Association of Taxation Technicians

Examination

November 2005

PAPER 2 – PART II

BUSINESS TAXATION

TIME ALLOWED - 3 HOURS
(for Part I and Part II)

You are required to answer **all** questions in Part I (printed separately) and any **three** out of five questions in Part II.

The maximum number of marks for each question in Part II is shown in brackets.
For Part II, start each answer on a fresh sheet.
All workings should be shown and made to the nearest month and pound unless the question requires otherwise.
Marks are specifically allocated for good presentation.

1. Zellon Ltd makes up an 18-month set of accounts to 30 November 2004 with the following results:

	£
Trading profits	240,000
Schedule D Case III income	18,000
Chargeable gain (1 July 2004 disposal)	300,000
Gift Aid donation (paid 28 December 2003)	(65,000)

The Schedule D Case III income accrued evenly throughout the period.

Zellon Ltd had the following tax losses brought forward at 1 June 2003:

	£
Trade losses	89,000
Deficit on non-trading loan relationships	27,000

The shares in Zellon Ltd are owned as follows:

	%
Mr S Brown – a UK resident individual	75
S.Brown (UK) Ltd – a UK resident company	25

S.Brown (UK) Ltd is Zellon Ltd's only associated company.

Zellon Ltd paid the following dividends during the 18-month period:

	£
12 January 2004	68,000
6 April 2004	75,000

On 12 November 2004, Zellon Ltd supplied goods to a major customer, Ashton Ltd prior to raising an invoice for their sale. The sales invoice was issued on 26 November 2004.

At 30 November 2004, Zellon Ltd's accounts included provision for a bad debt for a sales invoice dated 4 July 2004. Zellon Ltd prepares quarterly VAT returns co-terminus with the end of the above period of account.

You are required to:

1) **Calculate the profits chargeable to Corporation Tax for each of the accounting periods.** (6)

2) **Calculate the Corporation Tax payable for the accounting periods and due date for payment.** (9)

3) **State, with reasons, the tax point for VAT purposes for the goods sold to Ashton Ltd.** (2)

4) **State in which VAT quarter relief for the bad debt can be claimed and what conditions must be satisfied to allow the relief to be claimed?** (3)

Total (20)

2. Your tax partner is going on holiday for a week, and has asked you, in his absence, to liaise with two of his clients.

Rolf and Co, a firm of solicitors, are considering using the VAT flat rate scheme. Their senior partner, Mr Herzog, wishes to meet to discuss the implications of such a decision.

The following file notes will be useful to you prior to the meeting.

Flat rate scheme % for solicitors – 13%.

Summary of Rolf and Co's VAT Returns for the year ended 30 June 2005:

Quarter	Outputs		Inputs	Payment
	Net	VAT	VAT	VAT paid
1	21,000	3,675	325	3,350
2	20,250	3,544	375	3,169
3	23,500	4,113	315	3,798
4	25,125	4,397	115	4,282

You are required to prepare your notes for the meeting including detail and explanation of the following:

1) **The expected savings to Rolf and Co by using the flat rate scheme.** (4)

2) **How capital purchases are treated under the scheme.** (2)

3) **What other VAT schemes can be used in conjunction with the flat rate scheme.** (2)

Mark Nadler is an IT consultant and provides his services through his 100% owned company Nelly IT Ltd.

Your firm have recently been appointed as Nelly IT Ltd's tax adviser and the partner is concerned whether the services provided by Mark to his customers fall within IR35 legislation. Mark has provided the following information regarding the work he does and his customers.

1) Mark works 20 hours per week for a software development company, Save IT within their own IT support department and is paid an hourly rate.

2) The remainder of his time is spent on providing outsourced IT support to small businesses. He is paid a fixed monthly fee and the level of service provided to each customer varies depending upon demand. Mark has an employed assistant who supports him with these roles.

Nelly IT Ltd's profit and loss account for the year ended 31 March 2005 is as follows:

	£	£
Sales - Save IT	30,000	
Other	28,000	58,000
Expenses		
Professional indemnity insurance - for Save IT contract	740	
Director's salary	15,000	
Director's employer's National Insurance Contributions	1,142	
Assistant's wages and National Insurance Contributions	13,100	
Other administration expenses	8,750	38,732
Net profit before taxation		19,268

Your partner has asked you to write a letter to Mark setting out the following:

4) **Your concerns regarding IR35 legislation.** (7)

5) **Calculation of the expected 2004/05 deemed payment and employer's National Insurance Contributions.** (5)

Total (20)

3. Alan and Vincent commenced in partnership as training consultants on 1 May 2003, sharing profits in the ratio 1:2, after annual partnership salaries of £5,000 and £3,000 each respectively.

The partnership has one employee, James, who commenced employment with the partnership after an extended career break on 1 May 2003 with an annual salary of £25,000.

Alan left the partnership on 1 June 2004 and James was introduced as a new partner on 1 June 2004. From 1 June 2004, the profits are apportioned as follows:

	Salary, £	Balance, %
Vincent	3,000	70
James	4,000	30

The pre-capital allowances profits of the partnership are as follows:

	£
Year ended 30 April 2004	28,250
2005	55,750

Capital additions and disposals in the two-year period were as follows:

		£
1 May 2003	IT equipment purchased	5,750
10 June 2003	Office furniture purchased	3,275
17 May 2004	Ford Mondeo purchased (25% private use of a partner)	12,500

The partnership is considering accepting an offer from a Local Authority to provide educational services which would qualify as exempt from VAT under Group 6 VAT 1994 Sch 9.

You are required to:

1) **Calculate the profit apportionment after capital allowances for each partner for the accounting periods ended 30 April 2004 and 2005.** (10)

2) **Calculate James's expected National Insurance Contributions for 2004/05.** (5)

3) **Write a letter to the partners advising them briefly of the VAT implications of the inclusion of VAT exempt supplies in their services.** (5)

Total (20)

4. John Rochester is the managing director of Rochester Consulting Ltd. The company began trading shortly after John left his previous role in a multi-national consulting group to focus on a niche area of consulting.

The company's first set of accounts have been prepared for the 12 months ended 31 August 2005 and the results show the business has got off to a very successful start showing a profit before tax of £250,000 based on turnover of £1,000,000. The company has a number of corporate investors and Rochester is not a close company for tax purposes.

John has explained to you that he plans to grow the business quickly to establish the company as a leader in its area and therefore the headcount is planned to increase from its current level of 20 full time employees to around 50.

John has always been wary of the need to stay on top of various compliance issues and because of the growth of the business would like to understand the Corporation Tax compliance requirements for Rochester Consulting Ltd. John would like to understand what paperwork must be filed, when it must be filed, how long the tax authority has to enquire into the company's affairs and how they will know the Inspector has concluded his enquiries, when any corporate tax must be paid and any penalties for failing to submit the paperwork on time.

Additionally, due to the rising number of employees he would like to understand the company's obligations regarding National Insurance Contributions as the finance director has explained that the payroll team have had a few problems with the company's obligations.

Also, because of the rapid expansion the company is seeking to purchase a small office block, rather than rent as it currently does. The offices it has identified are ideal except for the fact that they are a little excessive for the planned 50 employees and so there would be excess capacity. As a solution, the finance director has suggested to John that Rochester Consulting Ltd rent the excess space to a third party for a period until it can utilise the space fully. The office block was constructed over 10 years ago.

John understands that, although Rochester Consulting Ltd is registered for VAT and makes fully taxable supplies, the VAT associated with the office purchase and costs of certain internal structural changes to the building to allow the lease could create VAT complications. John would like to understand these consequences in more detail and what options the company has.

You are required to write a letter to John:

1) **Explaining the Corporation Tax compliance requirements for Rochester Consulting Ltd for the period ended 31 August 2005 as he has requested.** (7)

2) **Detailing the types of National Insurance Contributions (excluding Class 1B) due by the company, the reporting requirements, the payment dates and the implications of late payment.** (7)

3) **Explaining the VAT implications and options open to the company in respect of the purchase of the offices and lease of excess space.** (6)

Total (20)

5. You have recently been out to see Jessica who is the finance director of a new corporate client, Plum Ltd. Plum Ltd produces various preservatives and has a wholly owned subsidiary, Mustard Ltd, which produces various sauces and food accompaniments. Plum Ltd has owned Mustard Ltd for over five years.

Jessica has requested some guidance on a number of matters and provided you with the following information:

1) The draft results for the period ended 30 June 2005 are as follows:

	Plum Ltd	Mustard Ltd
	£	£
Schedule D Case I	950,000	850,000
Schedule A	NIL	(20,000)

2) The Schedule A loss arose in the year due to Mustard Ltd needing to incur significant costs on redecorating the rental property it owns. Jessica would like to understand what relief can be obtained for the loss.

3) Plum Ltd needed to increase its production capacity and engaged in the following transactions in the year ended 30 June 2005:

   (a) Sold a small processing workshop to Mustard Ltd in December 2004 for £300,000, its market value. Plum Ltd had originally purchased the workshop in November 1999 for £189,000.

   (b) Sold a processing factory to an unrelated party for £450,000 in March 2005, which it originally acquired for £225,000 in May 1998.

   (c) Bought a new processing plant for £400,000 in January 2005.

4) Plum Ltd owns an investment in ordinary shares in Juice Ltd, a company that produces fruit based beverages. Plum Ltd's shareholding is equal to 15% of the total issued ordinary shares of Juice Ltd, which it bought for £128,000 in February 2005. The finance director is intending to sell its interest in Juice Ltd during the period ended 30 June 2006 and expects the shares to fetch around £200,000. The finance director understands that Plum Ltd can sell the shares without having a taxable gain.

5) The finance director explained that the business is forecast to grow healthily and the expected results (ignoring any impact from the sale of Juice Ltd) for the year ended 30 June 2006 are taxable profits of £1,050,000 and £900,000 for Plum Ltd and Mustard Ltd, respectively.

You also note from correspondence with the previous tax advisers that the taxable profits for Plum Ltd and Mustard Ltd for the years prior to 30 June 2005 have always been less than £750,000 each.

You are required to write a letter to Jessica to:

1) Set out how the Schedule A loss can be relieved including the position if Mustard had a trading loss rather than a profit. (3)

2) Show and explain the total taxable profits for both companies for the year ended 30 June 2005 after taking into account the various disposals and assuming any beneficial reliefs are taken. (6)

3) Explain what relief is potentially available for the disposal of the shares in Juice Ltd and the conditions that must apply. (5)

4) Explain the basis on which Plum Ltd must make Corporation Tax payments for the year ended 30 June 2005 and 30 June 2006 with an estimate of the amounts and payment dates. (6)

Total (20)