



Question 3.1

Using your recent work experience, describe how you have used your professional judgement in choosing between options.

EXAMPLE ANSWER

RESTRUCTURING OF A FAMILY FARMING BUSINESS

Mr J Katerson, a member of the CLA, owned a family farming business. Due to legacy reasons, the business was managed through two companies. The first one, Ram Ltd, being the land-owning company, let the farm land to the second one, HAP Ltd (HAP), for the day-to-day farming activities. In other words, Ram was a property company and HAP was a trading company. In 2018, Mr Katerson approached me with the desire to simplify the business structure and to ensure inheritance tax (IHT) reliefs are maintained.

The mutually exclusive options I considered were:

- Ceasing HAP and operating under Ram;
- Merging the two entities under Ram;
- Running a contract farming arrangement between the two companies.

The main advantage of ceasing HAP and running the farming activities from Ram was that the business affairs would be simplified. The restructuring mechanism would also be the most straightforward. However, there were a significant issue in terms of how to extract the retained profits from HAP effectively, bearing in mind that it had built up a reserve of almost £2 million over the years. The financial accounts suggested that this reserve related to an amount due from Ram, which meant that the shareholders could be exposed to a capital gains tax (CGT) charge when there was not any 'real' profit.

There were advantages of merging the two companies under a paper for paper exchange, i.e. HAP shareholders would exchange HAP shares (old holding) for Ram shares (new holding) as part of the reorganisation. Under this scenario, any capital gains could be rolled-over under sections 126-138A Taxation of Chargeable Gains Act (TCGA) 1992. However, the complication here was that the three family members did not have 75% voting rights in HAP and this might restrict their share capital. The remaining shares were owned by the family Trust, and there was, therefore, some uncertainty about whether the trustees would agree with the family members about significant decisions.

The third option involved Ram engaging HAP under a contract farming arrangement where HAP would provide labour and machinery. This would allow Ram to release working capital that would otherwise be tied up in machinery. By taking business risks in a contract farming arrangement, Ram would trade as a farmer for tax purposes. This approach could, however, be cumbersome as Mr Katerson would need to ensure that income and expenditure were paid into/from the correct bank account. An additional layer of administration would, therefore, be required. It would not simplify the business. The only benefit of this option was to allow the shareholders of both companies to gain a trading status so as to qualify for IHT business property relief (BPR).

On balance, I considered the second option of merging being the best option in long-run. The benefit of rolling over the capital gains tax was clear, and I judged that the risk of not passing any

Special Resolution required would be low enough to warrant the choice of this option, as the interests of different parties should generally have aligned.

EXAMPLE ANSWER

THIRD PARTY DUE DILIGENCE PROGRAM- CONDUCT BY IN HOUSE TEAM OR EXTERNAL PARTY

QRS (“the company”) was one of the top electronics component distributors and one of the top companies globally. During 2020~2021, the worldwide electronics product supply chain was severely impacted by the pandemic and resulted in market prices increasing. In addition, there was an increased risk of corrupt practices from business partners (“BPs”), e.g., improperly buying excessive products at preferential prices and then selling the products on the black market with much higher price. Therefore, management decided to put in place a due diligence screening program (“DD program”) to make sure the compliance risks from BPs, were properly evaluated and addressed.

I led the project to assess the implementation plan of the DD program in mainland Area 12 region as a pilot. The key factors to consider were whether to consider hiring an in-house team or an outsourced external firm to carry out the due diligence. Given that the DD program was only required when the company engaged new BPS or re-assessed the BPs’ information every two years, I considered the following options for comparison:

Option 1: Step-up an in-house DD program team comprising cross-functional team members, including legal, ethics and compliance, finance, business operation (“the team”) for the program, as part of the team members’ daily work.

Option 2: Outsource to an external consulting firm (“the firm”) which was expert in due diligence.

I carried out a Pros and Cons analysis between the two options as below:

Pros in option 1:

- a) The team could respond to user’s requests in a timely manner.
- b) The team had insightful understandings of the risk of this industry.
- c) No significant additional cost would be incurred.

Cons in option 1:

- a) The team members were scattered across 3 centralized offices, and it might be impractical for the team to perform site visits due to the travel restrictions during the pandemic.
- b) Sourcing of a user-friendly tool in the market was a challenge. I had reviewed a few resources in the market, but the functionality was still limited. Therefore, it was not clear how we could source an effective tool to cater for the needs for the team to record the due diligence results and run statistical reports for management review.
- c) There would be a long process to achieve the alignment on the program’s content due to the different knowledge background of team members.

Pros in option 2:

- a) The firm had comprehensive and mature DD programs in their database.
- b) The firm had an international operational business unit and could provide site visits on a global scale.
- c) The firm had an existing tool to capture the DD program results which was available for customers to access, review, comment and which could download the required statistical reports.

Cons in option 2:

- a) Significant cost would be incurred.
- b) Timely response to user’s request could be a challenge.

After weighting up the pros and cons for the two options, and also the urgency of the required roll-out of the DD program, I selected option 2 (i.e. outsourcing). The key benefits of outsourcing were to make sure the DD program was standardised, comprehensive, and ready for implementation soon. With its expertise in DD programs, the firm could provide insightful reports to help

management deal with the risk from BPs, especially during the period of uncertainty caused by the pandemic.