FAE COMMITTEE REPORT

FINAL ADMITTING EXAMINATION ELECTIVE INTERIM ASSESSMENTS

APRIL 2018

CHARTERED ACCOUNTANTS IRELAND

Information note

Please note that all content in this document is written to the FAE Competency Statement 2017/2018. As with all examinations, the solutions are "suggested" solutions only. Candidates who present alternative, valid solutions to any case study will always receive the appropriate credit in an examination.

Report from the FAE Committee for Elective Interim Assessment Examinations April 2018
Table of Contents

Introduction

The FAE Committee notes that this is the third year of the Elective Interim Assessment and is issuing this report to provide students with feedback on candidate performance to assist candidates prepare for the main elective exams in August 2018.

Executive Summary

The assessment has been introduced at FAE to allow candidates to gain some insight and practice in their FAE studies and to be eligible to earn some credit in advance of the main exam. Candidates will receive a percentage mark result based on the 15% weighting for their chosen elective. The April 2018 Interim Assessments carries a weighting of 15% towards a candidate's overall chosen FAE Elective result.

The Committee is pleased to see good performances in Audit and the two Taxation Interim Assessment papers; and the Committee notes the weaker performance in the APM Interim Assessment.

Further commentary is provided in the Examiner comments in each of the papers attached.

Results are presented below. As this is the first year of percentages, prior year comparators are unavailable. Table 1 presents the overall pass rates for FAE Interim Assessment. Table 2 presents the results per elective.

Table 1: Overall Performance at FAE Interim Assessment

Results across all candidates in all electives:

Mark Achieved	***No. of Candidates***	***Overall 2018 %***
More than 50 marks	896	**75%**
Less than 50 marks	301	**25%**
Total number of candidates sitting	**1197**	**100%**

Table 2: Summary of results per elective (percentage pass rates)

	APM	AUDIT	TAX ROI	TAX NI
Average mark achieved	*50.3*	62.0	*54.8*	*53.6*
Total # Scripts	325	562	244	66
# with > 50 Marks	202	488	160	46
% with > 50 Marks	***62%***	***87%***	***66%***	***70%***

Final Admitting Examination

CHARTERED ACCOUNTANTS IRELAND

PAPER 2 – ADVANCED PERFORMANCE MANAGEMENT

INTERIM ASSESSMENT

Saturday 21 April 2018: 10.00 am – 11.30am

INSTRUCTIONS TO CANDIDATES

1. This assessment is 90 minutes in duration inclusive of reading time.

A separate answer booklet is provided and MUST BE USED BY ALL CANDIDATES.

This is an OPEN BOOK Assessment.

2. Candidates should indicate clearly on their ANSWER BOOKLET whether they are answering the paper in accordance with the law and practice of Northern Ireland or the Republic of Ireland.

3. Candidates should assume the character of the case and answer accordingly.

4. All workings should be shown.

5. **Assessment** begins on Page 2 overleaf.

SIMULATION: JOE JACOBS PLC
(Suggested time 90 minutes)

You are Georgia Elliot, the recently appointed Group Financial Controller at Joe Jacobs plc (‘JJ’), an online betting and betting shop operator. Having invested substantially in its product offering, operational expertise and brand, JJ has held the number one position in its Irish home market since 2014. Encouraged by this success and given its substantial cash reserves, JJ began expanding abroad in 2015, opening betting shops and marketing its online site in the UK. After a period of losses, the JJ brand became established in the UK helped by its high-street presence, and JJ’s UK online operations are now profitable and fast growing. JJ’s UK retail operations, however, continue to incur losses, and the Group CFO, Hugo Boylan, has called on you to assist him with the preparation of a paper for a forthcoming board meeting focussed on UK retail.

JJ was initially attracted to the UK market by its proximity and similarity to Ireland. For example, customers bet on broadly the same products, apart from the casino game betting machines which are allowed in UK but not in Irish shops. Furthermore, several JJ executives had directly relevant experience, having previously worked for UK betting operators. These include Cecil Wright, JJ’s UK Retail CEO, who used his contacts to quickly establish relationships with preferred suppliers. This helped ensure the budgeted number of new shop openings was achieved each year, a key determinant of management’s annual bonuses, as JJ sought to achieve critical mass in the UK. Cecil was also highly instrumental in recruiting a small team of excellent managers that lead the shop staff, which comprise much more transient employees who do not tend to accumulate long service.

The board is however now quite divided on the attractiveness of UK retail, with a number of recently appointed directors believing the retail market is mature and the focus should be solely on online. Hugo notes that “All the indicators are that the online market will grow at double-digit percentage rates for the next five years, with retail growth projected at relatively pedestrian low single digit percentage rates over the same period. After that, the retail market could be flat, or even in slow decline if the migration of betting online accelerates.” These directors are also concerned with the increasing level of UK losses, and point out that even JJ’s more mature shops are earning lower profits per shop than comparably sized competitors’ units. This is despite the fact that JJ’s revenues per shop are higher. This strong revenue performance is driven by non-machine product, i.e. traditional over-the-counter betting, with JJ underperforming competitors on betting machine revenue per shop.

Projected costs and returns on future UK shop openings have been prepared (see **Appendix I**). Hugo comments “We haven’t information on the historical accuracy of such UK projections but you can assume that they are reliable figures.” He adds that “shop opening costs represent the costs of fitting out the premises which are generally secured on 20 year operating leases (whilst it is possible to negotiate lessee-only break clauses every 5 years, Cecil prefers to obtain the annual rent reduction and swifter conclusion to negotiations by committing to a longer lease).” As a first input into his board paper, Hugo asks you to assess the financial case for continuing investment in new UK shops. “Also, please include any commentary on your financial assessment that you consider relevant. Finally a summary P&L of JJ’s UK retail estate for their first 3 years of operation is also included,” Hugo concludes.

Hugo would then like you to specifically set out any factors favouring the continuation of UK Retail activity/openings, and also factors against the continuation of UK Retail activity/openings. Hugo adds; “please include arguments specifically related to why JJ may have originally decided to invest in UK retail expansion, so that the newer directors get a full picture, and also be sure to consider and address the directors’ specific objections to further investment in UK retail – with which you may agree or disagree.”

Finally, Hugo wonders if JJ’s management team are making some mistakes or be missing some opportunities in terms of how UK retail operations are currently being managed/marketed. He asks you to make suggestions that might improve the UK retail business based on the specific facts provided.

You are delighted to be providing input into such an important strategic decision for the JJ Group and return to your desk to careful analyse the material Hugo has provided you with and address his requests.

APPENDIX I – JOE JACOBS UK RETAIL ESTATE

Projected Performance of New Shop Openings (£ 000)

Shop opening cost, per unit	172
Estimated fit-out useful life, years	7

	Year 1	Year 2	Year 3	Year 4	Year 5
Shop EBITDA	-15	40	70	85	85
Depreciation	-25	-25	-25	-25	-25
Shop EBIT	**-40**	**15**	**45**	**60**	**60**

Notes:

- UK Retail Head Office costs are relatively fixed, however an incremental amount of £ 4,000 per annum is incurred for central support services for each new shop;
- The UK Management Team believes they can open 30 shops next year which will on average achieve the projected performance of new shop openings;
- The projections assume 20 year shop leases but 5 year lessee-only break clauses are possible at a cost of circa £ 2,000 (8%) per annum higher rent;
- Shops are loss making initially, (e.g. as customer relationships are established) and take up to 4 years to fully mature;
- Projected shop performance reflects the Group's best estimate of retail market growth over the next five year; After 5 years, the Group wants to assume for prudence that the retail market slowly declines, causing a £ 13,000 per annum reduction in shop EBITDA;
- Seven years after the initial fit-out, refit activity at shops is anticipated at a cost of £ 10,000 per annum per shop;
- JJ's Pre-tax WACC for GBP £ investments is estimated at 8%. Shop EBITDA above is broadly equivalent to shop cash-flow;
- JJ assesses new store opening projects on a 5 and 10 year basis. You may ignore taxation;
- Historical P&L since inception.

Joe Jacobs plc. - UK Retail Estate
Historical P&L Since Inception (£ 000)

	2015	2016	2017
Shop opening costs incurred	1,750	2,595	4,350
Number of new shops opened	10	15	25
Cumulative number of shops	10	25	50
Total Shop EBIT	(198)	(418)	(371)
UK Retail Head Office Costs	(400)	(449)	(542)
Total UK Retail EBIT	**(598)**	**(867)**	**(913)**

END OF INTERIM ASSESSMENT

FAE APM APRIL 18 IA - Joe Jacobs Simulation Solution

Examiner comment – overall

Results for the FAE APM Elective Interim Assessment have slipped year on year when compared with April 2017. Whilst the examiner wishes to acknowledge some excellent individual scripts, in general candidates have performed poorly and missed an opportunity to earn credit towards their final elective result in August.

The examiner feels that lack of sufficient exam technique in answering the paper to be the biggest challenge facing APM candidates in April 2018.

Candidates do not have to answer the paper in the order in which issues were presented. Some candidates recognised this and answered issues #2 and #3 first before attempting the Investment appraisal. This approach paid off for those candidates as a majority of candidates spent a lot of time on Issue #1 at the expense of very little written for issue #3.

The examiner is grateful for the feedback provided by CASSI. The CASSI report indicated that candidates found Issue #1 to be the most difficult. Candidates reported they found the format of the issue to be unexpected and that EBITDA was a 'curve-ball.' The examiner would like to respond to this; each APM assessment or paper is rigorously tested for timing. The papers are deliberately set that candidates will write into the 90th minute of an interim assessment and the 240th minute of the main elective.

At FAE level all candidates should understand what EBITDA is and the context in which it was to be used in the case. The examiner would like to point out to candidates that APM is part of the Core suite of papers and that wider Core knowledge should not be abandoned at APM.

Finally the examiner would like to remind candidates to ready widely. The April interim assessment was based on a high profile sports betting company.

Issue #1:

Evaluate and assess international investment opportunities…. (3.1) & (3.2)

Financial case for continuing to invest in new UK shop openings

Revised Projections	**Year 0**	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Year 6**	**Year 7**	**Year 8**	**Year 9**	**Year 10**
Original shop EBITDA		(15)	40	70	85	85	72	59	46	33	20
Additional rent for break clauses		(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)
Additional central costs per shop		(4)	(4)	(4)	(4)	(4)	(4)	(4)	(4)	(4)	(4)
Re-fit activity									(10)	(10)	(10)
Initial shop fit out costs	(172)										
Net Pre-tax cash flow per shop	**(172)**	**(21)**	**34**	**64**	**79**	**79**	**66**	**53**	**30**	**17**	**4**
Discount rate @ 8% WACC	1.00	0.93	0.86	0.79	0.74	0.68	0.63	0.58	0.54	0.50	0.46
Discounted Pre-tax cash flow per shop	**(172.00)**	**(19.44)**	**29.15**	**50.81**	**58.07**	**53.77**	**41.59**	**30.92**	**16.21**	**8.50**	**1.85**

It is essential that JJ opt for leases with break clauses in order to avoid being committed to substantial on-going lease obligations at £25,000 per unit (£2K/8%) for what would become loss making shops after 10/11 years, if the retail market begins to decline after 5 years as has been assumed for prudence.

There is some uncertainty over the exact level of return given the costs of closing shops after 10 years isn't known definitively however given the leases can be exited, employees have short tenure/high natural staff attrition and any costs incurred would be heavily time discounted, it's reasonable to suggest it would not materially lower the projected return and can be excluded.

In any event, prior to any closure costs there is a very positive NPV of £99K per shop after 10 years (IRR 18%) and this could be outperformed if the retail market was to be flat rather than in decline after 5 years. It is also worth noting that even if the outlook deteriorates more than expected, shops could in the extreme be closed after 5 years and the NPV is projected at zero and the 8% Kc has been achieved, an important consideration given the inevitable uncertainty in longer term projections.

Regarding the historic actual results achieved, these do not appear inconsistent with the projections (for example, new shop opening costs have averaged £173,900, compared to £172,000 projected, and historical losses would be expected given shops are initially loss making), albeit it would be worthwhile to examine the historical results on the basis of individual shop performance to assess if the projected annual improvement in shop performance are actually being achieved.

In conclusion, the financial case for continuing to invest in new UK shop openings is strong based on the projections provided, assuming lease-only break clauses are obtained.

Note: Some candidates calculated the investment appraisal based on the full 30 shops. This approach albeit longer was still accepted and marks were earned accordingly.

Examiner comment – Issue #1

CASSI reported that candidates found Issue #1 to be the most challenging and that the issue was presented differently to previous investment appraisal questions. Investment appraisal, attempted correctly is a template driven challenge. The inputs into the calculation will largely be constant, ie Inflows, outflows, relevant costs, net flows discount factors and present values. Because of the same constant format of the answer, the examiner will always strive to present investment appraisal in different ways.

As mentioned earlier some candidates struggled with EBITDA, yet the question alerted candidates to the fact that EBITDA equated to cash-flow.

Candidates demonstrated poor understanding and technique unnecessarily multiplying all figures by 30 shops, Investment appraisal on one shop is equivalent to all.

The examiner would like to acknowledge that the investment appraisal was the best answered issue on the APM Interim Assessment. Candidates who worked their way through the requirements scored well as well as commenting on the numbers and other considerations.

Issue #2:

Analyse the reasons by businesses in Ireland would want to extend beyond national boundaries. (1.1)

JJ's rationale for original expansion into the UK

- ***Growth Opportunity***: JJ attained a number one position in the Irish market in 2014 which likely limits its ability to grow within Ireland by taking market share / further penetrating the market. As **Ansoff's Matrix** indicates, options for further growth then include:
  - New products into the existing market – JJ has already invested substantially in its product offering. In addition, returns from product investment are likely to be somewhat limited by the relative small size of the Irish market.
  - Diversifying i.e. new products into new markets – this is likely to be more risky, and unnecessary given growing demand for JJ's existing products. New market entries with existing product – this seems the most attractive option given the quality of JJ's product and a large similar proximate market in the UK.

Factors Favouring Continuation of UK Retail Activity/Expansion

UK market similarity / size / familiarity: The UK market is growing (particularly online) and has a high degree of product overlap. JJ executives also have extensive experience of the UK market reducing risk. In addition, expanding into the UK is logistically much simpler than many other countries given cultural similarities (e.g. same language) and geographic closeness (e.g. no time difference, simpler management oversight etc.). Foreign exchange risk and Brexit do however represent negatives.

- ***Retail complements online:*** It is stated that JJ's high street presence helped establish its UK brand, with consumers often associating a retail presence with a more trustworthy online operation. Retail operations can also add more scale to recoup investment in UK brand marketing, product development or other initiatives. In particular, in response to certain directors' comments, it should be noted that <u>*UK retail investment does not preclude UK online investment*</u> (given for example the Group's strong cash position) – hence while UK online is probably the more attractive market, UK retail also offer attractive returns and actually complements online expansion.

- ***Profitability:*** the ability to leverage off existing product and operational expertise should improve the profitability of UK expansion.

- ***Surplus cash:*** while JJ should compare if shareholders will be better off from either:
    - (a) a return of surplus cash;
      Or
    - (b) its re-investment in the Group,
      Once a return above the cost of capital is expected, the ready availability of funding through surplus cash removes a possible barrier to investment in business expansion.

  In addition, JJ's actual experience of the market to date offers further support to continued UK retail activity:

- ***Above cost of capital financial returns:*** If we perform an IRR calculation, we see this gives JJ an 18% return and whilst we do not have the original UK retail budget targets, the performance of the business to date appears broadly in line with future projections for its performance. <u>*The large and increasing level of losses*</u> highlighted by some directors are not therefore a concern *per se* given they simply reflect (a) start-up losses from an accelerating number of new shop openings and (b) a lack of scale to cover UK Retail HO costs.

- ***Strong revenue performance; cost and revenue opportunities***: while certain directors have highlighted that JJ's mature <u>shop profits are less profitable than competitors'</u>, the key point is that the level of shop profits projected by JJ is sufficient to offer an attractive return on investment of 18% (see above). In addition, there are indications that the underperformance on machine revenue and costs per shop relative to competitors could be addressed (see below).

Factors Against Continuation of UK Retail Activity/Expansion

While there are many points supportive of UK expansion it is not without risks and issues:

- ***Migration online:*** There is potential for migration online to accelerate and lead to bigger declines in the retail market than have been projected. For example, online operators have lower operating costs and could price more aggressively to accelerate migration online.

- **Operating Lease commitments**: It is essential that leases with at least 5 year lease only break clauses are obtained. This could delay / limit the options for new shop openings and lead to higher rents than projected. Shop performance could also fall into negative cash generation just after a break clause has expired leaving JJ with a 5 year lease commitment of c£125K. Sub-letting opportunities for shops should also perhaps be assessed when entering leases...

- ***Brexit / FX uncertainty:*** Brexit could contribute to recession in the UK and/or further weakness in sterling (which would reduce the euro denominated value of the sterling profit stream).

- **Regulatory uncertainty**: Book making is a regulated industry with a trend towards increasing regulation and compliance costs. The betting machines within UK retail shops for example have been subject to extensive negative comment on their social impact and may be subject to staking limits which could significantly affect shop profitability.

- ***Competitive forces:*** UK retail betting is a competitive industry and management may wish to assess competitor reaction to JJ's expansion. For example, could competitors begin to open in direct competition with JJ's UK retail outlets with aggressive pricing in order to stop JJ establishing a presence in UK retail?

- ***Shop closure costs and employee impacts:*** Employee contractual commitments in the event of future shop closures also need to be assessed and managed. For example, employee tenure could become longer than assumed or employee morale (and indeed customers' perception of the JJ brand) could be adversely affected by large scale shop closures in the UK in 5 / 10 years' time.

Examiner comment – Issue #2

In general this indicator was well answered by candidates who were able to identify factors for and factors against continuation of UK retail activity. Some candidates demonstrated great ability to link their arguments back to the facts of the case and which is very encouraging.

Weaker scripts tended to focus on one-sided arguments, thus limiting the amount of marks that could be earned and also some candidates offered lists of two to three word bullet points. At FAE these short bullet points will not earn marks. They need to be teased out into a couple of sentences to earn any score.

The requirement had an interesting addendum to it as it asked candidates to identify the reasons why JJ originally chose to invest in the UK. The examiner was looking to see if candidates could identify any strategic imperative for such expansion and perhaps reference a strategic framework. Ansoff's Matrix or Porters Diamond conditions would be suitable and a minority of scripts referred to these models, which is good to see.

It is important to note that candidates were able to achieve good marks in this issue without referencing a strategic framework.

Issue #3:

Assess the management and marketing opportunities and challenges that arise as the organisation evolves…into a global entity (1.2)

Suggestions for improving UK retail activities

- ***Lease obligations:*** management needs to monitor and more tightly manage the 20 year commitments that can arise under its UK shop operating leases. Given the uncertainty surrounding long term retail revenue growth, Cecil's preference for a slightly cheaper lease and faster negotiation seem incorrect and it would seem far preferable to negotiate 5 year break clauses.

- ***Costs/Supplier Tenders:*** JJ shops have a higher cost base than comparable competitors' units and its supplier relationships reflect 'quickly established relationships with preferred suppliers' based on personal contacts. Given also the growth in scale in JJ's activities, it appears very possible that cost savings could be made by conducting supplier tenders / renegotiations. Some specific cost category benchmarking could be undertaken in an effort to understand why operational costs are out of line with competitors.

- ***Shop opening target bonuses:*** excessive emphasis/bonuses on reaching shop opening targets may encourage management to compromise on the quality of openings, and it would be better to seek a more long term measure of performance such as shops successfully reaching mature shop profitability targets, and/or to partially defer bonus payments until long term returns are achieved.

- ***Machine gaming product:*** JJ under-performs competitors on this product, which does not exist in its domestic market, but outperforms competitors on its other products. Hence a specific review of JJ's machine product offering, its marketing etc. relative to competitors may improve performance.

- ***Traditional gaming product:*** It would be useful to understand what JJ is doing better at traditional gaming product that sees it out perform its competitors. There may be some USP (unique selling point) that JJ has not previously considered and this could be further exploited for further advantage.

- ***Post-implementation capital expenditure proposal reviews:*** it appears that these are not being conducted and their introduction should help improve the accuracy of JJ's capital expenditure proposals, and maybe reduce the risk of opening underperforming units.

- ***Review for loss making units:*** The information available is all based on average shop performance across 50 units. It is very possible that some shops significantly underperform and should be identified for attempts at remedial action, or in the extreme cases, closure. Their profile (location, unit size, unit layout, costs etc.) should also be established and used as part of the screening criteria for any new shops in the future so as to avoid repeating the errors.

- ***Review of profile of best performing units:*** Similarly, the best performing units should be reviewed to establish their profile which should feed into the selection of future shop sites.

- ***Additional openings:*** given the strongly above cost of capital returns projected from the 30 new openings, management should consider if this opening target could be exceeded, even if the return from these new shops are slightly more marginal.

Examiner comment – Issue #3

Issue #3 was a broad issue allowing candidates scope to display their knowledge.

As referred to in the overall comment, there is evidence of candidates running out of time and not fully addressing this indicator. This combined with some poor answers resulted in issue #3 being the worst answered indicator.

Final Admitting Examination

PAPER 2 – ADVANCED AUDITING & ASSURANCE

INTERIM ASSESSMENT

Saturday 21 April 2018: 10.00 am – 11.30 am

INSTRUCTIONS TO CANDIDATES

1. This assessment is 90 minutes in duration inclusive of reading time.

A separate answer booklet is provided and MUST BE USED BY ALL CANDIDATES.

This is an OPEN BOOK Assessment.

2. Candidates should indicate clearly whether they are answering the paper in accordance with the law and practice of Northern Ireland or the Republic of Ireland.

3. Candidates should deem each monetary amount shown with the €/£ symbol to be stated in their relevant currency.

4. All workings should be shown.

5. **Assessment** begins on Page 2 overleaf.

SIMULATION – DREALAN SUPERMARKETS
(Suggested time: 90 minutes)

It is 21 April 2018 and you are Martin Byrne, an audit manager working for Ferne & Co. You have been assigned to the audit of Drealan Supermarkets (**DREALAN**) which you have worked on for the last five years. You and the audit partner, Darren Lambe have just met with Drealan's Finance Director Mary Berna. You have compiled minutes of this meeting (see **Appendix I**).

DREALAN was incorporated 30 years ago by Patrick and Mary Drealan when they opened their first mini-supermarket in a regional town in the midlands of Ireland. Since then they have acquired and rebranded eight supermarkets across the midlands and west of Ireland. During 2008 they also set up three "super" stores on the outskirts of key urban areas. These stores are significantly larger than their standard mini-supermarket. The Directors had hoped these larger stores would enable them compete with the larger retail chains.

The group of 12 stores trades through one company and is continuing to struggle during 2017. Two of the mini-supermarkets are under performing and incurred losses during 2017 (€/£ 195,000 and €/£ 250,000 for Store A and Store B respectively) due to increased competition in their local area from the larger retailers. The carrying value of these stores is €/£ 825,000 each in the draft financial statements as at 31 December 2017.

The group's finance costs continue to be a burden. The significant finance costs are as a result of bank facilities obtained in 2008 to build the three "super" stores. The carrying value of these stores is €/£ 6,250,000 in the draft financial statements as at 31 December 2017. A copy of the company's draft 2017 financial statements is included (see **Appendix II**).

We have been auditors to the group since its incorporation.

Darren has asked you to draft an agenda for the planning meeting with our audit team outlining under each agenda item the main issues we will need to discuss. You should also clearly identify the key audit risks for the company and how we should address these when carrying out our audit fieldwork.

Bank confirmation letters were sent to DREALAN's bank a number of weeks ago and have just been received back. Included on the bank confirmation are a USD account and a Japanese YEN account which are the only two new accounts included on the confirmation letter compared to last year's confirmation.

APPENDIX I: Minutes of meeting with Mary Berna, Finance Director Drealan Supermarkets

Date: 21 April 2018
To: Audit File
CC: Darren Lambe, Audit Partner
From: Martin Byrne, Audit Manager
RE: Minutes of meeting held with Mary Berna, Finance Director, Drealan Supermarkets

- Both revenue and gross margin have increased by 2% year on year. Mary attributes this improvement primarily to the increased motivation of each of the store managers coupled with a general improvement in economic conditions and consumer confidence. Store managers were incentivised during the year to reach revenue and margin targets by way of a 10% bonus, paid quarterly in arrears. Ten of the stores reached their targets for the year. Two of the stores significantly underperformed during the year. Despite their underperformance, the Directors decided to pay a 10% bonus to these two store managers to reward them for their efforts during the year.

- Mary is concerned that bank covenants will not be met for a second year running. The key covenants are;
    - Interest cover of 2.5 times
    - EBITDA of €/£ 200,000

  The depreciation and amortisation charges for the year included in the draft financial statements are €/£ 350,000 and €/£ 40,000 respectively. Her team have not yet made these calculations. Mary expects difficult conversations with the bank should these covenants be breached.

- During the year a customer fell at one of DREALAN's stores and seriously injured themselves. The customer has taken a personal injuries claim against DREALAN's. At 31 December 2017 DREALAN's legal representatives believe there is an 80% chance that if the claim were to end up in courts the customer would be successful in their claim of circa. €/£ 320,000. The company's insurance providers will compensate DREALAN for 90% of the claim. The director's intentions are not to adjust the financial statements for this potential claim or to make any disclosure in this regard. They believe this could be deemed an admission of liability.

- As mentioned above two of the mini-supermarkets are under performing and incurred losses due to increased competition in their local area from the larger retailers. The Directors, based on their assessment, believe the fair value less costs to sell for both of these stores is €/£ 520,000. Value in use calculations for both stores are set out below;
    - Store A €/£ 850,000
    - Store B €/£ 500,000

  No impairment has been accounted for in the financial statements for the year ended 31 December 2017 as Mary and the Board of Directors believe no impairment has arisen.

- The Directors obtained a third party valuation of €/£ 890,000 for the company's investment property at 31 December 2017. This was previously held in the financial statements at €/£ 490,000 at 31 December 2016

- Mary explained that during the year a number of temporary and seasonable staff were paid in cash from tills. Mary estimates that the total amount paid on this basis was approximately €/£ 45,000.

- Mary confirmed that opening retained earnings for the year were €/£ 1,470,000. Dividends of €/£ 110,000 were declared and paid during 2017.

APPENDIX II: DRAFT 2017 FINANCIAL STATEMENTS FOR DREALAN SUPERMARKETS

Draft Statement of Financial Position as at 31 December 2017

Assets	€/£ '000	€/£ '000
Non-current assets		
Property, plant and equipment		8,450
Investment Property		890
Intangible asset		420
Total non-current assets		9,760
Current assets		
Inventories	385	
Other receivables	45	
Cash and cash equivalents	545	
		975
Total assets		10,735
Equity and liabilities		
Capital and reserves		
Ordinary share capital		100
Revaluation surplus-investment property		400
Retained earnings		1,115
		1,615
Non-current liabilities		
Loans		7,820
		7,820
Current liabilities		
Trade payables	730	
Current portion loans	540	
Current tax payable	30	
		1,300
Total equity and liabilities		10,735

Draft Statement of Profit or Loss and other comprehensive income for the year ended 31/12/2017

	€/£ '000	€/£ '000
Revenue	11,480	11,220
Cost of sales	(8,340)	(8,420)
Gross profit	3,140	2,800
Distribution costs	(1,330)	(1,120)
Administrative expenses	(2,030)	(1,840)
Finance costs	(465)	(490)
Profit before tax	(685)	(650)
Income tax expense	-	-
Profit for the year	(685)	(650)
Other comprehensive income:		
Items that will not be reclassified to profit or loss:		
Revaluation surplus on investment property	400	-
Total comprehensive income for the year	(285)	(650)

END OF APPENDIX

END OF INTERIM ASSESSMENT

FAE Audit April 2018 Interim assessment - Suggested Solution

Examiner comment overall:
A total of 562 candidates presented for the April 2018 Audit interim assessment paper. Overall the standard of scripts was greatly improved compared to previous sittings. In general, students demonstrated a good knowledge of planning and agenda items. Answers to the audit risk issue were improved compared to previous years with students in the majority identifying the “obvious and specific“ audit risks.

It was noted that some students appeared confused regarding the presentation of the financial information. At FAE level it is expected that students are capable of interpreting financial information, no matter what format provided. It should have been clear from the first column provided in the Statement of Profit or loss and other comprehensive income that the fair value of the investment property increased in that year which corresponded to the amount shown in the Statement of Financial position as at 31 December 2017. Furthermore a number of students failed to identify the incorrect accounting of investment properties and also the un-reconciled retained earnings.

Memo

To: Darren Lambe

From: Martin Byrne

Date: April 2018

Subject: Drealan Supermarkets

Darren,

Below I have presented below a draft agenda for our audit planning meeting as well as highlighting the main issues for discussion under each agenda item. I have also set out below the primary audit risks as I see them and suggested responses to these.

Please let me know when it would suit you to have the meeting and I will coordinate with the other team members.

Martin

Issue #1
The candidate demonstrates they are aware of the key issues to be considered when planning an audit.
The candidate demonstrates ability to understand the business issues and is able to assess materiality and identify risks of material misstatement. (2.3)

Audit Planning Meeting re Drealan Supermarkets

Agenda

1) Attendees

a) The following team members must be in attendance:

Darren Lambe – Audit Partner

Martin Byrne – Audit Manager

A. Another – Audit Senior

Other team members

Internal audit experts (if relevant) e.g. tax team, valuations team regarding goodwill impairment review

2) Independence

a) We need to consider our independence for this audit. We have been auditors for 30 years, need to consider rotation of Partners and senior staff over the years.

b) This should include a review of all non-audit engagements we have carried out in the last year and discussions as to the nature of these engagements with the staff involved.

c) Once happy that we can be considered independent, we must confirm with those charged with governance of the client.

3) **Knowledge of the client**

a) Discussion of client structure and business performance to brief team members on the nature of the company to be audited.

b) Team to share information on knowledge of any significant transactions or events that have happened to the company during the past year-refer to Minutes of Meeting held with Mary Berna, Finance Director of the group.

4) **Audit Scope**

a) We should consider the scope of the audit. We assume we will be carrying out a statutory audit to enable the company to meet their statutory obligations.

b) We are therefore required to issue an opinion on the financial statements as to whether or not they give a true and fair view of the group's results for the year.

c) We are also required to consider all information included with the financial statements to ensure that this is consistent.

d) We should consider the audit coverage, including the number and locations of the stores to be included.

5) Engagement letter

a) We need to consider whether an engagement letter should be issued. As this is not the first year of the audit assignment, it is possible that the engagement letter issued previously is still current. We should review the previous engagement letter to determine whether there has been any change in scope and if a new letter is required.

6) Materiality

a) Need to discuss and agree the level of materiality for the audit. As this is a trading company, a measure of materiality based on turnover or profitability is appropriate.

b) Based on the draft information available to me a materiality level of €/£ 115,000 to €/£ 230,000 would be appropriate (based on 1%-2% of revenue)

c) Performance materiality should therefore be €/£ 103,000 to €/£ 206,000 (based on 90% of materiality) (other answers based on reasonable % of materiality can be accepted).

d) We will need to continue to review the materiality level as the audit progresses, revisiting this as and when required.

7) Timetable

a) We should consider the audit timetable. We need to agree with the client when we will carry out and complete our audit planning work and the timing and extent of our further audit procedures. The timing of these activities will be dependent on the client's deadline for completion of the financial statements and the signing of the audit report.

8) Consideration of Fraud

a) ISA 240 requires us to consider and discuss how and where the client's financial statements may be susceptible to material misstatement due to fraud including how fraud might occur. This includes a presumption that there are risks of fraud in revenue recognition. We should also have a discussion among the audit team specifically with respect to planning emphasis of how/where Drealan's financial statements may be susceptible to material misstatement due to fraud.

b) In the context of our client, we need to consider additional potential fraud risks e.g. this is a cash business therefore risk of cash appropriation is higher particularly as there is cash wages paid also. The incentives in place for management based on revenue and gross margin % may also increase the risk of fraud.

c) Once the risks are considered, we need to determine responses to these risks.

9) Risk Assessment

a) As set out below we need to consider the key audit risks for this company and our responses to such risks.

10) Other

a) Consideration of related party transactions

b) Consideration of potential for management override particularly given the poor financial performance

c) Consideration of roles and responsibilities of each member of the audit team.

d) Required communications with those charged with governance

e) Assessment of the appropriateness of the use of the going concern basis of accounting

f) Any other relevant points

Examiner comment: Issue #1 Audit Planning Meeting Agenda

Overall the standard of answer for this issue was good. Students who didn't perform well tended not to include specific points which are directly linked back to the case study for the following areas;

Knowledge of the client
Audit scope
Consideration of fraud
Materiality

Often answers covering these areas were very generic and didn't link back to facts of the case study.
It is expected at FAE level that you tailor standard procedures to the specific information provided in the case study. An example of this is set out below, under the heading of consideration of fraud;

In the context of our client, we need to consider additional potential fraud risks e.g. this is a cash business therefore risk of cash appropriation is higher particularly as there is cash wages paid also. The incentives in place for management based on revenue and gross margin % may also increase the risk of fraud.

Issue #2
The candidate critically assesses the information provided and identifies the risks facing the company.
Gain and understanding of the entity and assess the related business risks (2.1)

Issue #3
The candidate critically assesses the information provided and develops responses to the risks identified
Gain and understanding of the entity and develop responses to the risks (2.3)

Audit risks

We need to discuss the potential audit risks we need to address and mitigate before completing the audit process. Based on the information provided I have identified the following risks and outlined how I think they should be addressed:

<table>
<tr><th></th><th>Audit risk</th><th>Work required to mitigate audit risks</th></tr>
<tr><td>1)</td><td>Both revenue and gross margin have increased by 2% and 12% respectively year on year. Mary attributes this improvement primarily to the increased motivation of each of the store managers. Store managers were incentivised during the year to reach revenue and margin targets by way of a 10% bonus, paid quarterly in arrears

The fact that store managers were incentivised to reach revenue and margin targets increases the risk that both of these numbers could be fraudulently manipulated.</td><td>1) Use analytics to determine usual movements in revenue, either by analysing information by store, by week, by month etc. Investigate any potential outliers arising from such an analysis
2) Perform detailed testing of revenue through both analytical procedures and tests of detail to assess the likelihood of the overstatement of sales
3) Perform revenue cut off procedures at year end
4) Perform detailed testing of costs through both analytical procedures and tests of detail to assess the likelihood of the understatement of sales
5) Perform cost cut off procedures at year end
6) Perform unrecorded liabilities testing through both a review of payments post year end and also invoices received post year end
7) Review revenue GL’s and identify journal entries made directly into these accounts. Examine these entries and obtain relevant back up documentation</td></tr>
<tr><td>2)</td><td>There are clear signals that the company is struggling to meet its bank covenants.

<table><tr><td></td><td>€/£ ’000</td></tr><tr><td>Loss for the year</td><td>(685)</td></tr><tr><td>Finance costs</td><td>465</td></tr><tr><td>Depreciation</td><td>350</td></tr><tr><td>Amortisation</td><td><u>40</u></td></tr><tr><td>EBITDA</td><td>170</td></tr></table>
Interest cover is negative due to the continued losses with the business.

The ability of the company to continue as a going concern is under strain particularly if the bank discontinues support. The company has incurred a loss of €/£ 685,000 for the year ended 31 December 2017 and has net current liabilities of €/£ 1,985,000 at year end.</td><td>1) Check current agreed bank facilities to ensure these are in line with Mary’s explanations
2) Review all correspondence with the bank obtained during the year
3) Obtain bank confirmation regarding loan balances
4) Discuss company performance and plans for future with company directors
5) Review forecasts for a period of at least one year from the date the financial statements are planned to be signed off and challenge assumptions within them</td></tr>
</table>

<table>
<tr><td></td><td></td><td></td></tr>
<tr><td>3)</td><td>
DREALAN’s legal representatives believe there is an 80% chance that a customer personal injuries claim would be successful costing the company circa. €/£ 320,000. It is expected the company insurer will compensate 90% of this cost.
Per IAS 37 a provision should be recognised when;

An entity has a present obligation as a result of a past event,
It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
a reliable estimate can be made of the amount of the obligation

It would appear from the limited information we have that a provision should be recognised.
No contingent asset should be recognised for the 90% compensation likely from the insurers. However, disclosure of this should be considered.
</td><td>
1) Inquire with management regarding an update on the dispute
2) Inquire and discuss with DREALAN’s legal representatives the facts of the case study and their basis for conclusion that there is a 80% change of a successful claim
3) Review all correspondence regarding the claim to date
4) Obtain written confirmation from legal representatives
5) Potentially engage with a third party auditor’s expert to provide an assessment of likelihood of claim being successful
6) Prepare adjusting journal entries for this transaction and discuss with management
7) Review terms and conditions of insurance policy in place to ensure compensation will be received
8) Obtain confirmation from the insurer of their intention to cover 90% of the claim
</td></tr>
<tr><td>4)</td><td>
Based on a review of information received for the two underperforming stores it appears an impairment has arisen with regard to Store B of €/£ 280,000 in accordance with IAS 36.
<table>
<tr><th></th><th></th><th colspan="2">Recoverable Amt.</th></tr>
<tr><th></th><th>Carrying Amount</th><th>Value in Use</th><th>Fair Value less cost to sell</th></tr>
<tr><td></td><td>€/£ ’000</td><td>€/£ ’000</td><td>€/£ ’000</td></tr>
<tr><td>Store A</td><td>825</td><td>850</td><td>520</td></tr>
<tr><td>Store B</td><td>825</td><td>545</td><td>520</td></tr>
</table>
Store A No impairment
Store B Impairment of €/£ 280,000
Recoverable Amount=
Higher of VIU or FV VIU
<table>
<tr><th>Carrying Amount</th><th>REC Amount</th><th>Impairment</th></tr>
<tr><td>€/£ ’000</td><td>€/£ ’000</td><td>€/£ ’000</td></tr>
<tr><td>825</td><td>545</td><td>280</td></tr>
</table>
</td><td>
1) Discuss rationale with Mary Berna for not recognising an impairment in accordance with IAS 36
2) Obtain and review basis for and fair value calculations. Discuss same with Directors
3) Compare these fair values with similar buildings within the same area by reviewing relevant property sale websites etc.
4) If there is still a doubt with regard to these valuations consideration should be given to obtaining an external third party valuation per ISA 500 or ISA 620.
5) Obtain and review value in use calculations
6) Challenge all assumption made in these calculations, particularly the following;

Discount rate (should be cost of capital)
Revenue levels and sustainability of these (particularly considering decline during 2017
Sustainability of costs and any planned reduction of same

7) Projections included in the value in use calculations should be
</td></tr>
</table>

		compared to revenue and costs of similar stores 8) Calculate impairment and discuss adjustment with the client
5)	*The investment property fair value increase is significant year on year. Also the fair value appears to have been incorrectly accounted for as a Revaluation surplus in accordance with IAS 16 through OCI and Equity rather than as a Fair value movement under IAS 40 through PL.*	1) For the valuation obtained we should ensure we have followed relevant procedures per ISA 500 which include • Evaluate the competence, capabilities and objectivity of the expert e.g. their qualifications, experience of valuing similar properties etc. • Obtain an understanding of the work of the expert, i.e. understanding of valuation basis etc. • Evaluate the appropriateness of the expert's work as audit evidence 2) Compare the fair value with similar buildings within the same area by reviewing relevant property sale websites etc. 3) If there is still a doubt with regard to the valuations consideration should be given to obtaining an external third party valuation per ISA 620 4) Discuss incorrect accounting treatment with the client and request that they correct this error
6)	*A number of temporary and seasonable staff were paid in cash from tills. Mary estimates that the total amount paid on this basis was approximately €/£ 45,000.* While the amount appears immaterial there is a risk of fraud and therefore a significant risk associated with potential misappropriation of cash and/or incorrect calculation of wages and amounts due to Revenue.	1) Obtain an understanding of the systems in place to record and calculate wages for such employees 2) Prepare walkthrough of casual wages system for a no of different stores 3) Obtain listing of cash wages paid 4) Agree to cash summary sheets for the relevant stores 5) Recalculate taxes on cash wages and ascertain potential liability 6) Agree amounts paid to Revenue regarding these wages and reconcile to recalculation above
7)	The movement in reserves is less than the profit before tax (after allowing for a reasonable tax charge) €/£ 000s Opening Retained Earnings 1,470 Less loss for year (685) Less dividends (110) 675 Closing Retained Earnings 1,115	1) Obtain equity reconciliation from the client 2) Agree opening retained earnings figure in tis reconciliation to last year's signed financial statements and the nominal ledger 3) Agree profit and tax figures to Statement of Profit or Loss 4) Obtain supporting documentation

	Unexplained difference (440) There is a risk that retained earnings are materially misstated	for items other than profits or opening balances 5) There is a possibility that the different in in relation to additional dividends declared, if so agree to board minutes
8)	*The bank confirmation letter received indicates that the company has a number of bank accounts denominated in foreign currencies. This is unusual considering the company trades in Ireland and assumingly its purchases are in Euro.*	1) Re confirm with the bank that the foreign currency bank accounts definitely relate to DREALAN 2) If so, discuss with Mary Berna as to rationale and need for these bank accounts 3) Investigate all transactions in these accounts

Examiner comment: Issue #2 Identification of specific audit risks

Generally there was a great improvement in answers compared to previous years. However, poor scripts relied on boiler plate template answers including risks that had no relevance to the case study e.g. management override.

A large number of candidates identified account balances where they believed there might be risks e.g. property, plant and equipment, provisions, going concern, revenue recognition however they then failed to explain explicitly what the specific risk was in the context of the case study. Candidates are reminded that audit risks identified should be drawn from the material within the case study and that little credit is available for repeating generic audit risks e.g. “revenue recognition”, “management override”, “impairment” without linking these to specific issues arising from the facts of the case study.

Examiner comment: Issue #3 Identification of audit procedures to address specific audit risks

Many candidates made a good attempt at this indicator with audit risk specific tests suggested. The best candidates addressed all the risks previously identified across the relevant financial statement areas. Some students continue to suggest generic audit tests that were not linked to the facts of the case – little credit was available for this.

END OF SUGGESTED SOLUTION FOR INTERIM ASSESSMENT

Final Admitting Examination

CHARTERED ACCOUNTANTS IRELAND

PAPER 2 – ADVANCED TAXATION (NI)

INTERIM ASSESSMENT

Saturday 21 April 2018: 10.00 am – 11.30 am

INSTRUCTIONS TO CANDIDATES

1. This assessment is 90 minutes in duration inclusive of reading time.

A separate answer booklet is provided and MUST BE USED BY ALL CANDIDATES.

This is an OPEN BOOK Assessment.

2. Candidates should answer the paper in accordance with the law and practice of Northern Ireland and in accordance with the appropriate provisions up to and including the Finance Act 2017.

3. All workings should be shown.

4. **Assessment** begins on Page 2 overleaf.

SIMULATION – PLEASURE CRUISES LTD

(Suggested time: 90 minutes)

Today is 20 April 2018 and you are Jordan Little, a tax manager in a medium sized accountancy practice in Enniskillen. Over the last few years, you have become familiar with the income tax and corporation tax files for Denis and Mary McIntyre and their company Pleasure Cruises Ltd **(PCL)**. Denis and Mary have a combined shareholding of 50% (that is, 25% each). PCL was incorporated in 2002 and its trade involves the hiring out of pleasure cruisers on Lough Erne in Northern Ireland (NI). Denis and Mary are married and have always taken salaries from PCL each year to fully utilise their respective personal allowances. They also take dividends each year from PCL to completely utilise their basic rate bands.

The remaining 50% shareholding in PCL is owned by a third-party, Pamela Johnstone. Pamela purchased her 50% shareholding in PCL in December 2009, 25% from Denis and 25% from Mary, when the company desperately needed cash to ensure it did not go into administration. Pamela paid £ 200,000 (plus stamp duty of £1,000) for the 50% shareholding. Pamela was delighted to find this investment opportunity as she had been seeking to invest in another company since the sale, in September 2009, of her marketing company from which she made a chargeable gain of £9.5 million. This disposal qualified for entrepreneurs' relief in 2009, up to the relevant limits at the time. Denis and Mary introduced the proceeds from the sale of shares to the company and this was fully repaid to them within three years. Pamela is 56 years old and she takes a salary of £12,000 plus dividends each year from PCL which push her into the higher rate tax band. All shareholders in PCL are UK tax resident.

As a result of the £ 200,000 cash injection in 2009, the trade of PCL was turned around and soon became profitable again. As soon as Pamela became a shareholder in PCL she began working as the marketing director for the company. She worked fulltime for PCL until April 2014. Since then she has worked on a part-time basis as the marketing director.

Pamela is adamant that PCL should expand their service offering to Ireland and Scotland by purchasing additional river cruisers. However, Denis and Mary do not agree. They feel that the NI market is sufficient for them at the moment as PCL's annual turnover has steadily increased to be in the region of £900,000 for the last few years. On this basis, Denis and Mary refuse to agree to access bank funding for the purchase of 6 new 10 berth river cruisers. Denis, Mary and Pamela are not willing to compromise and therefore board meetings have been unproductive for the last 12 months. It is clear from recent management accounts that PCL's turnover is decreasing significantly as a result of the differences in opinion on the growth strategy for the company. Pamela has told Denis and Mary that she has no option but to sell her shares and leave the company as she cannot work with people who do not share her vision to expand. A snapshot of the most recent statement of financial position for PCL is outlined below which shows that the value of the company is £ 1,400,000.

Non-Current Assets	
Plant & Machinery	£ 510,000
Investment – quoted shares	£ 100,000*
Current Assets	
Stock	£ 10,000
Cash	£ 780,000
	£ 1,400,000

* A return of 5% is generated on these investments annually.

The company has distributable revenue reserves of £ 850,000.

You had a meeting with all three shareholders yesterday and you have been asked to draft a tax memo for your manager which provides a tax analysis of the different structuring options for Pamela to be paid the £ 700,000 she requires immediately for her 50% shareholding. Denis and Mary have been provisionally approved for a £ 700,000 loan from their local bank but they are concerned about the monthly repayments and how these will be met for the term of the loan. Denis and Mary have asked for tax advice on how they can extract extra funds from PCL in the most tax efficient way and if PCL could buy Pamela's shareholding?

Pamela, in 2010, purchased a 5 acre field adjacent to Lough Erne. She paid £ 500,000 for the land (plus £ 21,000 stamp duty and legal fees associated with purchase) and since its purchase she has rented it to PCL for market rent as all cruisers are stored on it when in need of repair and in low season when demand for the cruisers is not as high. Pamela wishes to sell this land at the same time as her shares but Denis and Mary have indicated they are not interested in purchasing it as they can utilise other suitable land at a much reduced rental cost. Pamela's 5-acre field is now valued at £ 900,000. Pamela has requested tax advice regarding her own personal tax position if she sells both the shares in the company and the land adjacent to Lough Erne.

Just before yesterday's meeting drew to a close, Pamela informed you that PCL has received a HMRC enquiry letter into the entertainment expenses contained in the statement of profit or loss for the year ended 30 September 2016. Pamela, as a result of a HMRC enquiry letter, reviewed the nominal ledger code for entertainment. Pamela stated that, upon review, she now thinks that £ 16,000 of prospective client entertaining costs were mistakenly classified as a trade conference cost in the financial statements for the year ended 30 September 2016. After the meeting you looked at the filed corporation tax return for the year ended 30 September 2016 and you cannot see any adjustments for client entertainment in the tax adjusted trading calculation. However, you do note that £ 25,000 in corporation tax was paid for the tax liability for the year ended 30 September 2016. Pamela has asked that you guide PCL on how this oversight should be corrected bearing in mind that it was a translation error by the book-keeper. She is very worried that the company name will appear on a tax defaulter list because of this oversight.

END OF INTERIM ASSESSMENT

ATx NI APRIL 2018 INTERIM ASSSESSMENT:
(Suggested solution)

Examiner comment overall
This case study examined three main areas:
- Advising on the options for cash extraction from a company and a share buy-back by a company.
- Advising on the capital gains tax implications for the individual involved in the share buy-back and the application of entrepreneurs' relief to the share disposal and an associated disposal of land.
- Advising how to correct an error in a corporation tax return submitted to HMRC, the potential penalties which may be payable in connection with this and the possibility of the company being published as a tax defaulter.

The general quality of the answers was good. For issue one, most students identified the share buyback as being an option given the facts in the simulation presented. The majority also discussed the issue of cash extraction from the company but it was disappointing that in many cases this was not answered in the context of the simulation with the cash being needed to specifically fund loan repayments.

With regards to issue two, many students considered the availability of entrepreneurs' relief on the disposal of the shares but candidates in general did not consider the land sale as an associated disposal.

Issue three was the issue that candidates scored least well in with many candidates giving general advice on the amount of tax due as a result of the error, without detailing the potential penalties and the concern of publication.

Tax Memo

To: Manager
Date: April 2018
Re: Share buy-back and correcting error

Issue #1
The candidate demonstrates knowledge of *competency in Advanced Taxation NI (2.1 & 2.9)*

Buy shares in PCL personally
If Denis and Mary borrow the money personally to buy Pamela's shares in PCL, then they will have to fund the loan repayments out of their after tax income. They can either take additional salary or dividends from PCL to fund the loan repayments.

Denis and Mary already extract salaries from PCL to utilise their respective personal allowance and on an annual basis they receive dividends to fully utilise each of their basic rate bands.

Therefore, any additional salary that is paid will be subject to PAYE and NICs. The following facts should be noted in respect of the decision to extract additional income from PCL via salary:

- Denis and Mary will receive only a net salary as PCL will have put the salary through payroll. They will therefore need to ensure that their net payments are sufficient to meet the monthly loan payments. We note that Mary and Denis have utilised their basic rate band so additional salaries will be liable to income tax at 40% and NICs (12% up to £45,032 and 2% thereafter). Where income exceeds £150,000 the additional rate of 45% will apply.
- Denis and Mary will have their personal allowance restricted where their net adjusted income exceeds £100,000. Their personal allowance will be reduced by £1 for every £2 of income above £100,000. Therefore, if their income exceeds £122,600 they will have no personal allowance.
- Salary income is therefore not likely to be liable to any further taxes in the hands of Denis/Mary.
- The salary (and employer's NICs at 13.8%) is deductible for tax purposes against the PCL's profit. This represents a 19% tax benefit to PCL.
- For Denis and Mary, salary can increase the capacity to boost pension.

PCL could make additional annual distributions to Denis and Mary by way of dividend and they could use these dividends to repay the loan. These dividends will be paid once Pamela is no longer a shareholder and therefore Pamela is not entitled to a dividend. However, the following points are relevant in respect of the discussion to generate extra income in the hands of Denis and Mary to enable them to fund the loan repayments.

- Dividends paid by PCL are not deductible for corporation tax purposes.
- There is no employer's NICs on dividends therefore, this is a saving for PCL
- PCL must have sufficient distributable reserves to make the distributions.
- Denis and Mary must remit any balance of income tax due to HMRC and declare the dividend income in their annual tax return. Additional tax will be due at the 32.5% rate up to earnings of £150,000. The rate of income tax for dividends falling in the additional rate band is 38.1%. The £5,000 dividend allowance will already be utilised by the normal amount of dividends paid up to the basic rate band.
- Denis and Mary will have their personal allowance restricted where their net adjusted income exceeds £100,000. Their personal allowance will be reduced by £1 for every £2 of income above £100,000. Therefore, if their income exceeds £122,600 they will have no personal allowance.
- Dividends can be paid annually or they can be paid on a more regular basis. PCL will have no further action to take except for the documenting of minutes and the preparing of dividend vouchers.

Due to the fact that no NICs are due on dividends and that the rate of income tax on dividends, which fall to be taxed in the higher rate band (i.e. £33,500 to £150,000), is 32.5%, it will be more tax efficient for Denis and Mary to take dividends rather than salary. However, as discussed below, a share buy-back by PCL would have a much more favourable outcome for Denis and Mary as they would not need to take out a loan personally and therefore they would not need to extract additional money from PCL to make the loan repayments.

Share buy-back by PCL

As noted above, any consideration passing to Pamela, as a shareholder of an unquoted company (PCL) in respect of her shares will be a deemed distribution and taxed as income. However, where certain conditions are met, such consideration may be taxed as a chargeable gain and liable to CGT treatment. As Pamela is a higher rate taxpayer, the current CGT tax rate for any sale of her shares will be 20% versus a potential 32.5%/38.1% rate if the deemed distribution is taxed as income.

To qualify for CGT treatment in the hands of Pamela, the share buy-back must be for the benefit of the company's trade. Examples of "for the benefit of the company's trade" (also known as the "trade benefit test") include where there is a disagreement between shareholders over the management of the company which could adversely impact on the business and it is necessary to remove the dissenting shareholder. It is likely that the disagreement between the shareholders in PCL regarding the expansion of the company would satisfy the trade benefit test as it does not appear that the dispute can/will be resolved.

To satisfy the conditions to get CGT treatment, the following conditions must be adhered to:
1. Pamela (the vendor) must be resident in the UK in the year of the share disposal – This condition is satisfied.
2. Pamela must have owned the shares for a period of five years up to the date of disposal – This condition is satisfied as Pamela has owned the shares since 2009.
3. Following the share buy-back, Pamela's shareholding in PCL must have been reduced to 75% or less of her interest before the disposal - this condition is satisfied as she will hold no shares in PCL after the buyback.
4. Following the share buy-back, Pamela must not be connected with the company, i.e. not own more than 30% of issued share capital or voting power or assets available on a winding up of the company – This condition is satisfied as Pamela will hold no shares or rights in PCL after the buy back.
And
5. the share buy-back must not be part of any scheme whose purpose is to enable the owner of the shares to participate in the profits of the company without receiving a dividend – The fact that the buyback meets the trade benefit tests shows that it is being undertaken for the good PCL's trade.

As PCL has distributable reserves available to cover the amount that Pamela is to receive for her shares, the share buyback can be undertaken. An independent valuation should be obtained in respect of the shares to be bought back and PCL should pay market value for the shares.

HMRC guidance states that it will not consider the costs of implementing a share buy-back as a trading expense. Any professional fees (i.e. legal, tax advice, etc.) connected with the share buy-back should therefore be disallowed in PCL's tax computation.

PCL will incur a stamp duty liability at 0.5% on the share buy-back.

The share buy-back is clearly the most favourable option for Denis and Mary McIntyre. Denis and Mary will have no additional income tax liabilities if the share buyback option is undertaken.

Examiner comment: Issue #1
The issue presented the scenario where a dissenting shareholder wishes to sell their shareholding in the company and was well answered by many candidates.

The simulation required candidates to provide tax advice on the extraction of additional funds from the company to cover repayments on a loan to purchase the shares of the dissenting shareholder. Most candidates outlined the main tax implications of extracting funds in the form of salary or dividends but many did not explain that the dividend option would be more favourable. A number of candidates covered the option of extracting funds in the form of pension contributions which was not relevant in this case as it was clearly stated that the funds were required to repay a loan. These candidates used time explaining the amounts that could be contributed to a pension scheme and the tax benefits of pension contributions, but there was no credit given for this.

It was encouraging to see the vast majority of candidates identify a share buyback as an option available for the company and its shareholders. Most candidates referenced the income tax versus capital gains tax treatment for the selling shareholder and correctly concluded that the disposal would be liable to CGT in this case as the necessary conditions could be met. Most candidates did not go as far as to state that this option was more beneficial to the remaining shareholders as it removed the need for them to extract the additional funds from the company to cover the loan repayments.

Issue #2
The candidate demonstrates knowledge of *competency in Advanced Taxation NI (2.2)*

If Pamela sells her shares back to PCL she will be subject to capital gains tax (CGT) on the disposal. She will also be subject to CGT on the disposal of land which she rented to PCL.

The current rate of CGT is 10% where entrepreneur’s relief applies and otherwise 20% (assuming the taxpayer has fully utilised their basic rate band with their income).

The availability of entrepreneurs’ relief (ER) needs to be considered by Pamela. The current limit for ER is £10,000,000. When Pamela sold shares in her marketing company to a third party in September 2009 and made a gain of £9.5 million, the relevant ER limit at that time would have been £1m. Therefore, Pamela now has £9m of her lifetime ER limit available. This is ample to cover the current proposed disposals.

To qualify for the relief a disposal must be:
1. a material disposal of business assets; and
2. a disposal associated with a relevant material disposal, e.g. the disposal of a business property rented by the company in which the material disposal is being made.

A disposal of shares in a company which has been the individual’s personal trading company qualifies for ER. For the purposes of entrepreneurs’ relief, “personal company” is defined as one in which an individual holds at least 5% of the ordinary share capital, and that holding also gives at least 5% of the voting rights in the company. As Pamela owns 50%, this condition should be satisfied. ER also requires Pamela to be an employee or officer of PCL throughout the period of one year ending on the date of disposal. This condition is also satisfied.

It is noted that PCL owns some investment assets currently valued at £100,000 which generate £5,000(i.e. a 5% return) income annually. As noted above, for ER to apply to the disposal PCL must be a trading company. That is, PCL must carry out trading activities and its non-trading activities must not be “substantial”. For these purposes, “substantial” non-trading activities are where non-trade income or assets, or management time dealing with such non-trade activities, are in excess of 20%. Given the level of income generated from the quoted shares, the value of the quoted shares and also the fact that very little management time would need to be devoted to this type of investment, PCL will be treated as a trading company and hence the disposal of shares will be eligible for ER.

As noted above, ER can apply to associated disposals. For ER, there is an associated disposal if:

- the individual makes a material disposal of shares;
- the individual makes the associated disposal as part of the withdrawal from participation in the business of the company; and
- the assets disposed of are in use for the business for a period of one year up to the earlier of the date of the material disposal and the date of cessation of the business.

However, ER is restricted where the assets disposed of were rented to the company. Therefore, as Pamela charged PCL market rent for the use of the land, no ER will be available on the disposal of the land.

Pamela's CGT position is outlined below:

<u>CGT on disposal of shares</u>

	Share buyback - ER £	
Proceeds	700,000	
Less cost	(200,000)	
Less stamp duty	(1,000)	
	499,000	
Less AE	-	Used against land disposal
Gain	499,000	
CGT at 10%	**49,900**	

<u>CGT on disposal of field</u>

Proceeds	900,000
Less cost	(500,000)
Less stamp duty & costs	(21,000)
	379,000
Less AE	(11,300)
Gain	367,700
CGT at 20%	73,540

Examiner Comment: Issue #2

This issue was reasonably well answered and in almost all cases candidates correctly advised that entrepreneurs' relief would apply to the disposal of shares as part of the company buy-back of shares and the capital gains tax due was also correctly calculated in most scripts. Although the investment asset on the balance sheet did not ultimately affect the availability of entrepreneurs' relief, it was expected that candidates would give consideration to the trading status of the company as a result of these assets but this point was only addressed by a small number of candidates.

It was also expected that candidates would identify the potential sale of land as an associated disposal which should also be considered for entrepreneurs' relief but this point was not raised in the majority of scripts. In most cases, candidates treated the share disposal and the land disposal as two unconnected transactions for capital gains tax purposes.

Issue #3
The candidate demonstrates knowledge of *competency in Advanced Taxation NI (1.3)*

The amount of the add backs in the tax adjusted trading profits calculation for PCL for the year ended 30 September 2016 were £16,000 under declared. Any customer/supplier entertainment amounts should be added back.

The corporation tax return filing deadline for the year ended 30 September 2016 was 30 September 2017. As the corporation tax liability was £25,000 before the above adjustment, it will increase to £28,200 (i.e. £25,000 + £16,000 x 20%).

As PCL has received HMRC enquiry notification, the company can only make a prompted disclosure.

There will be no penalty imposed where a taxpayer company takes reasonable care, but inadvertently submits a tax return containing an inaccuracy. A taxpayer becomes careless when, on realising there is an error in the return, they fail to report it to HMRC, or fail to take reasonable care with the return.

The level of penalty will depend on HMRC's view of the taxpayer company's behaviour.

- Where HMRC view the behaviour to be careless, the maximum penalty will be 30%. With co-operation and the fact that the taxpayer makes a prompted full disclosure, this penalty can be reduced to 15%.
- Where HMRC view the behaviour to be deliberate but not concealed, the maximum penalty for a prompted disclosure will be 70. However, this can be reduced to 35% where PCL
- HMRC has the power to suspend a penalty in respect of a careless inaccuracy for up to two years, subject to certain conditions being met. Provided the taxpayer is compliant with the conditions, the penalty, or part thereof, may be cancelled. Makes a prompted disclosure.

Pamela should not be worried about PCL being published as a tax defaulter as, even if the underpayment is deemed to be deliberate and not concealed, the amount of underpaid tax is less than £25,000 publication will not be considered by HMRC.

Examiner comment: Issue #3

Most candidates recognised that the £16,000 of client entertainment costs should have been added back in the adjusted profits calculation and this would have been subject to tax at 20%. However, a surprising number of candidates calculated the additional tax due at the current tax rate of 19% which was incorrect.

It was recognised by many candidates that the correction would be a prompted disclosure but surprisingly, many answers did not address how this would impact on the potential penalty that could be charged to the company.

With regards to the potential penalty charge, HMRC will focus on the behaviour of the taxpayer. Many candidates addressed this point in a general way but did not relate this to the facts given in the simulation or provide comment on which category of behaviour would apply to the company. Similarly, whilst many candidates mentioned possible levels of penalties, the scripts lacked clarity of how this would be dependent on the taxpayer behaviour and how the penalty level would be impacted by a prompted disclosure.

In the case study, the director raised the fear of publication as a concern and only a small number of candidates addressed this specifically. Some candidates expressed an opinion that HMRC were unlikely to publish the company's name as a tax defaulter without stating categorically that this could not happen as the tax amounts involved fall below the limit where publication would be considered by HMRC. In many cases candidates did not address the issue of publication in any way and this serves as a reminder to ensure that all specific requirements of an issue are identified and addressed in an answer.

Final Admitting Examination

PAPER 2 – ADVANCED TAXATION (ROI)

INTERIM ASSESSMENT

Saturday 21 April 2018: 10.00 am – 11.30 am

INSTRUCTIONS TO CANDIDATES

1. This assessment is 90 minutes in duration inclusive of reading time.

A separate answer booklet is provided and MUST BE USED BY ALL CANDIDATES.

This is an OPEN BOOK Assessment.

2. Candidates should answer the paper in accordance with the law and practice of the Republic of Ireland and in accordance with the appropriate provisions up to and including the Finance Act 2016.

3. All workings should be shown.

4. **Assessment** begins on Page 2 overleaf.

SIMULATION – PLEASURE CRUISES LTD

(Suggested time: 90 minutes)

Today is 20 April 2018 and you are Jordan Little, a tax manager in a medium sized accountancy practice in Galway. Over the last few years, you have become familiar with the income tax and corporation tax files for Denis and Mary McIntyre and their company Pleasure Cruises Ltd **(PCL)**. Denis and Mary have a combined shareholding of 50% (that is, 25% each). PCL was incorporated in 2002 and its trade involves the hiring out of pleasure cruisers on the waterways in Ireland. Denis and Mary are married and have always taken salaries from PCL each year to fully utilise their respective standard rate bands.

The remaining 50% shareholding in PCL is owned by a third party Pamela Johnstone. Pamela purchased her 50% shareholding in PCL in December 2007, 25% from Denis and 25% from Mary, when the company desperately needed cash to ensure it did not go into administration. Pamela paid € 200,000 for the 50% shareholding. Pamela is 65 years old and her next birthday is on 24 December 2018. All shareholders are Irish tax resident for many years.

As a result of the € 200,000 cash injection in 2007, the trade of PCL was turned around and soon became profitable again. As soon as Pamela became a shareholder in PCL she began working as the marketing director for the company. She worked fulltime for PCL until April 2014. Since then she has worked on a part-time basis as the marketing director.

Pamela is adamant that PCL should expand their service offering to Northern Ireland and Scotland by purchasing additional river cruisers. However, Denis and Mary do not agree. They feel that the Irish market is buoyant enough for them at the moment and therefore they refuse to agree to access bank funding for the purchase of 6 new 10 berth river cruisers. Denis, Mary and Pamela are not willing to compromise and therefore board meetings have been unproductive for the last 12 months. It is clear from recent management accounts that PCL's turnover is decreasing significantly as a result of the differences in opinion on the growth strategy for the company. Pamela has told Denis and Mary that she has no option but to sell her shares and leave the company as she cannot work with people who do not share her vision to expand. A snapshot of the most recent statement of financial position for PCL is outlined below which shows that the value of the company is € 1,400,000.

Non-Current Assets	
Plant & Machinery	€ 510,000
Investment – quoted shares	€ 100,000
Current Assets	
Stock	€ 10,000
Cash	€ 780,000
	€ 1,400,000

The company has distributable revenue reserves of € 850,000.

You had a meeting with all three shareholders yesterday and you have been asked to draft a tax memo for your manager which provides a tax analysis of the different structuring options for Pamela to be paid the € 700,000 she requires immediately for her 50% shareholding. Denis and Mary have been provisionally approved for a € 700,000 loan from their local bank but they are concerned about the monthly repayments and how these will be met for the term of the loan. Denis and Mary have asked for tax advice on how they can extract extra funds from PCL in the most tax efficient way and if PCL could buy Pamela's shareholding?

Pamela also informed you at the meeting that she has been offered € 750,000 for her 50% shareholding by a Dutch company whose trade is similar to PCL, albeit operated in Holland. Due to the Dutch company's financial year end, this offer would not be finalised until 31 March 2019, at the earliest. Pamela has requested tax advice regarding her own personal tax position if she receives € 700,000 immediately versus waiting for the € 750,000 from the Dutch company.

Just before yesterday’s meeting drew to a close, Pamela stated that it has come to her attention that € 16,000 of prospective client entertaining costs were mistakenly classified as a trade conference cost in the financial statements for the year ended 30 September 2016. After the meeting you looked at the filed corporation tax return for the year ended 30 September 2016 and you cannot see any adjustments for client entertainment in the tax adjusted trading calculation. However, you do note that € 25,000 in corporation tax was paid for the tax liability for the year ended 30 September 2016. Pamela has asked that you guide PCL on how this oversight should be corrected bearing in mind that it was a genuine translation error by the book-keeper.

END OF INTERIM ASSESSMENT

SOLUTION – PLEASURE CRUISES LTD

Examiner comment overall:
This case study examined three main areas. A candidate's ability to:
- Advise on the most tax efficient way for remaining shareholders to fund the acquisition of shares. Consideration was required in respect of a share buyback by the company versus the tax position where the remaining shareholders buy the shares personally and fund the loan repayments from after-tax income.
- Advise on the capital gains tax (CGT) treatment where there is a disposal of shares by a shareholder.
- Advise that self-correction, from a corporation tax perspective, is the most efficient way to deal with an error.

The quality of answers provided varied greatly on all three issues.

In respect of issue 1, the majority of candidates correctly identified that the share buyback was a viable option given the facts of the simulation.

For issue 2, many candidates discussed the CGT implications of both the buyback and the proposed sale to the Dutch company and recognised the implications of Pamela waiting until she was 66 for retirement relief purposes. A small number of candidates, made a viable assumption based on the facts of the simulations and therefore, also considered the availability of entrepreneur relief. Unfortunately, the number of candidates who clearly showed a clear understanding of the retirement relief implications of the investment assets held by PCL was disappointing.

The quality of answers to issue 3 was disappointing. A worrying number of candidates seemed to consider that self-correction was no longer an option or they simply ignored self-correction and suggested that an unprompted qualifying disclosure should be made.

Candidates, in general, were able to advise more competently issues 1 and 2. Unfortunately, issue 3 presented some difficulty and was generally the most poorly answered indicator.

Tax Memo

To: Manager
Date: April 2018
Re: Share buy-back and correcting error

Issue #1
The candidate demonstrates knowledge of *competency in Advanced Taxation ROI (2.1)*

Buy shares in PCL personally
If Denis and Mary borrow the money personally to buy Pamela's shares in PCL, then they will have to fund the loan repayments out of their after tax income. They can either take additional salary or dividends from PCL. However, it should be noted that the director's loan account position for Denis and Mary should be established. If PCL currently owes them any money, then this amount should be extracted tax free before considering the amount to be extracted via salary or dividend.

Denis and Mary already extract salaries from PCL to utilise their basic rate bands on an annual basis. Therefore, any additional salary that is paid will be subject to PAYE/PRSI and USC. The following facts should be noted in respect of the decision to extract additional income from PCL via salary:

- Denis and Mary will receive only a net salary as PCL will have put the salary through payroll. They will therefore need to ensure that their net payments are sufficient to meet the monthly loan payments. We note that Mary and Denis have utilised their standard rate band so additional salaries will be liable to income tax at 40% and PRSI and USC.

- Salary income is therefore not likely to be liable to any further taxes in the hands of Denis/Mary.
- The salary (and employer's PRSI where applicable) is deductible for tax purposes against the PCL's profit. This represents a 12.5% tax benefit to PCL.
- For Denis and Mary, salary can increase the capacity to boost pension contributions and can also increase a termination payment if one is being made in the future.

PCL could make annual distributions to Denis and Mary by way of dividend and they could use these dividends to repay the loan. These dividends will be paid once Pamela is no longer a shareholder and therefore Pamela is not entitled to a dividend. However, the following points are relevant in respect of the discussion to generate extra income in the hands of Denis and Mary to enable them to fund the loan repayments.

- Dividends paid by PCL are not deductible for corporation tax purposes.
- Dividend withholding tax at 20% must be withheld by PCL on each of the gross dividend payments to Denis and Mary.
- PCL must remit this withholding tax along with the appropriate declaration on the 14th day of the month following the distribution; thus increasing the administrative burden for the company especially if the dividends are paid every year.
- There is no employer's PRSI on dividends therefore, this is a saving for PCL
- PCL must have sufficient distributable reserves to make the distributions.
- Dividends paid by PCL to Denis and Mary can be used to help PCL avoid a close company surcharge every year.
- Denis and Mary must remit any balance of income tax due to Revenue and declare the dividend income in their annual tax return. The gross dividend will also be liable to USC and PRSI and a credit will be available for the DWT withheld by PCL.

Due to the corporate tax deduction that is available for salary, it is likely that salary is slightly more favourable overall than the dividend option. However, as discussed below, a share buy-back by PCL would have a much more favourable outcome for Denis and Mary as they would not need to take out a loan personally and therefore they would not need to extract additional money from PCL to make the loan repayments.

Share buy-back by PCL

As noted above, any consideration passing to Pamela, as a shareholder of an unquoted company (PCL) in respect of her shares will be a deemed distribution and taxed as income under Schedule F. However, where certain conditions (contained in s176 TCA 1997) are met, such consideration may be taxed as a chargeable gain and liable to CGT treatment. Currently the CGT tax rate is 33% (subject to no reliefs applying) versus a potential 55% rate (income tax, PRSI and USC) if liable under Schedule F.

To qualify for CGT treatment in the hands of Pamela, the share buy-back must be for the benefit of the company's trade. Examples of "for the benefit of the company's trade" (also known as the "trade benefit test") include where there is a disagreement between shareholders over the management of the company which could adversely impact on the business and it is necessary to remove the dissenting shareholder. It is likely that the disagreement between the shareholders in PCL regarding the direction which the expansion of the company, would satisfy the trade benefit test. The recent management accounts which show a reduction in turnover would be evidence of how the disagreement is directly adversely impacting the company's trade.

To satisfy the conditions to get CGT treatment, the following conditions must be adhered to:
1. Pamela (the vendor) must be resident **and** ordinarily resident in Ireland in the year of the share disposal – This condition is satisfied.
2. Pamela must have owned the shares for a period of five years up to the date of disposal – This condition is satisfied as Pamela has owned the shares since 2007.
3. Following the share buy-back, Pamela's shareholding in PCL must have been reduced by at least 25% - this condition is satisfied as she will hold no shares in PCL after the buyback.
4. Following the share buy-back, Pamela must not be connected with the company, i.e. not own more than 30% of issued share capital or voting power or assets available on a winding up of the company – This condition is satisfied as Pamela will hold no shares or rights in PCL after the buy back.
And
5. the share buy-back must not be part of any scheme whose purpose is to enable the owner of the shares to participate in the profits of the company without receiving a dividend – The fact that the buyback meets the trade benefit tests shows that it is being undertaken for the good PCL's trade.

As PCL has distributable reserves available to cover the amount that Pamela is to receive for her shares, the share buyback can be undertaken. An independent valuation should be obtained in respect of the shares to be bought back and PCL should pay market value for the shares.

The share buy-back is clearly the most favourable option for Denis and Mary McIntyre. Denis and Mary will have no additional income tax liabilities if the share buyback option is undertaken.

Examiner comment Issue #1

This issue was well answered by the majority of candidates. On average, candidates scored highest in this issue.

The main focus of this issue was to advise how Denis and Mary could fund the loan repayments if they purchased Pamela’s shares personally versus the option of the company buying back the shares.

Every candidate recognised that a share buyback was an option with many candidates discussing, to a very high standard, the conditions of a share buyback which would enable the funds to be subject to CGT in the hands of Pamela. Some candidates failed to pick up marks for stating that PCL would need to have distributable reserves available to cover the €700,000 share value despite the fact that the distributable reserves value was clearly stated in the simulation.

It was disappointing to note that a significant number of candidates did not align the cash extraction part of the issue to Denis and Mary’s need to fund the bank loan repayments if they purchased the shares personally. Such candidates were given merit for comparing and contrasting the tax position on extracting the money via dividends and salary. However, more competent candidates clearly linked their cash extraction discussion to the situation where Denis ad Mary purchased Pamela’s shares personally.

Unfortunately, some candidates wrongly discussed the possibility of PCL making pension contributions and/or making a termination payment to Pamela. As noted above, this issue required candidates to decide how cash could be extracted to fund the loan repayments which Denis and Mary would need to make if they draw down the bank loan to purchase the shares directly from Pamela. As pension contributions would not provide such cash in Denis and Mary’s hands and as a termination payment would be made to Pamela, neither comments were given any merit. In addition, it was disappointing to see that a number of candidates discussed the extraction of €700,000 immediately. No merit was given for any discussion in relation to Denis and Mary extracting €700,000 from PCL by way of loan as such a loan would fall foul of company law and would have adverse tax implications for PCL and for Denis and Mary.

A number of strong candidates clearly stated that the share buyback was the most favourable option for Denis and Mary as they would not need to personally fund the bank loan repayments under this option. Such a clear level of understanding from a taxation and business perspective was pleasing to note.

Issue #2

The candidate demonstrates knowledge of *competency in Advanced Taxation RoI (2.2)*

Regardless of whether Pamela sells her shares back to PCL or sells to the Dutch company, she will be subject to capital gains tax (CGT) on the disposal. The current rate of CGT is 33%. Therefore, she has the following potential CGT exposures before reliefs:

	Share buyback	**Sale to Dutch company**
	€	**€**
Proceeds	700,000	750,000
Less cost	(200,000)	(200,000)
	500,000	550,000
Less AE	(1,270)	(1,270)
Gain	498,730	548,730
CGT at 33%	**164,581**	**181,081**

Retirement relief, under s598/599 TCA 1997, may be available to Pamela. Retirement relief is a CGT relief on certain disposals of business assets by an individual aged 55 years or over. As Pamela is 65 years old, she fulfils this age condition.

Retirement relief applies to the disposal of qualifying assets. Qualifying assets includes shares in a family trading company where the shares have been held by the individual making the disposal for a period of not less than 10 years ending on the disposal and the individual has been a working director of the company for 10 years, five years of which they have been a full-time working director of the company. A company is a family company in relation to an individual who is disposing of the shares, if she owns at least 25% of the shares.

As Pamela has held her 50% shareholding since 2007, she fulfils the 10 year holding requirement and the family company requirement. PCL is also a company carrying on a trade.

With regard to the working requirement condition for retirement relief, Pamela should satisfy this condition as she became a full-time working director in December 2007 and she continued in this fulltime role until April 2014 and has remained since then, working on a part-time basis as marketing director. She has been a director for in excess of 10 years and she was a fulltime working director for over 6 years.

In order to decide the amount of retirement relief available, the statement of financial position for PCL should be reviewed to see if there are any investment assets. If investment assets are held within a trading company, an apportionment would be required to see what amount of the consideration would qualify for the relief. Upon review of the statement of financial position it is noted that there are investments assets (i.e. quoted shares) to the value of €100,000. Therefore, retirement relief will be restricted and will not apply to these investment assets.

With regard to the availability of entrepreneur relief, as Pamela has only worked part-time since April 2014 it is assumed that she will not meet the "qualifying person" definition as she will not have spent 50% or more of her working time in PCL in a managerial or technical capacity for a continuous period of not less than three years in the five years immediately before the disposal of the shares. Therefore, retirement relief is the only relief available to Pamela.

As Pamela is eligible for retirement relief, the timing of the disposal to the Dutch company is an issue. For retirement relief purposes, where the disposal is to a person or entity other than a child, then the relief only applies to disposals that generate proceeds totalling €750,000. This €750,000 threshold is a lifetime limit for disposals an individual makes after reaching age 55. Therefore, the limit that will apply to the share buyback will be €750,000. However, in respect of the proposed sale to the Dutch company, as this will not happen until Pamela is 66, the limit of €750,000 is reduced to €500,000.

As a result of this reduction in the lifetime limits, it is clear from the calculations below that Pamela will have a higher after tax lump sum from the sale of her shares if she opts for the share buy-back despite the fact that the sales proceeds are €50,000 lower.

Share buyback

Proceeds not in excess of €750,000	**€**
Gain	500,000
CBA/CA	510,000/610,000
Gain qualifying for retirement relief	418,033
Gain not qualifying for retirement relief	81,967
No AE available	-
CGT at 33%	27,049
Net proceeds for Pamela after tax	**672,951**

Sale to Dutch company

Pamela will be over 66, therefore €500,000 proceeds limit applies.

Sale proceeds to be taken into account = €750,000 x €510,000/€610,000

= 627,049

This is in excess of the €500,000 limit. Therefore, marginal relief needs to be considered. Marginal relief limits CGT to the lower of half the proceeds in excess of €500,000 limit or the actual CGT computed.

Proceeds of €627,049 - €500,000 = €127,049. €127,049/2 = 63,525

Actual CGT is	627,049
Less cost (200k x 510/610)	167,213
Gain	459,836
CGT 33%	151,746

Therefore 63,525 is lower and this is the amount that applies

Gain on investment property element:	**€**	
Proceeds	750,000	
Less cost	(200,000)	
Gain	550,000	
less gain covered by MR		
x 510,000/610,000	(459,836)	
Gain not qualifying for retirement relief	90,164	
No AE available		
CGT at 33%		29,754
Total CGT		93,279
Net proceeds for Pamela after tax		**656,721**

Examiner comment – A candidate could have assumed that when Pamela reduced her working time with PCL to part-time from April 2014 she continued to spend 50% or more of her working time in PCL. Where a candidate clearly stated this assumption and concluded that Pamela would have been entitled to entrepreneur relief as she worked as a director in a managerial or technical capacity for a continuous period of not less than three years in the five years immediately before the disposal, then the following alternative solution was given credit.

Revised entrepreneur relief provides a 10% rate of CGT to an individual who disposes of chargeable business assets if that individual is a "relevant individual" or "qualifying person". There is a lifetime limit of €1,000,000 of chargeable gains that qualify for the 10% rate.

Chargeable business assets include ordinary shares in a qualifying company carrying on a qualifying business, provided that the individual selling the shares owned 5% or more of the ordinary share capital in the company being sold. Pamela meets the shareholding requirement as she held 50% of the shares in PCL. For entrepreneur relief, a "qualifying business" is a business that does not include:

- the holding of shares/securities held as investments;
- the holding development land; or
- the development or letting of land.

PCL is carrying on a qualifying business as its trade involves the hiring out of pleasure cruisers in Ireland.

A "qualifying person" is an individual who:

- has been a director or employee of the company – Pamela was a director of PCL; and
- who was required to spend 50% or more of their working time in that company in a managerial or technical capacity and has done so for a continuous period of not less than three years in the five years immediately before the disposal of the assets – it is noted that Pamela has worked on a part-time basis for PCL since April 2014. It is assumed that working on a part-time basis for PCL means that Pamela continued to spend 50% or more of her working time with PCL in a managerial capacity. Based on this assumption, she meets the definition of a qualifying person for entrepreneur relief.

The definition of chargeable business assets is different for entrepreneur relief and retirement relief. No restriction applies in respect of the quoted shares held by PCL for entrepreneur relief purposes. This contrasts with the position for retirement relief where an apportionment is required in respect of the amount of 'chargeable business asset/chargeable assets'. In addition, the entrepreneur relief lifetime limit is €1,000,000.

The sales proceeds for the sale to the Dutch company are €750,000. That is, €50,000 higher than the share buyback amount. Given the €500,000 retirement relief limit (as she will be 66 years old when the sale takes place) and the additional tax exposure as a result of the investment assets for retirement relief purposes, it can be concluded that entrepreneur relief coupled with the €50,000 additional proceeds will lead to the most favourable after-tax position for Pamela.

Pamela's CGT liability and net proceeds position where entrepreneur relief is claimed on the sale to the Dutch company is outlined below:

	Sale to Dutch company
	€
Proceeds	750,000
Less cost	(200,000)
	550,000
Less AE	(1,270)
Gain	548,730
CGT at 10% as ER available	**54,873**
Net proceeds	**695,127**

It is therefore advisable that Pamela waits and sells to the Dutch company for €750,000 as an entrepreneur relief claim will mean that she retains the highest amount of net proceeds.

Examiner comment Issue #2
Answers to this issue were mixed with poor quality computations remaining a problem for many candidates.

Many candidates displayed a clear understanding of the conditions of retirement relief and applied the conditions to the facts of the simulation. It was pleasing to note that the vast majority of candidates recognised the reduction in the retirement relief limits when Pamela reaches 66. The simulation clearly provided details of the assets on the statement of financial position which included some investment assets. A worrying number of candidates simply ignored this information and calculated retirement relief as if all assets were chargeable business assets. The majority of candidates considered entrepreneur relief and concluded that as Pamela only worked part-time from April 2014 she did not meet the qualifying conditions.

A small number of candidates clearly stated that they assumed Pamela continued to spend more than 50% of her working time with PCL even though she dropped to working for PCL on a part-time basis from April 2014. Where a candidate was very clear in making this assumption and then continued to display knowledge of how the conditions of entrepreneur relief were satisfied, merit was given to advice in respect of an entrepreneur relief claim, as opposed to retirement relief. It was pleasing to note that a small number of candidates scored very well in this indicator as they displayed comprehensive knowledge of the conditions of entrepreneur relief as well as acknowledging that the definition of chargeable business assets was different for entrepreneur relief when compared to the retirement relief definition.

Issue #3
The candidate demonstrates knowledge of *competency in Advanced Taxation RoI (1.3)*

The amount of the add backs in the tax adjusted trading profits calculation for the PCL for the year ended 30 September 2016 were €16,000 under declared. Any customer/supplier entertainment amounts should be added back.

The corporation tax return filing deadline for the year ended 30 September 2016 was 23 June 2017 if filing on ROS. As the corporation tax liability was €25,000 before the above adjustment, it will increase to €27,000 (i.e. €25,000 + €16,000 x 12.5%).

A tax payer company, such as PCL, can decide to make a self-correction to the corporation tax return for the year ended 30 September 2016.

Self-correction arises outside of the audit or enquiry process. A return may be self-corrected without penalty where:

- Revenue is notified in writing of the adjustments to be made, and the circumstances under which the errors arose.
- A computation of the correct tax and statutory interest payable is provided, along with payment in settlement.
- The errors must not be in the ‘deliberate behaviour’ category.

The time limit for self-correction of a corporation tax computation is within 12 months of the due date for filing the return. That is, 12 months from the due date of filing the return. Therefore, for the year ended 30 September 2016, the last date for self-correction is 23 June 2018.

It is therefore advisable that the self-correction is undertaken immediately and no later than 23 June 2018.

All company records should be reviewed to ensure that further amendments are not required because of similar errors in previous years.

Examiner comment Issue #3
Generally speaking, this issue was the most poorly answered.

The vast majority of candidates understood that the client entertaining expense should have been an add back in the tax adjusted trading profit calculation and worked out that the additional tax due was €2,000.

Candidates who correctly identified that self-correction was an option scored well in this issue as the remainder of issue 3 centred on the candidate's knowledge of the Revenue Audit Code of Practice. An unprompted qualifying disclosure clearly would not be the best advice due to the penalty advantage lost as a result of not considering self-correction.

Unfortunately, a number of candidates showed confusion around the corporation tax filing deadlines and therefore failed to recognise that the self-correction window was still open. No merit was given for a discussion around how an unprompted qualifying disclosure should be implemented and as such many candidates wasted valuable exam time writing about an option which was not the correct way the oversight should be dealt with.

Worryingly, a number of candidates appeared to think that self-correction and making an unprompted qualifying disclosure was the same thing. This was somewhat surprising as the issue of self-correction was examined in the interim assessment in 2017 and is dealt with clearly in the FAE Elective and Core textbooks.