Final Admitting Examination

Chartered Accountants Ireland

PAPER 3 ADVANCED TAXATION REPUBLIC OF IRELAND

SUMMER 2016 (Friday 19th August 2016: 10.00 am – 2.30 pm)

INSTRUCTIONS TO CANDIDATES

1. The first 30 minutes of this examination is dedicated to reading time.

   During this time, candidates may make notes on this examination paper or on their own pages and refer to their materials.

   Candidates are **NOT** permitted to open their answer books until instructed to do so.

2. Answer **BOTH** Simulations.

3. 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 2014.

4. All workings should be shown.

5. **SIMULATION 1** begins on Page 2 overleaf.

SIM 1: THE KELLY FAMILY

(Suggested time: 120 minutes)

You are Ben Shiels, a recently qualified chartered accountant working in the tax department of TML & Co., a medium sized accounting and tax practice. It is 19 August 2016 and Tom McLaughlin, a tax partner, calls you into his office to brief you on new clients, Patsy and Mary Kelly. Tom met with them yesterday and has told them to call back to the office on Wednesday to discuss a number of tax issues raised.

By way of background, Tom tells you that Patsy (62) and Mary (59) Kelly are married with no children. Patsy and Mary are both directors and shareholders in Kelly Contracts Ltd ("KCL"). Patsy owns 75% of KCL and Mary owns the remaining 25%. KCL is a trading company involved in the construction industry. The company prepares its financial statements to 30 November each year.

Mary lent € 100,000 to KCL in January 1995 when the company was incorporated. This money has not been paid back to date. With the help of this loan, the company has grown substantially over the years. Patsy has been a full-time working director since incorporation. Mary has always worked part-time with the company since incorporation, taking a gross salary of € 30,000 per annum. Due to ill health, Mary needs to cease working for the company immediately. She will retain her shares but would like to get a cash lump sum of € 140,000 from the company now to fund her medical needs. Tom states that Patsy and Mary would like our advice on how to extract the € 140,000 for Mary as tax efficiently as possible. The company currently has a cash balance in excess of € 400,000. In addition to this, surplus cash of € 100,000 has been generated every year for the last 4 to 5 years. The company does not currently operate a pension scheme.

Tom also informs you that Patsy would like to retire within the next three to five years. Patsy has had a few offers in the past for the company's trade (as opposed to the shares) but he feels that with the market improving, he might be able to further build up the value of the company's trade. Patsy would like us to put together some tax planning suggestions in respect of his anticipated sale of the company's trade and his retirement. He anticipates that he will be able to sell the company's trade to a competitor company for in excess of € 1,200,000. He has heard that other companies, like KCL, just get liquidated after their trade is sold. He wants to understand how much money he and Mary will be left with if this happens. Tom states that for the purposes of giving Patsy some figures, we are to base our advice on the assumption that KCL's statement of financial position (see **Appendix I**) immediately after the sale of the company's trade shows a value of € 1,000,000 available for distribution to the shareholders. You should also assume that all tax rates and reliefs remain unchanged from now.

Patsy said that as the company is now in a healthy position he would like to increase his salary to a maximum of € 100,000 per annum going forward and he would like to know if he/KCL should undertake any other tax planning before the company's trade is sold.

Tom finishes the meeting by saying "can you have a briefing note ready for Wednesday's meeting. In addition to the retirement and liquidation planning issues we have talked about, I need you to look at an email I have just sent you (see **Appendix II**) regarding VAT queries which Patsy needs help on. Please include your analysis of the VAT implications on the sale of the two properties in your briefing note for Wednesday's meeting."

APPENDIX I: PROJECTED STATEMENT OF FINANCIAL POSITION IMMEDIATELY AFTER SALE OF KCL'S TRADE:

Assets	**Note**	**€**
Bank	1	1,000,000
Share capital & Reserves		
Issued share capital	2	20,000
Retained earnings		980,000

Note 1 – Proceeds for sale of company trade after **all** company expenses and taxes are paid.
Note 2 – 20,000 shares with a nominal value of € 1.

APPENDIX II: EMAIL ON VAT QUERIES:

EMAIL
TO: b.shiels@tml.ie
FROM: t.mclaughlin@tml.ie
RE: Kelly Contracts Ltd – VAT

Ben

Please include details of KCL's VAT obligations on the sale of the following properties in your briefing note for Wednesday's meeting:

- A commercial unit near Athlone town centre is to be sold for € 200,000 plus VAT (if any). KCL bought the undeveloped site in 2002 and they then constructed the unit on the site. The development of the property was completed on 1 August 2002. KCL used the unit for its own trade until recently. The cost of the site was € 50,000 and the development of the unit cost € 150,000 plus 13.5% VAT. No further development has been carried out since then. Interest in this property has been slow however, the estate agent has informed Patsy that a dentist has viewed this property a couple of times and she intends to move her dental practice to the unit if she buys it. She is however concerned about VAT being charged on the purchase of the property because her business is VAT exempt;
- A pub premises in Cork is to be sold for € 250,000 plus VAT (if any). KCL purchased this property for € 175,000 in 2006 as part of its ongoing construction trade. The property was originally a residential premises. KCL bought this property because of its location and undertook the construction project to convert it to a pub premises in 2013 with the development costs totalling € 60,000 plus 13.5% VAT.

Thanks

Tom

END OF SIM 1

SIM 2: PETER MCGOWAN

(Suggested time: 120 minutes)

You are Joyce O' Connor, a tax senior at Carmody Tax Partners, a medium sized firm based in Tralee. You and Garrett Carmody, the firm's tax partner, have just come out of a meeting with Peter McGowan, a new client of the practice. Peter is looking for some taxation advice on a number of issues and Garrett has asked you to prepare a briefing memo for him regarding the same. You can assume today's date is 1 February 2016.

Peter McGowan who is currently Irish resident and domiciled owns 100% of Ice ("ICE") Limited, a company engaged primarily in the research and development of new technologies for smart phones and devices. Peter also owns 100% of Polar ("POLAR") Limited, a company engaged in the development and manufacture of "smart" devices. Both companies are Irish resident and have a 30 June year end. The company's financial controller has estimated that POLAR will have current year adjusted trading profits in line with previous years. ICE has substantial trading losses forward as well as substantial estimated current year trading losses. ICE is entitled to the R&D tax credit but as it is loss making Peter feels the company has little use for the credit.

The first issue on the agenda at today's meeting was that an investment company has recently approached Peter and is interested in acquiring POLAR's head office in Killarney. POLAR acquired this office in the 1980s and should the sale go ahead it is likely to generate a substantial gain for the company.

In the meeting Peter said "I am delighted about the prospect of this sale as a significant gain should be generated. The sale is not likely to happen for at least another 9 to 12 months which gives us plenty of time to find a new head office... However a significant capital gain is likely to arise on the sale. As time is on our side I want you to consider ways this liability could be minimised."

Peter then goes on to tell us about ICE's R&D activities. He explained to us that neither he nor the company's financial controller know much about the R&D tax credit but ICE does qualify for the credit on its R&D revenue expenditure. He then proceeded to say that "the company's financial controller calculated the credit to be € 40,000 for the year ended 30 June 2015 but ICE is loss making and the company never has a corporate tax liability so we have no use for the R&D credit. I have heard that you can surrender R&D credits to key employees, but our employees get significant bonuses as it is, so we are not interested in this option." Garrett and I looked at one another, both of us recognising Peter's error, when he said the company had no use for the R&D credit. Garrett asked Peter had ICE filed its 2015 corporation tax return and Peter said it was on his desk to be signed but it was not yet filed with Revenue.

Peter informs you and Garrett that they are looking at ways to make ICE profitable again. ICE is looking to expand its operations into Scotland over the next few years. By 2017 ICE intends to acquire a warehouse in Scotland for storage and display purposes. By 2018 ICE will hire a Scottish employee to run the day to day operations of its Scottish activities. All key decisions regarding the Scottish operations will continue to be made by the head office in Ireland. By 2019 Peter intends to split his time between Ireland and Scotland. Peter intends to keep his family home in Ireland and his wife and children will remain in Ireland during this period. While in Scotland he will be negotiating contracts on behalf of ICE. Peter anticipates that he will spend 18 days out of every month in Scotland.

Peter is interested in finding the taxation implications for ICE regarding its Scottish operations in particular for the years 2017, 2018 and 2019. Peter also states "I have done some research of my own and in 2019 I think I could be UK resident as well as being Irish resident. Could this be possible? I would also like your advice in this regard as I do not want any unexpected surprises from HM Revenue and Customs."

Finally Peter ends the meeting by saying that his wife Avril is also looking for tax advice. Avril is happy for Carmody Partners to bill her separately for this advice. She is an architect and currently runs this business as a sole trader. Due to the upturn in the economy the business is doing well and last year alone tax adjusted profits of € 120,000 were generated. She only takes drawings of approximately € 50,000 each year and the excess is placed in a deposit account which earns interest. She knows that incorporating is beneficial due to the 12.5% tax rate but she is interested in any other considerations (income tax and corporate tax) to be taken into account before incorporating. Avril will be a 100% shareholder in this newly formed company. Peter says that “Avril keeps talking about the start-up exemption for companies and that she won’t have to pay corporation tax for three years.” Avril is not interested in the CGT, VAT or stamp duty implications of incorporating.

Garrett has asked you to prepare a briefing memo on the taxation issues that have arisen from the above meeting.

END OF SIM 2

END OF PAPER