but wants you to take another look at the proposal and identify any other tax issues she has not considered.

Following the transfer Joe indicates that he may consider placing Cover Ltd into liquidation and wind up the company; however, there is no pressing urgency on the liquidation.

Joe also holds the entire share capital, and is a director of, a company that is tax resident in the Isle of Man (referred to hereafter as “IOMCo”). The company operates a business of international shipping. The company requires funds for capital expenditure, and Joe is considering arranging for Book Ltd to make an interest-free loan to IOMCo in the amount of €1m. The current net asset value according to the latest balance sheet of Book Ltd is €6.5m.

Book Ltd is currently under Revenue audit. The audit commenced last month and covers the tax years 2007 and 2008 for VAT. A prompted qualifying disclosure was made on behalf of Book Ltd during the opening meeting for tax underpayments in the Careless Behaviour category of tax default for VAT issues in both 2007 and 2008. Up to now, Joe and the Financial Controller have handled the audit as they thought that it would be a relatively straightforward process. The auditor is satisfied that the items disclosed in the opening meeting are correctly calculated and appropriate to the Careless Behaviour category of default. However, during the course of the audit, the auditor has uncovered that PAYE, PRSI and levies totalling €28,800 were not operated by Book Ltd on a bonus of €60,000 paid to Joe in June 2008. Joe returned the bonus in his 2008 personal tax return and took a credit for PAYE, PRSI and levies of €28,800 which now transpires not to have been paid by Book Ltd. Total payroll taxes paid by Book Ltd for tax year 2008 amounted to €150,000.

Joe doesn't know how to deal with these issues and what impact these will have on the prompted voluntary disclosure already made by Book Ltd if additional taxes are due.

Requirements:

Prepare a memo to Mary addressing the tax issues relevant to the information discussed during the meeting. Mary would like your analysis to be supported by appropriate tax legislation, case law references and calculations. Your file note from the meeting summarises the issues which Mary wants addressed as follows:

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1. Recommend a tax plan for the sale of the retail trade which meets the objectives of the purchaser and Joe.
23 Marks
 2. Advise on the company law issues that should be considered if the restructuring proposal goes ahead.
4 Marks
 3. Identify and discuss tax issues not already considered by Mary in relation to the proposed transfer of the property from Cover Ltd to Book Ltd.
8 Marks
 4. Identify the tax implications of the proposal to liquidate Cover Ltd after the property is transferred to Book Ltd and recommend how tax efficiencies can be achieved.
5 Marks
 5. Explain the Irish tax and company law implications of Book Ltd making a loan to IOMCo.
8 Marks
 6. Recommend how to deal with the Revenue Audit issues as described by Joe.
10 Marks
- Commercial awareness **2 Marks**
Total Marks **60 Marks**

Paper 1 Suggested Solution

Section 1

Case Study A: Solution

1. Discuss the Irish tax treatment of Humphrey O'Neill's remuneration package in Ireland.

Humphrey will be tax resident in Ireland for 2010 and 2011 as he will spend more than 183 days in Ireland in 2010 and 2011. It also appears that Humphrey is UK domiciled. On that basis, Humphrey is liable to Irish income tax on his Irish source income and foreign income remitted to Ireland under **section 71(3) TCA 1997**.

While Humphrey's employment with Casco Plc is a foreign contract of employment, he will be liable to PAYE on income attributable to that employment which is exercised in Ireland under **section 985D TCA 1997**. Casco Plc will therefore be obliged to register for PAYE in Ireland and to operate Irish payroll taxes on Humphrey's employment income attributable to his Irish duties.

We are told that approximately €500,000 of Humphrey's salary is attributable to the employment exercised in Ireland. Irish PAYE must also be operated on Benefit in Kind arising on the company car and the private school fees paid by Casco Plc. On the basis that Humphrey is jointly assessed with his wife, the PAYE arising on his employment exercised in Ireland in 2010 is as follows:

BIK on company car	$€150,000 \times 30\% =$	€45,000
Cash value of school fees		€15,000
Salary Attributable to Irish duties		<u>€500,000</u>
Total Salary for PAYE purposes		€560,000
Taxed		
$€45,400 \times 20\% =$		€9,080
$€514,600 \times 41\% =$		<u>€210,986</u>
Total		€220,066

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Tax credits	
PAYE Tax Credit	(€1,830)
Married Persons Tax Credit	<u>(€3,660)</u>
Income Tax	€214,576
Income Levy	
€75,036 × 2% =	€1,500
€99,943 × 4% =	€3,998
€385,021 × 6% =	<u>€23,101</u>
Income Levy total	€28,599
Total income tax and income levy	€243,175

Humphrey can remain on the UK social insurance system and not pay PRSI and Health Contribution in Ireland if Casco Plc secures a Form E101 as he is a temporary assignee between EU member states.

Casco Plc is obliged to register for PAYE in Ireland under **section 985D TCA 1997** and make monthly payments of PAYE to Revenue on a Form P30. If Casco Plc fails to operate PAYE on Humphrey's salary then Casco Ireland Ltd will be held liable for the PAYE as Humphrey will be treated as working for Casco Ireland Ltd.

Humphrey is subject to Irish income tax on foreign income (other than employment income) remitted to Ireland under **section 71(3) TCA 1997**. Therefore, UK rental income will be subject to Irish income tax if remitted into the State. Given that €500,000 of Humphrey's salary will be subject to Irish income tax in any case, he should remit salary rather than rental income to fund his living expenses if he does not have sufficient accumulated capital or savings to meet this cost.

Humphrey should be entitled to claim income tax relief under **section 825B TCA 1997** in relation to his taxable salary as the following conditions are satisfied:

- Humphrey is not Irish domiciled
- He is tax resident in Ireland for 2010
- He was tax resident in the UK (DTA country) before coming to Ireland

Paper 1 Suggested Solution

- He was employed in the UK by the same employer
- He is on assignment in Ireland for more than 12 months and
- He will continue to be paid from the UK.

This means that Humphrey may make a claim that the income tax due on his salary is calculated on the higher of:

- The emoluments earned and received in or remitted to Ireland for 2010 and
- €100,000 plus 50% of the excess of his emoluments over €100,000

The PAYE deducted from Humphrey's salary for 2010 is deemed to be a remittance into Ireland. If Humphrey is unable to supplement his living expenditure in Ireland with income or savings accumulated before 1 January 2010, then the living expenditure of €9,000 per month will be treated as a remittance also. Given the level of remittances required to fund his living expenses, he should remit salary rather than the rent.

Applying the formula, Humphrey may claim relief under **section 825B TCA 1997** so that the Irish income tax due on the salary related to his secondment to Ireland is calculated on the higher of:

- The employment income earned and received in or remitted to Ireland for 2010 (PAYE of €243,175, plus BIKs of €60,000 plus remittances of salary €108,000) = €411,175.
- €100,000 plus 50% of the excess of his employment income over €100,000 (€100,000 plus 50% (€560,000 – €100,000) = €330,000.

Therefore Humphrey would be entitled to claim a refund of the income tax paid on income of €148,825 (€560,000 less €411,175). Humphrey must file an income tax return to make the claim for relief under **section 825B TCA 1997** on his income tax return for 2010.

2. What are the tax consequences of the proposed bonus arrangement with George?

Relief is available under **section 201 TCA 1997** for the payment of ex-gratia termination payments to retiring employees, provided that they are not contractually entitled to such payments. As the bonus of €50,000 is in respect of performance achieved by George during the course of the employment, this will not qualify as a termination payment under the provisions of **section 201 TCA 1997**. Therefore, PAYE must be operated by Casco Ireland Ltd on the payment of the bonus to George.

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Similarly, the proposal that the bonus be exchanged for the company car will not negate Casco Ireland Ltd's obligation to operate PAYE on the bonus. Salary bonuses which are convertible into benefits will fall foul of **section 118B TCA 1997**. Therefore, Casco Ireland Ltd must operate PAYE on the bonus of €50,000. On the basis that George is a top rate taxpayer, PAYE, PRSI, health contribution and income levies arising on the bonus is €28,000 and George will receive a net bonus of €22,000. George can use the after-tax payment to purchase the company car but he must fund the shortfall between the market value and his after-tax bonus himself, otherwise further PAYE could arise on the difference.

Alternatively, Casco could give George an ex-gratia payment qualifying for tax relief under **section 201 TCA 1997** to make up the shortfall to buy the company car.

Under the basic exemption calculation, George can take €18,575 (€10,160 plus €765 × 11).

Under the increased basic exemption method, on foot of advance Revenue approval, George can take a payment of €18,575 plus €10,000 minus any tax-free lump entitlement on retirement.

The Standard Capital Superannuation Benefit method is also subject to a deduction for the tax-free lump sum entitlement on retirement.

George has accumulated a pension fund of €7,560,000. As he is a 5% director, he can take 25% of the accumulated pension fund tax free which amounts to €1,890,000. However, the tax-free lump sum is subject to a limit of 25% of the Standard Fund Threshold as set out in **section 7870 TCA 1997** which amounts to €5,418,085 × 25% = €1,354,521. Any amount of lump sum paid in excess of the limit is liable to tax at the marginal rate of income tax.

On the basis that George will opt to take the tax-free lump sum within the limits of the Standard Fund Threshold, the SCSB claim would be as follows:

$$\text{SCSB} = \frac{€876,666}{15} \times 11 = €642,889 - €1,354,521 = \text{Nil}$$

Given the size of George's tax-free lump sum entitlements from his pension, the increased basic exemption and the SCSB are not available to him.

I recommend that Casco Ireland Ltd make a tax-free ex-gratia payment to George of €18,575 calculated using the basic exemption method, which he can use along with the net of tax

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bonus to fund the purchase of his company car from Casco Ireland Ltd. George could also fund the shortfall himself out of his tax-free pension lump sum. However, any payment by Casco Ireland in excess of the basic exemption is a taxable emolument.

3. Detail how George will be taxed on his pension fund.

George has indicated that he wishes to use 75% of the pension fund net of the lump sum payment to purchase an annuity and the balance then is to be transferred to an ARF. Becoming entitled to drawdown a tax-free lump sum is a Benefit Crystallising Event (BCE) as set out in **section 7870 TCA 1997** and triggers 41% income tax on the excess of the BCE above the remaining Standard Fund Threshold.

Accumulated Fund	€7,560,000
Less Tax-Free Lump Sum	<u>(€1,354,521)</u>
Value of BCE 2010	€6,205,479
Available Standard Fund Threshold	<u>(€4,063,564)</u> (i.e. €5,418,085 – €1,354,521)
Taxable excess	€2,141,915
Taxed at 41%	€878,185

This tax must be collected and returned by the administrator of the pension scheme within three months of the BCE, otherwise George is directly liable for the tax.

A BCE will also take place if the pension rates increase above 5% or, if higher, above the Consumer Price Index plus 2%, which will be taxable at 41% as the Standard Fund Threshold is utilised on the taking of the lump sum payment, purchase of an annuity and transfers to an ARF.

George will be subject to income tax, the health contribution and the income levy on annuity payments and ARF payments. Payroll will be operated on these payments by the pension provider.

4. Advise Casco Ireland Ltd how it should deal with the Revenue Audit issue.

Revenue has issued a notice of a Revenue Audit to Casco Ireland Ltd. As the underpaid tax is less than 15% of the payroll taxes of Casco for each year in question, the company's details will not be published in the Tax Defaulters list under **section 1086 TCA 1997**. However it is still advisable that Casco proceeds with making a prompted qualifying

Stage 3 Integrated Tax

disclosure under the provisions of **section 1077E(1) TCA 1997** for the purposes of maximum penalty mitigation.

We should therefore notify Revenue of the intention to make a Prompted Qualifying Disclosure within 14 days of the audit notification. This will entitle Casco Ireland Ltd to a 60-day postponement of the audit for the purposes of preparing the qualifying disclosure.

Casco Ireland Ltd is aware that a consultant paid gross as a self-employed person should have been subject to PAYE and payroll taxes should have been operated by the company. This individual has actually paid income tax, income levy, PRSI and health contribution through the self-assessment system on these payments. With the exception of employer's PRSI and assuming he did not claim any expenses that were not wholly, exclusively and necessarily incurred in the performance of his duties, there is an argument that no loss of revenue arises to the Exchequer in this case. The 2010 Code of Practice provides a concessionary treatment for No Loss of Revenue in cases of VAT and RCT. We may be able to negotiate with Revenue that the No Loss of Revenue treatment should be extended in this case albeit that the tax-head in question is PAYE as we have evidence that the consultant paid income tax, income levy, PRSI and health contribution through the self-assessment system. The effect of making a successful No Loss of Revenue claim is that the PAYE would not be collected; interest is only payable for the temporary period that the tax was not paid and a significantly mitigated penalty is available.

The employer's PRSI would have to be paid, however, and a No Loss of Revenue claim would not be possible in the settlement of this liability. As this is the company's first prompted qualifying disclosure and the underpayment of tax is less than 15% of the total PAYE liability for the year, the default will be regarded as careless behaviour without significant consequences. Assuming that the outstanding PRSI is settled by February 2010, the calculation of the tax, penalties and interest on the employer's PRSI underpayment would be as follows:

Tax

Employer's PRSI 2006
 $€150,000 \times 10.75\% = €16,125$

Employer's PRSI 2007
 $€150,000 \times 10.75\% = €16,125$

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Interest

Year	Liability	Due date	Date paid	Interest rate to 30/6/2009	Days	Interest rate from 1/7/2009	Days	Interest cost
2006	16,125	15/2/07	15/2/10	0.0322%	866	0.0274%	229	5,508
2007	16,125	15/2/08	15/2/10	0.0322%	501	0.0274%	229	<u>3,613</u>
								9,121

Penalty

Careless behaviour without significant consequences

2006	€16,125 * 10% =	1,612
2007	€16,125 * 10% =	<u>1,612</u>
Total		€3,224

A penalty will also be applied on the tax which should have been collected through the PAYE system but was incorrectly paid through the self-assessment system. The penalty for a first-time offence for No Loss of Revenue under a prompted qualifying disclosure is the lower of 6% of the tax in question or €15,000. Assuming the tax paid under self-assessment is accepted by Revenue as being the amount that should have been deducted through payroll, the penalty for No Loss of Revenue is as follows:

2006

Total taxes paid by consultant	€71,250
6% Penalty	€4,275

2007

Total taxes paid by consultant	€69,750
6% Penalty	€4,185

I recommend that Casco Ireland Ltd make a prompted qualifying disclosure on this basis and pay PRSI totalling €32,250, interest of €9,121 and penalties totalling €11,684 when making the qualifying disclosure.

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5. Detail how the proposed new cloud computing business should be structured from a tax perspective.

Casco Ireland Ltd is a close company under **section 430(1) TCA 1997** as it is an Irish tax resident company under the control of five or fewer participants. It is a close company under the control test as Casco Ireland Ltd is 100% owned by Casco Plc which in turn is controlled by three principals who hold 86% of the voting rights. For the purposes of the control test, Casco Plc is not excluded as a close company even though it is a quoted company as set out in **section 431 TCA 1997** because of the 86% voting power held by the three founders.

Close company rules will impact Casco Ireland Ltd in respect of the interest earned on the proposed funds to be held on deposit in Ireland for the purpose of setting up the new cloud computing trade. Deposit interest will be subject to tax at 25% and will also be subject to a close company surcharge of 20% if Casco Ireland does not pay dividends to its parent company, Casco Plc. However, I note that it is Casco Plc policy not to take group dividends so this option is not viable for the purposes of avoiding the surcharge.

Alternatively, Casco Plc could set up a branch in Ireland and hold the required funds on deposit to finance the operation. While tax of 25% will arise on deposit interest, Casco Plc is excluded as a close company under **section 430(1) TCA** as it is a non-resident company and will therefore not be liable to a 20% surcharge.

If Casco Plc sets up a branch in Ireland, then the losses arising to the branch may be available for offset against Casco Ireland Ltd's taxable profits under the group relief provisions set out in **sections 411 and 420 TCA 1997**. Group relief provisions apply to EU Member State resident companies in respect of activities which are within the charge to Irish tax. Therefore, the losses of an Irish branch of a UK resident company can be offset against the profits of an Irish resident company in the same group as defined under **section 411(1)(c) TCA 1997**.

I recommend that Casco Plc establish the UK tax consequences of operating the new cloud computing business as a branch in Ireland and that double taxation issues be fully explored before making a final decision on how to structure the business.

Based on the information provided, my calculation of the tax consequences of Casco Ireland Ltd carrying on the business compared to Casco Plc setting up the branch is as follows:

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New business undertaken by Casco Ireland Ltd

	25%	12.5%
Cloud Computing Business		
Profit/(loss) before Tax		(5,000,000)
Add: Depreciation		<u>300,000</u>
		(4,700,000)
Less: Capital allowance		<u>(200,000)</u>
		<u>(4,900,000)</u>
Case I loss		(4,900,000)
Casco Ireland Ltd Established Trade		
Profit before Tax		15,000,000
Add: Depreciation		500,000
Deduct: Deposit Interest		<u>(900,000)</u>
Tax adjusted Case I		14,600,000
Less: Capital allowances		<u>(600,000)</u>
Case I income – established business		14,000,000
Less: S.396A loss (current year)		<u>(4,900,000)</u>
		9,100,000
Corporation Tax @ 12.5%		1,137,500
Case III	900,000	
Corporation Tax @ 25%		225,000
Close Company surcharge		
Distributable Investment Income	675,000	
Trading company deduction	7.5%	<u>(50,625)</u>
		624,375
Surcharge	20%	<u>124,875</u>
Total Tax		1,487,375

Stage 3 Integrated Tax

New business undertaken by a branch of Casco Plc

	25%	12.5%
Cloud Computing Business		
Profit/(loss) before Tax		(4,100,000)
Add: Depreciation		300,000
Deduct: Deposit Interest		<u>(900,000)</u>
		(4,700,000)
Less: Capital allowance		<u>(200,000)</u>
		(4,900,000)
Case I loss		<u>(4,900,000)</u>
Case III	900,000	
Corporation Tax @ 25%		225,000
Value base Loss relief	1,800,000	<u>(225,000)</u>
		0
Loss Memo of Casco Plc Branch		
Trading losses		4,900,000
Losses utilized under section 396B		(1,800,000)
Losses surrendered under section 420A		<u>(3,100,000)</u>
		0
Casco Ireland Ltd Established Trade		
Profit before Tax		14,100,000
Add: Depreciation		500,000
		<u>14,600,000</u>
Tax adjusted Case I		(600,000)
Less: Capital allowances		<u>(600,000)</u>
Case I income – established business		14,000,000
Less: S.420A loss (current year)		<u>(3,100,000)</u>
		10,900,000
Total Tax @ 12.5%		1,362,500

Tax saving on using branch of Casco Plc

124,875

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As outlined in these workings, a tax saving of approximately €125,000 arises if the new trade is operated as a branch of Casco Plc rather than Casco Ireland Ltd due to the avoidance of the close company surcharge. Therefore, I recommend that the new trade is operated as a branch of Casco Plc.

END OF MEMO

Stage 3 Integrated Tax

Section 2

Case Study B: Solution

PRIVATE & CONFIDENTIAL

Mr Peter Barry
Oak Land House
Hill View
Skerries
Co Dublin

28 June 2010

Dear Peter

I refer to our recent meeting and subsequent correspondence. You have asked me to advise you on a number of matters which I deal with hereunder.

1. Provide a tax plan to Peter and Brian on the proposed transfer of assets which meets both of their objectives.

The proposal to transfer the shares and land from you to Brian will give rise to a potential CGT liability for you on the disposal of your assets and CAT and Stamp Duty liabilities for Brian on taking a gift of these assets. You both wish to structure the transfers in a manner which maximises available tax reliefs and allows you to continue working in the company. I now set out a tax plan and discuss available tax reliefs under each tax head triggered by the transfers.

Gift of farm and shares in FarmCo to Brian – CGT

The provisions of **section 547(4) TCA 1997** will apply to the gift from you to Brian by deeming you to have received proceeds equal to the market value of the assets disposed of. Therefore, a potential CGT liability is triggered on the disposal of 50% of the farm land and shares in FarmCo to Brian.

However, retirement relief may be available to remove or significantly reduce any CGT arising, under the provisions of **section 598** and **section 599 TCA 1997**. **Section 598**

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TCA 1997 deals with disposals to third parties while **section 599 TCA 1997** deals with disposals to children.

I note that you claimed retirement relief in 2008 on the sale of sites for €600,000. Relief on this disposal was available under **section 598 TCA 1997** and will not preclude you from claiming retirement relief under **section 599 TCA 1997** on proposed transfers to Brian provided all conditions relating to the relief are fulfilled.

There is no upper limit on the amount of proceeds that can be sheltered from CGT on the disposal to Brian as he is your child. Although the relief is titled “retirement relief”, retirement is not a condition for the relief, thus you can remain as a director of FarmCo and continue to work on the farm.

In relation to the shares in FarmCo, the following conditions must be satisfied in order for relief to be available:

- You must have attained the age of 55 years at the date of disposal;
- You must have held the shares in FarmCo for not less than 10 years ending with the disposal;
- FarmCo must be your “family company” (i.e. you must exercise at least 25% of the voting rights or your family exercises 75% of the voting rights and you exercise not less than 10%);
- FarmCo must be a trading or farming company;
- You must have been a working director of FarmCo for 10 years and a full-time working director for a period of not less than 5 years.
- The disposal must be for bona fide commercial purposes and not for tax avoidance reasons.

All of the above conditions would appear to be satisfied in your case.

The farm land also qualifies for relief under subsection (ii) of the definition of “qualifying assets” in **section 598 (1)(a) TCA 1997** as the land has been owned by you for at least 10 years ending with the disposal, the land has been used throughout that period by the family company, FarmCo, and is to be disposed of at the same time and to the same person as the shares concerned.

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Brian is only 25 years of age and, although he is interested in farming at the moment, this may not always be the case. **Section 599(4)(a) TCA 1997** provides that retirement relief can be clawed back if the child in question disposes of the asset that they received from their parent within 6 years of the disposal. The CGT that is clawed back is assessed on the child; however, the tax due is the amount of CGT that the parent would have been subject to had retirement relief not been available to shelter the disposal. In addition, CGT would be assessed as normal on Brian on the gain accruing for his period of ownership in such a scenario. The potential clawback may be sheltered by retirement relief under **section 598 TCA 1997**; however, as you have used €600,000 of the lifetime threshold of €750,000 on the disposal of the sites in 2008, this provision will be of limited relevance to you on a future clawback of relief under **section 599 TCA 1997**. We can examine this further if Brian decides to dispose of the land within the 6-year holding period.

Section 598(4) TCA 1997 deals with the calculation of relief on share disposals and the calculation below illustrates the position for you on a disposal of shares in FarmCo to Brian.

Step 1 – calculate the gain arising

The deemed proceeds of sale are €300,000 with €1 base cost; therefore the gain is €299,999, ignoring indexation.

Step 2 – compute the proportion of relief due

The chargeable business assets of the company are:

Plant and Machinery	€500,000 (qualifying asset)
Investments	€50,000 (non-qualifying asset)
Total	€550,000

The government stocks are not a chargeable asset as they are exempt from CGT. Cash, debtors and stock are also not chargeable assets as their disposal would be within the scope of CGT. Therefore the proportion of the value of the company attributable to qualifying assets due is as follows:

$$€300,000 \times \frac{€500,000}{€550,000} = €272,727$$

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Step 3 – compute gain relieved from tax

The gain which is relieved from tax is calculated as follows:

$$€299,999 \times \frac{€272,727}{€300,000} = €272,726$$

Step 4 – tax the remaining gain

The taxable gain is €299,999 – €272,726 = €27,273.

This gain would be subject to CGT at 25% = €6,818 (note that annual exemption is not available in the year in which retirement relief is claimed).

The disposal of the land should be completely exempt from CGT. Therefore, the total CGT arising on the transfer to Brian on claiming retirement relief amounts to €6,818.

If the investment assets were converted into cash on foot of a disposal prior to the gift of shares and it was successfully argued that the cash is required for working capital trading purposes the dilutive effect on the relief would be removed and CGT would be reduced to nil. You would first have to confirm the tax effects of liquidating the investment assets, however, to see whether this would be appropriate.

Section 980 TCA 1997 contains provisions which require tax clearance (known as CG50 Clearance) be put in place in order to avoid the obligation on the vendor to withhold 15% of the consideration on disposals of specified assets where the consideration or market value exceeds €500,000. While the market value of the land transferring to Brian is €1,500,000, the provisions of **section 980 TCA 1997** will not apply because only actual consideration paid is relevant for this section which will be zero in your proposed scenario.

Stamp duty

A potential stamp duty liability will arise for Brian on the conveyance of the farm land and shares, which attract stamp duty at 6% and 1% respectively.

A gift is charged to stamp duty as if it were a conveyance on sale based on the market value of the property as set out under **section 30 SDCA 1999**. In this case, the deemed consideration for the land will be €1,500,000 and the deemed consideration for the shares will be €300,000.

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Unfortunately a valuable relief from stamp duty known as Young Trained Farmers Relief is not available to Brian on the transfer of the farmland. Brian will not satisfy the condition as required by **section 81AA SDCA 1999** which requires him rather than FarmCo to spend more than 50% of his normal working time farming the land for at least five years from the date of transfer. As Brian will rent the land in question to FarmCo, it is FarmCo that will farm the land, not Brian.

Consanguinity relief as provided for in **paragraph 15 of schedule 1 SDCA 1999** should be available to reduce the amount of stamp duty arising on the transfer of the land from 6% to 3%. The deed of transfer must be submitted to Revenue for adjudication. This relief applies on transfers between blood relatives and as Brian is your son this condition will be satisfied. The relief does not apply on transfers of shares. The total duty arising for Brian will be as follows:

Land – €1,500,000 * 3% = €45,000

Shares – €300,000 * 1% = €3,000

CAT Reliefs

The receipt of a gift of shares in FarmCo and the farm by Brian would be regarded as a taxable gift and thus CAT should be considered. Business relief and/or agricultural relief may be available on the gifts to provide some element of relief from CAT to Brian.

Agricultural Relief:

Brian cannot claim agricultural relief from CAT on the gift of the farm land or shares in FarmCo. The shares in FarmCo do not qualify for agricultural relief as these assets are not included in the definition of agricultural assets as set out in **section 89(1)(a) CATCA 2003**. Brian will not qualify for agricultural relief on the transfer of the land as he appears to fail to pass the 80% farmer test set out in **section 89(1) CATCA 2003**.

In order to qualify as a farmer for the purposes of the relief, 80% of an individual's gross assets must include agricultural property on taking a gift/inheritance of agricultural property. The beneficiary may only deduct any mortgage that relates to their principal private residence from the value of their home for the purposes of the farmer test but in Brian's case this still does not qualify him as a farmer:

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Agricultural Assets

Farm Land	€1,500,000
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Non-Agricultural Assets

Shares in FarmCo	€300,000
Rental Property	€330,000
Car	€22,000
Equity in PPR	<u>€25,000</u>
	€677,000

$$\frac{€1,500,000}{€2,177,000} \times 100\% = 69\%$$

Business Relief:

In circumstances where Agricultural Relief is not available, Business Relief may still apply to reduce the CAT liability arising on a transfer of qualifying assets. **Section 93(1)(b)-(f) CATCA 2003** provides that unquoted shares in a company carrying on a business can qualify for relief from CAT. Similar to the treatment under retirement relief, Brian may also qualify for Business Relief under **section 93(1)(e) CATCA 2003** on land used by the company and transferred at the same time as the shares to the same beneficiary.

FarmCo carries on a farming enterprise; the term “business” is not defined, rather one must examine relevant case law to determine what constitutes a business. In *Smith vs Anderson (1880) 15 ChD 258*, Jessel MR gave a general definition of the word business: “anything which occupies the time and attention and labour of a man for the purpose of profit”. FarmCo is carrying out its farming activities with a view to realising a profit, thus FarmCo should be regarded as carrying on a business.

For the shares to qualify for relief, the beneficiary must satisfy one of three conditions; the first condition is that the beneficiary must control more than 25% of the voting rights of the company after taking the gift. Alternatively, the relief could be availed of if the beneficiary controlled the company with his or her relatives or if he or she owned at least 10% of all shares and securities issued by the company and had worked full-time in the company for the previous 5 years. As Brian will hold 50% of the ordinary share capital of the company he will satisfy the first condition. Once this condition is satisfied there is no need to examine the other two conditions.

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For the shares to be eligible for business relief in the case of a gift, the disponer must have held the shares for five years prior to the gift as set out in **section 94 CATCA 2003**. As you have held the shares in FarmCo for 25 years this condition should be satisfied.

Certain assets held by a company are regarded as “excepted assets” and the value attributable to them is not available for relief as stated in **section 100 CATCA 2003**. An excepted asset is an asset that was not used wholly or mainly for the purpose of the business for the last two years or five years, depending on the benefit. In this case the excepted assets held by FarmCo are the quoted shares and government stocks.

Business Relief is calculated as follows:

Gift of farm land	€1,500,000
Gift of FarmCo shares	<u>€300,000</u>
Total value of Benefit	€1,800,000
Less Liabilities Expenses Costs	
Stamp Duty	(48,000)
Taxable Value	€1,752,000
Less value attributable to excepted assets	<u>(70,000)</u>
Taxable value eligible for relief	1,682,000
Business Relief	<u>(1,513,800)</u>
	168,200
Add back excepted assets	<u>€70,000</u>
Total Taxable Value	238,200
Less Small Gift Exemption	<u>(3,000)</u>
Total Current Benefit	€235,200
Aggregate Prior Group A gifts	€397,000
Less Group A Threshold	<u>(414,799)</u>
Taxable Excess	€217,401
Taxed at 25%	€54,350
Less CGT arising on the same benefit	<u>(6,818)</u>
Net CAT due	€47,532

Section 101 CATCA 2003 provides for a clawback of business relief where the asset received (in this case shares in FarmCo and the land) is disposed of within the period

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of six years after the date of the gift. Relief can be maintained where a re-investment in qualifying assets is made within one year of the disposal.

2. Advise Peter of your views on the cash extraction scheme based on the information provided.

You have been approached by an advisor offering a cash extraction scheme for use with FarmCo. I am concerned that the scheme could be regarded as a tax-avoidance scheme. There is specific anti-avoidance legislation and general anti-avoidance legislation which could be enacted by Revenue to challenge this scheme. Specific anti-avoidance is provided for under **section 817 TCA 1997**. If, after a disposal or deemed disposal of shares, the shareholder's interest is not substantially reduced, then **section 817 TCA 1997** may tax the proceeds as Schedule F, which is subject to income tax rather than CGT tax rates, unless it can be demonstrated that the transaction was for bona fide commercial purposes and not part of a tax-avoidance scheme.

If the scheme does not fall within the ambit of specific anti-avoidance then Revenue could utilise general anti-avoidance legislation under **section 811 TCA 1997** to challenge the scheme. Where Revenue successfully challenge a scheme it has various powers to remove the tax advantage from a transaction, giving rise to a tax liability on the part of the taxpayer along with possible interest and penalties.

For a transaction not to be classified as a "tax-avoidance transaction" the transaction must be undertaken or arranged primarily for purposes other than to give rise to a tax advantage or to obtain the benefit of a tax relief (and that benefit does not amount to a misuse/abuse of the relief). It is generally accepted that some entirely commercial transactions properly structured may give rise to a tax advantage. In this case the scheme would appear to lack commercial substance so an element of risk must be factored into your decision-making process.

Revenue can open an enquiry or take action at any time in connection with **section 811 TCA 1997**.

The Revenue Commissioners vs O'Flynn Construction Co Ltd, John O'Flynn and Michael O'Flynn is the only court case that deals with **section 811 TCA 1997**. This case is very different from what has been proposed to you; the points worth noting are that the High Court found in favour of Revenue and that an appeal to the Supreme Court was taken by the taxpayer, the verdict of the case has yet to be issued.

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Section 811A TCA 1997 provides that, where the Revenue opinion that a transaction is a tax avoidance transaction becomes final, interest and a 20% surcharge will be payable on the tax that the taxpayer unsuccessfully attempted to avoid paying, unless the taxpayer makes a protective notification to Revenue within 90 days of beginning a transaction. In such circumstances, the taxpayer can obtain protection from the possibility of such interest or surcharge arising should Revenue challenge the transaction successfully. The notification is taken on a wholly non-prejudicial basis.

An incentive to make such a notification is that Revenue must form an opinion that a transaction is a tax avoidance transaction under **section 811A TCA 1997** within two years from the date of the notification. Where a notice is not made Revenue can form an opinion under **section 811 TCA 1997** at any time.

Where a taxpayer takes an appeal against a Revenue opinion under **section 811 TCA 1997** and a protective notification has not been made, the Appeal Commissioners (and the Courts) are required to determine the appeal on the basis of whether there were grounds on which the transaction could reasonably be considered to be a tax-avoidance transaction. This lowers the bar for a ruling against the taxpayer from the position of having to hold that the transaction is a tax-avoidance transaction where a protective notification has been made.

It is also worth noting that a new mandatory reporting requirement under **section 817D TCA 1997** has been introduced in Finance Act 2010; this will require promoters of certain tax schemes to report the workings of the scheme to Revenue along with the details of any clients that have implemented the tax-avoidance scheme. Revenue may then decide to challenge the scheme if it is unacceptable to them.

The apparent lack of commercial purpose to the scheme, as outlined briefly by you, suggests that the anti-avoidance legislation and associated disclosure requirements should be examined closely before you contemplate proceeding with such a scheme.

I require further details of the scheme to confirm the exact anti-avoidance measures you risk on entering into this scheme.

3. Explain the VAT treatment of the 12-month lease of the Rathgar property.

You have an existing waiver of exemption to charge VAT on short-term lettings. A new waiver of exemption cannot commence on or after 1 July 2008 following changes to VAT

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on property law as per **section 7B VATA 1972**. An existing waiver of exemption does not extend to a property acquired or developed on or after 1 July 2008. However, development carried out in completing a commercial development that was underway on 18 February 2008 by or on behalf of the person who exercised a waiver on or before 18 February 2008, does not prevent the extension of that waiver to the property. In this case you commenced the development prior to 18 February 2008 and completed it in December 2010. Your waiver of exemption will apply to the property that you are to let. I suggest that you make it clear to the tenant that VAT will apply on the rents.

4. What books and records do you recommend that Peter should retain for tax purposes?

Section 886 TCA 1997 provides for the rules relating to the keeping of books and records. As FarmCo is carrying on a farming activity subject to tax under Schedule D it must keep proper books and records so that correct returns of income may be made.

The definition of “records” includes accounts, books of account, documents or any other data maintained manually or by electronic means, relating to:

- Sums of money received and spent during the course of business
- All sales and purchases of goods and services
- The assets and liabilities of the business
- The acquisition and disposal of assets that would be subject to CGT

Linking documents (which show details of the calculations linking records to accounts) must be kept and all records must be maintained on a continuous and consistent basis.

Records must be kept for a period of 6 years after the completion of the relevant transactions or operations or a lesser period if agreed with Revenue. However, records must be kept for a greater period if the company has failed to make a return of income (in which case the time limit expires 6 years after the end of the year of assessment or accounting period in which the return is actually made).

All records relating to VAT transactions must be retained for six years from the date of the latest transaction to which the VAT record relates. For pre-1 July 2008 property transactions, records must be retained for the duration of the VATable interest in the property or the waiver of exemption, plus another six years.

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A penalty of €3,000 applies for non-compliance with the provisions of this **section 886 TCA 1997**.

Therefore, assuming that you and FarmCo have made full and complete returns of your income, you are only required to retain information relating to transactions, acts or operations which were completed in the last six years. However you must retain pre-1 July 2008 VAT on property-related documentation for the period in which you hold the VATable interest in the property in question plus six years.

5. What are the legal implications of Peter's plans to leave all his assets to Brian?

You have yet to make a will, however you wish to leave all of your remaining assets to your son, Brian, as you feel Deirdre will have sufficient assets in her own right to live comfortably. If Deirdre is dissatisfied with the provision you have made for her in your will she can seek what is known as her "legal right share".

Section 111 of the Succession Act 1965 provides that if you die and leave a spouse and children, your spouse shall have a right to one-third of the estate. The priority of this "legal right share" is protected under **section 112** of the Act.

The spouse does not have to go to Court to get their legal right share. The Executor is obliged to notify Deirdre of her right to this share. She can choose to take either the assets specified under the Will or the legal right share. The Executors must inform her in writing of her right to choose between these two options and she must exercise this right within 6 months of receipt of notification or within 12 months of the taking out of the Grant of Representation, whichever is later.

If you fail to make a will before you die, **Part VI of the Succession Act 1965** provides the rules which apply to the distribution of your estate. **Section 66 of the Succession Act 1965** details that all of the debts and liabilities of the deceased are to be discharged, followed by payment of any legal right share due to a surviving spouse.

Section 67 of the Succession Act 1965 directs that, if the intestate dies leaving a spouse and no children, the spouse is to take his whole estate. If the intestate leaves a spouse and children, then the spouse is to take two-thirds, and the remaining one-third is to be distributed amongst the children. If you were to die intestate, two-thirds of your estate

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would pass to your wife, while one-third would pass to Brian. This would mean that Brian would not receive the assets in the way that you wish.

You should consult your solicitor for advice to fully explore the potential issues.

I trust that you find the foregoing to your satisfaction. I would be glad to discuss any queries you may have in further detail. Please contact me once you have had time to consider these matters and we can arrange to meet and discuss them in further detail.

Yours sincerely

Brendan Ashe
Chartered Tax Consultant
DEF Chartered Accountants & Co

Stage 3 Integrated Tax

Paper 2 Suggested Solution

Section 1

Case Study A: Solution

Memo

To: Ken Coleman

From: Barry Murphy

Date: 20 September 2010

Re: Frank Harris and his group of companies – tax and legal issues

1. Provide advice on how foreign tax paid at branch level will be treated in the calculation of PhoneCo's corporation tax liability for the year ended 31 December 2010.

Ireland has a double taxation agreement in place with France while no double taxation agreement is in place with Libya. The tax suffered by the French branch will be eligible for treaty relief. The tax suffered by the Libyan branch will be eligible for unilateral relief in accordance with **Paragraph 9DA, schedule 24 TCA 1997**. Relief is available on the basis that the income of PhoneCo is subject to tax in Ireland under Case I of Schedule D.

The provisions of **Paragraph 9FA Schedule 24 TCA 1997** cater for the situation where a company has branches in a number of jurisdictions and allow for a pooling of foreign tax on branch profits. The total of the foreign tax that has not been credited against the Irish tax may, in the pooling computation, be taken as a credit against the aggregate Irish tax payable on foreign branch profits. The computation is as follows:

Branch foreign tax credit relief and pooling	France	Libya
	€	€
Adjusted profits for Irish tax before foreign tax deduction	240,000	300,000
Foreign tax payable	120,000	15,000
Foreign effective rate	50%	5%

Paper 2 Suggested Solution

Branch treaty relief

Branch net income – treaty country	120,000
Gross up at lower rate	137,143
Irish tax at 12.5%	17,143
Foreign tax incurred	<u>120,000</u>
Irish tax payable	0
Excess Foreign Tax	102,857

Branch unilateral relief

Branch income (net foreign income grossed up at lower rate)	300,000
Irish tax at 12.5%	37,500
Unilateral relief	<u>(15,000)</u>
Irish tax payable	22,500

Pooling computation

Deductible foreign tax	102,857
Unrelieved foreign tax at 87.5%	90,000
Allocate against tax on other branch income	<u>(22,500)</u> <u>(22,500)</u>
Pooling credit available for carry forward	67,500
Tax Payable	Nil

The excess unrelieved foreign credit of €67,500 is carried forward and becomes part of the unrelieved foreign tax for the subsequent period as provided by **Paragraph 9FA(4) Schedule 24 TCA 1997**.

2. What are KeyCo's obligations in respect of the royalty payments?

KeyCo is obliged under **section 237(2) TCA 1997** to apply withholding tax at 20% on annual royalties paid to the UK resident individual. However, under the terms of Article 13 of the Ireland/UK Double Tax Treaty, royalties paid by a resident of one state to a resident of the other state are taxable only in the country of residence of the recipient.

The Ireland/UK Double Tax Treaty therefore overrides the provisions of **section 237(2) TCA 1997** and KeyCo does not have to apply withholding tax on the payments. The company must obtain clearance from Revenue before it can proceed with making payments without deduction of withholding tax. This means that KeyCo must have a Form IC7 (Individual) completed by the UK recipient of the royalty and then submit this form to Revenue. As the first payment is due in November, I recommend that KeyCo starts getting clearance in place as soon as possible.

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3. Provide a tax plan for KeyCo regarding the proposed disposal of shares in CupCo if it accepts the offer of €2,000,000.

KeyCo has received an offer of €2,000,000 for its shares in CupCo; the base cost of the shares is €500,000 and a significant chargeable gain will arise. CupCo is a UK incorporated and tax resident company. It will be necessary to examine the Irish/UK Double Tax Treaty to determine which country has the right to tax the transaction.

Article 14 of the Ireland/UK Double Tax Treaty deals with the taxation of capital gains. The DTA provides that where a company derives its value from UK immovable property (as is the case with CupCo) the gain may be taxed in the UK. This means that the sale by KeyCo would be potentially subject to tax in the UK and credit relief would be available in Ireland for any UK tax paid. I understand that, under domestic UK tax legislation, a charge to UK tax would not arise and thus only a liability to Irish corporation tax on chargeable gains would arise.

It then falls to be considered whether relief from chargeable gains as provided by **section 626B TCA 1997** would be available to KeyCo on the disposal of shares in CupCo.

The main conditions for relief are (the investor company is KeyCo, the investee is CupCo):

- The investor company is a parent of the investee company at the time of disposal or was a parent within the two-year period prior to the disposal.
- The investee company must be resident in an EU Member State or a country with which Ireland has a tax treaty.
- The investee company's business consists wholly or mainly of the carrying on a trade or trades, or
- The business of the investor company, each company of which the investor company is the parent, the investee company (if the investor company is not its parent) and any company of which the investee company is the parent company, taken together consists wholly or mainly of the carrying on of a trade or trades.

The first two conditions above are satisfied. KeyCo has held 100% of the ordinary share capital in CupCo since 2004 and CupCo is UK tax resident (i.e resident in an EU member state). With regard to the third and fourth conditions, CupCo is not carrying on a trade, it is carrying on a business of a property rental company. Because of this, for relief under **section 626B TCA 1997** to be available, KeyCo and CupCo together or aggregated must represent a wholly or mainly "trading group".

Paper 2 Suggested Solution

“Wholly or mainly” is taken to mean greater than 50%. The Revenue Commissioners outlined in Tax Briefing 66 that it would take into account the following factors when considering whether the wholly or mainly test is satisfied:

- the proportion of net trading profits
- the proportion of net trading assets
- trading turnover as a proportion of gross receipts
- the proportion of employees’ time devoted to trading and non-trading activities

The first two tests outlined above are regarded as the primary tests with a lower weighting attributed to the other tests. It is important to note that, when considering the above tests, intra-group transactions are excluded.

Based on the financial information provided, KeyCo and CupCo when taken together do not constitute wholly or mainly a “trading group” based on the following aggregate trading test:

Profits Test	Trading	Non-Trading	Total
KeyCo	100,000	–	100,000
CupCo	<u>–</u>	<u>150,000</u>	<u>150,000</u>
	40%	60%	250,000

Assets Test	Trading	Non-Trading	Total
KeyCo	300,000	–	300,000
CupCo	<u>–</u>	<u>2,000,000</u>	<u>2,000,000</u>
	13%	87%	2,300,000

It can be taken from this that relief under **section 626B TCA 1997** would not be available if KeyCo were to dispose of CupCo. The gain on the sale would amount to €1,500,000 and a tax liability of €375,000 would arise on the sale.

It is worth considering transferring the shares in CupCo from KeyCo to HoldCo in order for HoldCo to avail of relief under **section 626B TCA 1997**. The provisions of **section 617 TCA 1997** would apply to relieve any charge to corporation tax on chargeable gains on the transfer and HoldCo would take on KeyCo’s base cost and date of acquisition of the shares. HoldCo should qualify as a “parent company” of CupCo by virtue of **schedule 25A TCA 1997**. Under **section 626B TCA 1997** a company is only a parent company at any time if that time falls within an uninterrupted period of at least 12 months throughout which it directly or indirectly holds at least 5% of the company’s ordinary share capital, is

Stage 3 Integrated Tax

beneficially entitled to at least 5% of the assets on a winding up or would be beneficially entitled to at least 5% of the assets available for distribution. **Para 1 of Schedule 25A TCA 1997** provides that, in the context of the no gain/no loss section 617 transfer, the period for which shares were held by HoldCo would be extended by the earlier holding period of KeyCo for this purpose.

HoldCo and all of the companies of which it is a parent company should when taken together constitute wholly or mainly a trading group as the net profit levels and net asset levels, turnover and staff numbers attributable to the activities of WatchCo, PhoneCo and KeyCo outweigh the net rental profits and net investment assets etc., held by CupCo.

Profits Test	Trading	Non-Trading	Total
WatchCo	1,000,000		1,000,000
PhoneCo	500,000		500,000
KeyCo	100,000	–	100,000
CupCo	<u>–</u>	<u>150,000</u>	<u>150,000</u>
	91%	9%	1,750,000

Assets Test	Trading	Non-Trading	Total
WatchCo	9,000,000		9,000,000
PhoneCo	4,000,000		4,000,000
KeyCo	300,000		300,000
CupCo	<u>–</u>	<u>2,000,000</u>	<u>2,000,000</u>
	87%	13%	15,300,000

Relief from Irish stamp duty on the share transfer of shares in CupCo from KeyCo to HoldCo should be available under **section 79 SDCA 1999**. The UK tax consequences of the proposal require further investigation; however, the potential tax saving of €375,000 may merit further work.

4. Identify and discuss tax issues not already considered by Ken and company law issues on the proposed transfer of the green field site from Frank to Holdco.

Tax issues

It is proposed that HoldCo purchase the land from Frank, the consideration for the transfer will be that HoldCo assumes the entire of Frank's debt (€3,500,000). Clearly HoldCo is purchasing the property from Frank at above market value.

Paper 2 Suggested Solution

Section 130(3)(a) TCA 1997 provides that a transfer of assets for overvalue from a shareholder to a company is treated as a distribution. The quantum of the distribution would be the excess of the consideration given over the value of the property acquired.

As the property is being transferred by Frank to the company and the consideration given by the company exceeds the value of the property, HoldCo will be regarded as making a distribution to Frank of the difference (i.e. €2,500,000). As a result Frank will be subject to income tax on €2,500,000.

HoldCo will be obliged to operate Dividend Withholding Tax (DWT) on the distribution to Frank. As the consideration is in a non-monetary form, then prima facie deduction of DWT is not possible. However, **section 172B(3) TCA 1997** provides that in such circumstances, the recipient receives the “gross” distribution but the company must pay to the Collector General an amount (which is treated as a deduction of DWT) equal to the DWT which would have been required to be deducted from the distribution had it been a cash distribution (in this case €2,500,000*20%). The company is entitled to recover that amount from the recipient of the distribution as a simple contract debt. In this case HoldCo would be obliged to pay over DWT of €500,000, Frank could claim a tax credit of €500,000 on his income tax return and Frank would owe HoldCo a contract debt of €500,000.

HoldCo must submit a DWT declaration along with payment of €500,000 through ROS by the 14th day of the month following the month in which the deemed distribution (i.e. the transfer of the land at overvalue) is paid as per **section 172K(1) TCA 1997**. Frank is obliged to return the deemed distribution in his personal income tax return and pay additional tax owing as part of his income tax obligations for the year in question.

Section 589 TCA 1997 will also apply. This anti-avoidance provision operates to reduce the base cost of Frank’s shares in HoldCo. The extent of the reduction is the shortfall between the market value of the asset and the value at which it is transferred.

Company law issues

Directors of a company are required at all times to act in the best interests of the company. Even though the company itself is an artificial legal personality, the duty is still owed to the company, not to the shareholders or creditors of the company, though some duties to creditors and shareholders are imposed. It is difficult to see the benefit to the company from taking on the property and associated debt from Frank and this should be investigated further and legal advice taken.

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To provide protection to shareholders against the abuse of power by a company's directors **section 29 of the Companies Act 1990** provides that a company cannot enter into any arrangement with a director of the company where the company is to acquire a non-cash asset from a director, unless the arrangement is first approved by a resolution passed at a meeting of the company's shareholders.

A transaction entered into in contravention of the above requirement is generally voidable at the instance of the company. The company can cancel the transaction with certain limited exceptions.

Where an arrangement which breaches **section 29 of the Companies Act 1990** is entered into by a director, that director along with any other director of the company who authorised the arrangement is liable to:

- account to the company for any gain made directly or indirectly as a result of the arrangement, and
- indemnify the company for any loss or damage suffered as a result of the arrangement unless the director can show that he took all reasonable steps to secure the company's compliance with the section, or the connected person can show that, at the time the arrangement was entered into, he did not know that the arrangement constituted a breach of the section.

It should be noted that a director's liability as set out above continues to exist irrespective of whether or not the company has elected to void the transaction.

5. What are the key company law considerations in relation to the proposed dividend payment by HoldCo to Frank?

It is proposed that first WatchCo pay a dividend of €1m to HoldCo and that HoldCo pay a dividend of €1m to Frank. However, HoldCo acquired the shares in WatchCo 13 months ago when its reserves were approximately €9m and we are told that the reserves have not fluctuated materially since the acquisition. It is important to be cognisant of the provisions of **section 149 Companies Act 1963** which prevents the distribution of pre-acquisition profits. **Section 149(5) Companies Act 1963** will prevent the distribution by HoldCo of pre-acquisition profits of WatchCo to Frank, unless the company's auditors and directors are willing to certify the reserves as distributable.

Paper 2 Suggested Solution

6. Explain the firm's obligations under the Taxes Acts with regard to the irregularities identified by the audit team while working on WatchCo's audit.

Section 1079 TCA 1997 provides that all auditors and tax advisors who become aware in the course of their normal work of material tax evasion or non-compliance committed by a client company must report this to the company and request that the matter be rectified or that the company should report the offence to Revenue.

It further provides that if, at the end of 6 months, it is not established to the satisfaction of the auditor or advisor that the matter has been so rectified or reported, the auditor or advisor must cease to act as auditor, or cease to assist or advise the company in tax matters, for a period of either 3 years from the date of the (auditor/advisor's) report to the company or until the auditor or advisor is satisfied that the matter had been rectified or reported, whichever is the earlier. Any resignation under this section must also be reported to Revenue.

The list of reportable offences all relate to serious tax evasion. The question of whether there is material tax evasion is a matter for the auditor or advisor in any particular case to assess. The advisor must take account of their own professional standards and the requirements of the section.

Substantial penalties exist for breaches of this section including, on summary conviction, a fine of up to €1,265 and, on conviction on indictment, a fine of up to €6,345 or imprisonment for up to 2 years or both.

We need to discuss this matter in further detail with the client and we must establish if the irregularities constitute tax evasion. The warranties and indemnities provided on the acquisition of WatchCo must also be carefully examined to establish HoldCo's recourse to the previous shareholders for compensation for tax, interest and penalties arising from these irregularities.

END OF MEMO

Stage 3 Integrated Tax

Section 2

Case Study B: Solution

Note: Corporation tax on chargeable gains and capital gains tax are referred to hereafter as “CGT”.

Memo

To: Tax Partner, Mary O’Leary

Re: Joe Quinn and his group of companies

From: Lisa Lynch

Date: 30 July 2010

Re: Joe Quinn and Book Ltd

1. Recommend a tax plan for the sale of the retail trade which meets the objectives of the purchaser and Joe.

The purchaser wishes to purchase the retail trade of Book Ltd but will only undertake a share purchase. Joe is willing to proceed with the restructuring if it can be carried out in a tax efficient manner. He also wishes to receive the proceeds of the sale of the retail trade in his personal capacity. In order to achieve these goals the following restructuring could be implemented:

1. Joe incorporates NewCo (an Irish tax resident company) holding the incorporation shares in the company;
2. Book Ltd hives out its retail trade to NewCo;
3. The consideration for the transfer of the retail trade is the issue of shares in NewCo to the holder of shares in Book Ltd (i.e. Joe) (this is known as a three-party share for undertaking exchange);
4. Joe would then dispose of the shares in NewCo to the purchaser.

There are a number of tax reliefs available for taxes that may arise on the transfer. It may be possible to get a pre-transaction opinion from Revenue in relation to the availability of these reliefs.

CGT implications

CGT implications for Book Ltd & NewCo

The hive out of the retail trade to NewCo prima facie is a disposal chargeable to CGT under **section 28 TCA 1997** for Book Ltd. Although Book Ltd has not received the entire consideration for the disposal of the trade assets (it has received consideration in the form of the assumption of trade debts by NewCo), as the transaction is not a bargain made at arm's length, the provisions of **section 547(4) TCA 1997** will apply to deem Book Ltd to have received consideration for the disposal equal to the market value of the assets. However, relief from CGT should be available by virtue of the provisions of **section 615 TCA 1997**.

Section 615 TCA 1997 applies to the transfer of the whole or part of a "business" under a "scheme of reconstruction or amalgamation". The term "business" has a broader meaning than the term "trade" and as a result a transfer of a trade should qualify for relief. The hive out of the trade by Book Ltd to NewCo in exchange for an issue of shares to the holder of shares in Book Ltd should constitute a "scheme of reconstruction".

There is no statutory definition of a "reconstruction", however it has been held that a scheme for the reconstruction of a company comprises the transfer of the undertaking, or part of the undertaking of an existing company, to a new company with substantially the same members, and must involve the carrying on by the new company of substantially the same business as that transferred (*Brooklands Selangor Holdings Ltd vs IRC [1970] 2 All ER 76* and *Baytrust Holdings Ltd vs IRC [1971] 3 All ER 76*).

The other conditions for relief under **section 615 TCA 1997** that are relevant in this case are:

1. The company acquiring the assets (NewCo) must be resident in the State;
2. The company disposing of the assets (Book Ltd) must be resident in the State;
3. Book Ltd must receive no part of the consideration for the transfer other than the assumption by NewCo of the liabilities of the business. In this case the consideration is in two parts, the issue of shares to Joe by NewCo and the assumption of business liabilities by NewCo.

It can be taken from the above that the conditions necessary for relief under **section 615 TCA 1997** are satisfied and that relief should be available.

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Where **section 615 TCA 1997** applies, both companies, (i.e. Book Ltd and NewCo) are treated as if any assets included in the transfer were acquired by NewCo from Book Ltd for a consideration of such amount as would secure that, on the disposal by means of the transfer, neither a gain nor a loss would accrue to Book Ltd. For the purposes of indexation relief NewCo is treated as if the acquisitions of the assets by Book Ltd had been NewCo's acquisition of the assets.

As goodwill of a trade carried on in the State is being transferred and the value of the goodwill is over €500,000, it will be necessary to obtain a Form CG50A prior to the transfer in accordance with **section 980 TCA 1997**. In this case the consideration for the transfer is in non-monetary form. If CGT clearance is not obtained NewCo must within 7 days of the acquisition notify Revenue of:

- The asset acquired,
- The consideration for acquiring the asset,
- The market value of the consideration to the best of NewCo's knowledge or belief, and
- The name and address of the person making the disposal, i.e. Book Ltd.

NewCo must also pay to the Collector General an amount of CGT equal to 15% of the market value of the consideration so estimated if CG50 clearance is not in place. Where CGT is payable by NewCo under these provisions the tax is due within 7 days of the making of the acquisition.

Where NewCo has paid CGT under these provisions, it is entitled to recover the tax from Book Ltd as a simple contract debt. Book Ltd in turn is entitled to recover the tax paid over by NewCo from Revenue. To avoid such complications, it is advisable that a clearance certificate be sought in advance.

CGT implications for Joe

The proposed transfer of the trade and issue of shares by NewCo to Joe should not give rise to any charge to CGT for Joe. Broadly, the shares which Joe acquires in NewCo will be treated for CGT purposes as the same asset as the shares Joe currently holds in Book Ltd. A detailed tax analysis is given below.

As the proposed trade transfer should constitute a scheme of reconstruction, the provisions of **section 587 TCA 1997** will apply to Joe. **Section 587(2) TCA 1997** will deem Joe to have exchanged his shares in Book Ltd for shares in NewCo. Accordingly the provisions

Paper 2 Suggested Solution

of **section 586(1) TCA 1997** will apply to the exchange. **Section 586(1) TCA 1997** goes on to apply the provisions of section 584 TCA 1997 to the share-for-share exchange.

Section 584(3) TCA 1997 provides that a reorganisation of a company's share capital (i.e. the share-for-share exchange) shall not be treated as involving any disposal of the original shares (Joe's shares in Book Ltd) or any acquisition of new shares (the shares issued by NewCo to Joe) and that the new shares and the old shares will be treated as the same asset. Therefore Joe's base cost for CGT purposes on the sale of NewCo's shares will be derived from the original base cost of his shares in Book Ltd.

Relief under **section 578 TCA 1997** will not apply where the reconstruction is undertaken for the avoidance of a liability to tax. In this case the bona fide commercial rationale behind the reconstruction is to facilitate a sale of the retail trade of Book Ltd.

Stamp duty

Relief from stamp duty on the acquisition of the retail trade assets by NewCo should be available under **section 80 SDCA 1999** as the transfer qualifies under the conditions for relief which include the following:

- there must be a bona fide scheme of reconstruction or amalgamation;
- the scheme must be effected for bona fide commercial purposes and the purpose of the reconstruction/amalgamation must not be tax avoidance;
- the acquiring company (NewCo) must have limited liability (i.e. an unlimited liability company would not qualify);
- the acquiring company (NewCo) must be incorporated or, if a pre-existing company, must have its nominal share capital increased, with a view to the acquisition of the undertaking or part of the undertaking of the target company (Book Ltd);
- the consideration for the acquisition (other than any portion comprising the transfer to or discharge by the acquiring company (NewCo) of liabilities of the target company (Book Ltd) must consist of not less than 90% in the issue of shares in the acquiring company to the holders of shares in the target company (where an undertaking is being acquired).
- the acquiring company (NewCo) must be incorporated in a member state of the European Union.
- A claim for the relief must be accompanied by a statutory declaration of a solicitor setting out the details of the transaction.

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The relief is subject to adjudication by Revenue and it is necessary to submit many of the documents implementing the trade transfer together with other information to Revenue for their examination.

It is important to consider whether the retail trade carried on by Book Ltd would be regarded as an “undertaking”. The term “undertaking” has a wide meaning. It involves a level of activity as opposed to the mere ownership of assets. In *Baytrust Holdings Limited vs IRC [1971] 1WLR 1333*, Plowman J. stated that in his view the term “denotes the business or enterprise undertaken by a company”. The business must be capable of standing on its own two feet. In this regard the entire retail trade is being transferred to NewCo. On the basis that the retail trade is itself a separate business, then it should be regarded as an undertaking.

Reconstruction with onward sale

As outlined above, a reconstruction takes place where “an undertaking” carried on by a company is in substance preserved and transferred to another company consisting substantially of the same shareholders (“substantial identity of shareholding”). Following the reconstruction, Joe will dispose of his shares in NewCo to the purchaser; the concern would be that the “substantial identity of shareholding” requirement would not be satisfied. However, Revenue have confirmed in Tax Briefing 48 that the test of substantial identity of shareholding is only required immediately after the transaction. The fact that the next step in the process involves the shares in NewCo being sold does not impact on this test. However, it is important that the reconstruction of Book Ltd and NewCo is not contingent on the subsequent sale of NewCo. Therefore, no contract for the sale of NewCo should exist prior to the transfer of the trade from Book Ltd.

VAT

Relief from VAT should be available on the transfer of the retail trade from Book Ltd to NewCo. Where a trade and the assets of the trade are transferred then **section 3(5)(b)(iii) VATA 1972** should ensure that VAT does not arise on the transfer.

For the purposes of this relief, the business being transferred from Book Ltd to NewCo must be capable of being carried on as a business in its own right and both Book Ltd and NewCo must be taxable persons.

It should be possible to contend that the retail trade is capable of being operated on an independent basis.

Paper 2 Suggested Solution

As a supply qualifying for relief under **section 3(5)(b)(iii) VATA 1972** is specifically deemed not to be a supply for VAT purposes, no VAT input credit is available to the purchaser. Where VAT is charged in error by the transferor, a VAT deduction may be denied to the transferee notwithstanding that he may hold an invoice from the transferor charging VAT and the VAT charged in error may have been paid to Revenue by the transferor. Therefore it is important to ensure that no VAT is charged on the transfer of the trade from Book Ltd to NewCo.

In addition, the transfer of intangible assets such as goodwill will not give rise to a charge to VAT under the terms of **section 5(8) VATA 1972**. As the transfer of the business is not a taxable supply, VAT incurred on professional fees associated with the transfer will not be recoverable.

Clawback of tax reliefs

There are no provisions that would apply a clawback of the CGT reliefs claimed on a subsequent sale of the shares in NewCo by Joe.

A subsequent sale of NewCo will not trigger any clawback of relief claimed under **section 615 TCA 1997** by Book Ltd.

There are no clawback provisions in respect of stamp duty relief claimed under **section 80 SDCA 1999** on a share-for-undertaking three-party swap. A clawback will only arise if the relief was originally granted on the basis of false information.

A subsequent sale of NewCo will not impact on the VAT reliefs claimed on the transfer of the retail trade from Book Ltd to NewCo.

2. Advise on the company law issues that should be considered if the restructuring proposal goes ahead.

The two main issues to be considered are the distributable reserves position of Book Ltd and whether the transfer of the trade to NewCo will prejudice creditors of Book Ltd.

The distributable reserves of Book Ltd amounts to €6m (assuming no deterioration between the accounts date and the date of the hive out) while the net value of the trade being

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transferred amounts to €2m. It can be taken from this that Book Ltd should have sufficient distributable reserves to carry out the hive out of the retail trade.

Where the creditors of Book Ltd are unfairly prejudiced by the hive out of the trade to NewCo they can, in certain circumstances, apply to have the hive out overturned by a court. Joe should consult his solicitor for further advice in this regard.

3. Identify and discuss tax issues not already considered by Mary in relation to the proposed transfer of the property from Cover Ltd to Book Ltd.

CGT implications

As Book Ltd holds 100% of the share capital of Cover Ltd, the companies should satisfy the conditions of **section 616 TCA 1997** and form a group of companies for CGT purposes. Recognising that a group of companies can be no more than a single business operating via a number of companies for operational and commercial reasons, e.g. limited liability, the CGT group legislation (contained in **section 617 TCA 1997**) effectively treats a group of companies as one economic entity and allows the tax-free transfer of assets between members.

In order for a transfer of assets to avail of CGT group relief the following conditions must be satisfied:

1. One member of a group transfers an asset to another member of the same group; and
2. The company making the disposal is Irish tax resident at the time of the disposal or the asset is a chargeable asset (i.e. a “specified asset”) in relation to that company immediately before that time; and
3. The receiving company is Irish tax resident at the time or the asset would be a chargeable asset in relation to that company immediately after the transfer; and
4. The receiving company is not an authorised investment company.

Where these conditions are satisfied the transferor and the transferee company are treated for CGT purposes as if the asset acquired were disposed of and acquired for consideration that would give rise to a no gain/no loss situation for the transferor company. This treatment applies regardless of the amount of actual consideration given for the asset. It can be taken from this that it should be possible to transfer the property from Cover Ltd to Book Ltd without a charge to CGT arising. Book Ltd will take on Cover

Paper 2 Suggested Solution

Ltd's base cost for the property. If Book Ltd leaves the group within 10 years on taking the transfer of the property, then a CGT liability will be triggered based on the value of the property on the date of the original transfer from Cover Ltd as per **section 623(4) TCA 1997**.

It is important to consider whether it is necessary to obtain CGT clearance from Revenue as required by **section 980 TCA 1997**. In this circumstance the consideration for the transfer is deemed to be of an amount that would give rise to a no gain/no loss situation for the transferor company. The deemed consideration in this case is €400,000. As the deemed consideration is less than €500,000 no requirement to obtain CGT clearance arises.

Stamp duty implications

The sale of freehold land is usually completed in two steps, the first being the contract for sale and the second being the conveyance. The contract transfers the beneficial interest in the land while the conveyance transfers the legal interest. A charge to stamp duty arises only when a conveyance is taken and is stampable under **Schedule 1 SDCA1999**.

Relief from stamp duty should be available under **section 79 SDCA 1999** as Book Ltd and Cover Ltd are associated companies. For the purposes of **section 79 SDCA 1999**, two companies will be associated if they are under 90% common ownership. Based on the circumstances of this case, the relevant test for common ownership is a test based on 90% ownership of ordinary share capital. As Joe owns 90% of the share capital of Book Ltd and Cover Ltd, then this condition is satisfied.

4. Analyse the tax implications of the proposal to liquidate Cover Ltd after the property is transferred to Book Ltd and recommend how tax efficiencies can be achieved.

CGT implications

The winding up of Cover Ltd should not give rise to a clawback of CGT for Book Ltd. The concern would be that, on the winding up of Cover Ltd, Book Ltd would cease to be a member of a CGT group as it is a stand-alone company and no longer the member of a group. However, **section 623(1)(d) TCA 1997** provides that a company shall not be regarded as ceasing to be a member of a group in consequence of another member of the group being wound up or dissolved.

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Stamp duty implications

A clawback of relief under **section 79(7)(b) SDCA 1999** arises where the qualifying relationship between the transferor and the transferee ceases to exist within the period of two years from the date of the instrument. It may be possible to obtain concessionary treatment from Revenue in relation to the clawback where:

- the factory premises is retained by Book Ltd for the period of two years from the date of the original transfer;
- the liquidation is effected for bona fide commercial reasons and the transaction is not part of a scheme or arrangement for the avoidance of any tax or duty.

If concessionary treatment is not available, the clawback could be avoided by delaying the liquidation of Cover Ltd until the two-year holding period elapses.

5. Explain the Irish tax and company law implications of Book Ltd making a loan to IOMCo.

Tax Issues

Book Ltd is a close company as defined under **section 430 TCA 1997** as it is owned by five or fewer participators i.e. Joe is 100% shareholder. As Book Ltd is making a loan to a company tax resident outside of the EU, the provisions of **section 438 (6) TCA 1997** will apply. **Section 438(6) TCA 1997** is designed to apply close company provisions on loans to participators which are non-resident companies located outside the EU. Book Ltd will be deemed to have paid an annual payment of an amount which, after deduction of standard rate tax, equals the amount of the loan. Therefore Book Ltd will be assessed to tax and be required to pay an amount of tax to Revenue when filing its tax return for the period in which the loan is made. For the purposes of calculating the tax due the loan is re-grossed at the standard rate of tax for the year in question. The tax liability arising on a loan of €1m would amount to:

€250,000 (€1m re-grossed at 20%, taxed at 20%).

When the loan is repaid by IOMCo to Book Ltd, Book Ltd can reclaim the tax paid over to Revenue; effectively the tax payment to Revenue is similar to a refundable deposit.

Company law Issues

Section 31 of the Companies Acts 1990 prohibits companies from entering into certain types of transactions, which would otherwise be lawful, for the benefit of a director or

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a party connected with a director. A company may not make a loan to a director of the company or of its holding company or to a person connected with such a director.

Section 26 of the Companies Act 1990 defines a connected person. A loan from Book Ltd to IOMCo would fall foul of **section 31 of the Companies Act 1990** as both companies are under the control of Joe.

There are a number of exemptions from section 31, the most relevant one in this case is that the loan would be under 10% of the net asset value of Book Ltd. As Book Ltd has a net asset value of €6.5m and the loan is €1m, this exception will not be available.

If the provisions of section 31 are breached the transaction is voidable at the instance of the company, this means the company can cancel or reverse the transaction. Any director who authorised the transaction is liable to account to the company for any gain made by them and is liable to indemnify the company for any loss suffered as a result. If the company is dissolved and if the breach of section 31 contributed to the insolvency of the company then the person who benefited from the transaction can be held to be personally liable for the debts of the company.

A breach of section 31 loans is a reportable indictable offence under **section 194 Companies Act 1990**.

Joe should consult his solicitor for advice in this regard.

6. Recommend how to deal with the Revenue audit issues as described by Joe.

The company has underpaid PAYE, PRSI and levies of €28,800 on a bonus paid to Joe in June 2008. Therefore, the P35 for 2008 is incorrect and interest of 0.0274% applies from 21 July 2008 – the due date for payment of the relevant PAYE, PRSI and levies. The classification of tax default will be that in place pre-28 December 2008 as the tax default took place in July 2008.

The key issue for us is to establish why this underpayment took place. If the underpayment was a result of Deliberate Behaviour then the prompted qualifying disclosure already made by Book Ltd will be invalid. In order for a prompted qualifying disclosure to be valid under the provisions of **section 1077E(1) TCA 1997** it must include the amounts of all previously undisclosed liabilities relating to tax, interest and penalties within the scope of

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the audit including related liabilities for tax heads or periods not within the scope of the original audit. However, the disclosure must also state the amount of all defaults within the deliberate behaviour category of default.

If it can be demonstrated that the underpayment of PAYE is not within the scope of the original audit and is a default in the Careless Behaviour category of tax default, then the prompted qualifying disclosure will not be invalidated. Per **section 1077E(1) TCA 1997**, careless is defined as “failure to take reasonable care”. The penalty may be further mitigated if the Careless Behaviour does not give rise to significant consequences. This category of default applies if the tax underpaid is less than 15% of the ultimate liability due. As the total payroll taxes actually due for 2008 amount to €178,800, the underpaid tax of €28,800 represents 16% of total payroll tax due in 2008 and therefore the Careless Behaviour with Significant Consequences category of tax default will apply.

As this default has arisen on foot of the Revenue auditor’s findings, it may not be possible for Book Ltd to now make a disclosure for the purposes of maximising penalty mitigation. If Book Ltd makes every effort to co-operate with the auditor then the penalty for the underpayment in the Careless Behaviour category should be mitigated to 30% i.e. €8,640. This penalty along with the underpaid tax and interest must be paid to Revenue for the purposes of finalising the settlement.

There may also be implications for Joe as he claimed a credit of €28,800 for tax which was not paid in his 2008 personal tax return. Under **section 997A TCA 1997** a director who controls 15% or more of the ordinary share capital of a company cannot claim a credit for PAYE unless there is documentary evidence to show that tax was paid to the Collector General. Therefore Joe’s personal tax liability for 2008 is technically underpaid. We need to discuss this matter in further detail with Joe as it may be advisable for him to make an unprompted qualifying disclosure to Revenue to claim mitigated penalties.

The foregoing is a technical analysis of tax issues arising on foot of the PAYE issue identified by the Revenue auditor. We may be able to negotiate further mitigations for Joe provided that the default was not deliberate and full co-operation is extended to Revenue. It is also important that Book Ltd can demonstrate that it has proper procedures in place to ensure that taxes are correctly returned and paid to Revenue in the future.

END OF MEMO