

## Masters Case Study

### The T and A Repurchase Proposal

Taite Moneybags and his business colleague Aramis Lotsamoney are residents of the UK for tax purposes. They have approached you, as their tax advisor, with some questions about starting a business. They have an interesting business concept involving land development activities.

The two plan to set up a parent company, borrow money through the company structure, and loan the money at a commercial rate to a 100% owned subsidiary company. Their initial thoughts are the undertaking will encompass a 2 year planning phase, 5 years of business operation and then the sale of the subsidiary company. During the 5 years of operation the subsidiary will buy and develop land for subdivision and sale.

There are no planned changes in the shareholdings in either company in this 7 year time period. It is planned the subsidiary will pay interest and dividends to the parent company.

The business model involves the sale of the subsidiary company by shares to the least competent tender applicant and its subsequent repurchase at a significantly lower price than sale price after 2 – 3 years, refinancing the company's existing loan if necessary. This plan requires significant initial borrowings with associated expenses including interest

The business model involves the sale of the subsidiary early in the relevant financial year after five years of operation. It is expected the sale will generate losses due to the continuing interest expenses in the year of sale and the relevant years following the sale as the loans will not be paid out, only the necessary loan commitments will be paid. The losses will then be utilised to maximise the time before the repurchased subsidiary has a taxable income.

Formulate, with reference to appropriate legislation and case law, a concise explanation in the form of a report utilising sub headings which specifically addresses the following points:

1. Whether Taite and Aramis would be operating through a permanent establishment, and discuss the role the permanent establishment plays in determining their liability to tax in Australia.
2. Assuming the taxable entities involved are a resident of Australia for tax purposes discuss whether interest expenses will be deductible **prior** to commencing business activities, **during** the life of the land development business and **after** the sale of the business. In particular explore the effect **refinancing** may have on the deductibility of interest expenses after the planned repurchase,
3. The deductibility of the expected losses after repurchase
4. Whether the fact the land is trading stock for the subsidiary means they will be exempt from CGT on the sale of the subsidiary
5. Identify the business risks associated with this plan and suggest some risk management strategies.

**(Ignore GST and stamp duty issues)**