Association of Taxation Technicians

Examination

November 2005
(FA 2005)

PAPER 2 – PART I

BUSINESS TAXATION

Answers

ANSWERS TO SHORT FORM QUESTIONS

Q1

11 MONTHS TO 31 DECEMBER 2005

			POOL	ALLOWANCES
WDV B/FWD			20,000	
Sale Proceeds 1/7/05			(8,000)	
			12,000	
WDA @ 25% *11/12			(2,750)	2,750
			9,250	
01.05.05	Van	12,000		
	FYA@ 40%	(4,800)		4,800
			7,200	
WDV C/FWD			16,450	
ALLOWANCES				7,550

1 MARK FOR WDA
1 MARK FOR FYA

Q2

A non-trade deficit can: -

- Be set against profits of the deficit period
- Be carried back and set against profits of earlier accounting period arising from non-trade loan relationships.
- Be surrendered as group relief
- Be carried forward and set against future non-trading profits

1 MARK FOR ANY OF THE ABOVE
1 MARK FOR ANY TWO FROM OTHER THREE

Q3

Assessment for 2005/06

Year ended 30 June 2005	60,000	(12 months)
Add: Period ended 30 November 2005	50,000	(5 months)
	110,000	
less: Overlap Relief (as below)	(37,500)	
	72,500	

Overlap

Opening arising in 1997/98	
£90,000 * 9/12 =	67,500
less: Used on change of a/c date * 5/9	(37,500)
	30,000

I MARK FOR ASSESSMENT
1 MARK FOR OVERLAP

Q4

Profits chargeable to corporation tax	£40,000
Tax thereon @ 19% =	7,600
Less: Marginal relief	
(50000 – 40000) * 19/400 =	(475)
	7125
Effective rate	17.81%
Therefore Tax liability:	
15,000 @ 19%	2,850
25,000 @ 17.81%	4,452
	7,302

1 MARK FOR EFFECTIVE RATE
1 MARK FOR TAX LIABILITY

Q5

1. If in the accounting period it is carrying on a trade it may claim a deduction for an additional 50% of the qualifying R & D expenditure. (i.e. can claim deduction for 150% of expenditure).

2. If the company has a loss for the period the company can instead claim an R & D tax credit (repayment) equal to the lesser of: -

- 16% of the loss applicable to the R&D expenditure (or the unrelieved loss if lower)

or

- total PAYE and Class 1 NIC liability paid.

1 MARK FOR EACH OF THE ABOVE

Q6

The amount of staff bonuses not paid within 9 months of the year end must be added back in the corporation tax computations = £15,000.

The pension contributions unpaid at the year end must be added back in the corporation tax computations = £20,000

1 MARK FOR EACH OF THE ABOVE

Q7

Mr Hall

As Mr Hall is connected with the company as a participator all transactions must be carried out at market value or be adjusted for tax purposes thereto.

As a result he will be deemed to have received a distribution equal to the underpayment. This will be taxed in same way as a dividend.

(Examiner's note: He will be allowed to pay the difference or to reverse the transaction under Revenue concession)

Tag Ltd

The original chargeable gains computation will be amended to reflect the additional deemed consideration. Additional corporation tax will be due and an interest liability is likely to arise.

1 MARK FOR EACH

Q8

Sale Proceeds	400,000
Less: Cost	(200,000)
	200,000
Less: Roll-over relief	(50,000)
Gain chargeable	£150,000
(proceeds not reinvested)	
Gain after taper relief (25%)	£37,500

Base Cost of new premises
Cost £250,000 less roll over £50,000 = £200,000.

1 MARK FOR GAIN AFTER TAPER
1 MARK FOR BASE COST OF NEW PREMISES

Q9

Provision for bad debts c/fwd	12,000
Bad debts w/off in year	2,000
	14,000
Provision for bad debts b/fwd	(9,000)
P&L Charge	5,000

Tax Deduction

P&L Charge	5,000
Less: increase in general provision	(1,000)
	4,000

1 MARK FOR P&L CHARGE
1 MARK FOR ADJUSTMENT

Q10

Relief for the loss can be claimed against income of:

- the tax year in which the loss is incurred (2005/06)

or

- the tax year preceding that in which the loss is incurred (2004/05)

Additionally the loss can be carried forward for relief against profits from the same trade.

Where a loss has been claimed against income an additional claim can be made to relieve against capital gains in the same year.

1 MARK FOR INCOME LOSS RELIEF
1 MARK FOR EXTENSION AGAINST CAPITAL GAINS

Q11

Big Ltd 31/12/05 £420,000 corresponding period to 31/7/05 = 7 months
Therefore £420,000 * 7/12 = £245,000

Little Ltd 31/7/05 £480,000 corresponding period from 1/1/05 = 7 months
Therefore £480,000 * 7/12 = £280,000

Max group relief = £245,000

Big Ltd	420,000
Less: group relief	(245,000)
	175,000

175,000 @ 30%	=	52,500
Less: Marginal relief		
(750,000 – 175,000) * 11/400	=	(15,812)
		36,688

1 MARK FOR CORRECT GROUP RELIEF
1 MARK FOR TAX CALCULATION

Q12

- A qualifying hotel must be open for at least four months during April to October and whilst open during these months have at least ten letting bedrooms,
- Its services must normally include providing breakfast and evening meals, making beds and cleaning rooms.

1 MARK FOR EACH OF THE ABOVE

Q13

Dave's share of profits to 30 June 2005

Profits	30/09/05	220,000 * 9/12 =	165,000	
		Prior Salary		
		£20,000 * 9/12 =	(15,000)	15,000
			150,000	
		1/10 of remainder	(15,000)	15,000
				30,000

Overlap Profit calculation

Profits 30/09/02		140,000	
	Prior Salary		
		(20,000)	20,000
		120,000	
	1/10 of remainder	(12,000)	12,000
			32,000
Period 1/10/01 to 5/4/02	6/12ths thereof		16,000
Therefore 2005/06 assessment	£30,000 - £16,000 =		£14,000

1 MARK FOR PROFIT SHARE TO 30/06/05
1 MARK FOR OVERLAP RELIEF CALCULATION

Q14

The losses cannot be carried forward against the future trading profits of a company if:

- Within any period of three years there is a change in ownership of the company
- And there is a major change in the nature or conduct of the trade preceded by, followed by or coinciding with the change.

1 MARK FOR EACH POINT

Q15

Andover Ltd share of losses

100,000 * 20%*6/12(1/10/04 to 31/3/05) =	10,000
100,000 * 35%*6/12(1/4/05 to 30/9/05) =	17,500
	27,500

but relief limited to profits of £15,000.

Bury Ltd share of losses

100,000 * 20%*6/12(1/10/04 to 31/3/05) =	10,000
100,000 * 35%*6/12(1/4/05 to 30/9/05) =	17,500
	27,500

Profits £30,000 therefore relief of £27,500 available.

1 MARK FOR EACH COMPANY

Q16

A company is associated with another company if one of the two has control of the other or both are under the control of the same person or persons.

Control means the ability to exercise or to acquire control, including:

- The greater part of the share capital or issued share capital
- The greater part of the voting power
- So much of the issued share capital as would give the right to receive the greater part of the income
- The right to the greater part of the assets in a distribution on a winding up

1 MARK FOR GENERAL DEFINITION
1 MARK FOR REASONABLE ATTEMPT AT DEFINING CONTROL

Q17

A) Invoice outstanding for more than six months after end of 30-day payment period.
Adjustment required = 575/1175 *£175 = £85.64 (£86 to nearest £)
In form of negative input VAT entry on return.

B) Due to 30-day payment period the six month period has not been exceeded and therefore no adjustment is required.

1 MARK FOR EACH

Q18

VAT can be reclaimed on services supplied after the date of de-registration and which relate to taxable supplies of the business carried on by him before deregistration.

A claim must be made and it must be made within three years of the date on which the supply of services was made.

1 MARK FOR REFERENCE TO SERVICES ONLY AND TO RELATING TO BUSINESS
1 MARK FOR COMMENTS RE: CLAIM AND TIME LIMIT

Q19

1. The purchaser must be VAT registered, at the time of the purchase be required to register or be accepted for voluntary registration.
2. There must be no significant break in the trading pattern immediately after the transfer.
3. The assets being purchased must be intended for use in the carrying on the same kind of business.
4. If only part of the business is being acquired that part must be able to operate alone.

1 MARK FOR POINT 1
1 MARK FOR ANY 1 OF POINTS 2 TO 4

Q20

Directors have an annual period for NIC purposes, therefore: -

Annual primary threshold	£4,895
April salary	£3,000

Below threshold therefore NIC due on April Salary =£NIL

Annual primary threshold	£4,895
April and May salary	£6,000

Surplus above threshold = £1,105 @ 11% = £122

NIC due on May Salary = £121.55 - £NIL = £122

1 MARK FOR APRIL NIC
1 MARK FOR MAY NIC

ANSWERS TO LONG QUESTIONS

Question 1

Zellon Ltd

1 **Profits chargeable to corporation tax**

		Total £	Yr to 31/05/05	6 mths to 30/11/05
SchDI		240,000	160,000	80,000
Loss b/fwd under s393(1)ICTA88		89,000	(89,000)	
			71,000	80,000
SchDIII		18,000	12,000	6,000
NTLR	b/fwd	27,000		
	utilised	27,000	(12,000)	(15,000)
	c/fwd	-		
Chargeable gain				300,000
Charge on income			(65,000)	
PCTCT			6,000	371,000

2 **Corporation tax payable**

	Yr to 31/05/05	6 mths to 30/11/05
Corporation tax due	1/3/06	1/9/06
CT @ 19%/30%	1,140	111,300
Less: marginal relief		
= (M-P) x I/P x MRF	903	110
	237	111,190
Underlying rate of tax = 237/6,000 = 3.95%		
Non-corporate distn rate applies to £4,500 @ 19%	855	
Remaining PCTCT at underlying rate £1,500 @ 3.95%	593	
Total CT due	1,448	111,190

Note:	No. of associates = 1			
		M	25,000	375,000
		P	6,000	371,000
		I	6,000	371,000
		MRF	19/400	11/400

Due dates for payment
Period to 31 May 2005 - 1 March 2006
Period to 30 November 2005 - 1 September 2006

3 Tax point

Since the invoice was issued within 14 days of supply, the invoice date will be treated as the tax point. Therefore the tax date is 26 November 2005.

4 VAT relief

VAT relief can be claimed on bad debts 6 months after the later of tax point and payment date, and this will be in the quarter to 31 March 2006.

The conditions:

1. The debt must have remained unpaid for a period of six months after the later of time payment was due and date of supply
2. Must have accounted for VAT on the supply and paid it to Customs
3. Must have written off debt in day to day VAT account.
4. Debt must not have been paid, sold or factored under valid legal assignment

Question 2

Rolf & Co

Notes for Meeting

1 Savings

VAT paid in year ended 30 June 2006		14,599
VAT paid in same period under Flat rate Scheme		
Total income (incl VAT)	105,604	
Apply FRS %		13,728
Money saving		**871**

Admin saving

Very simple calculation saves on admin costs/time

2 Capital purchases

If you buy a single capital asset with an invoice value, including VAT, of £2,000 or more you can claim the input tax on your VAT return in the normal way.

If you do recover VAT on an expensive capital asset, any subsequent disposal of that asset has to be accounted for using the normal VAT accounting rules.

3 Other schemes

Annual accounting – yes
Cash accounting – no, FRS has its own cash based system
Retail scheme – no
Margin scheme – no

Nelly IT Ltd

Year ended 31 March 2006

4 See overleaf

5 Calculation of the deemed payment

Save IT contract income			30,000
Less:	5%	1,500	
	PII	740	
	Employer's NI	1,142	
	Directors' salary	15,000	18,382
Deemed payment inc Ers NIC			11,618
Deemed payment = 11,618*100/112.8			10,300
Er's NIC			1,318

4

Date

ABC Advisers
Address

Mr M Nadler
Address

Dear Mark

Save IT Contract

Following our recent conversation, I have set out below my concerns regarding the tax treatment of the income from your Save IT contract including calculation of the income from the contract treated as your own income.

IR35 Legislation

From 6 April 2000, legislation has been in place affecting the tax treatment of income from some contracts between businesses and companies supplying personal services. The rules will apply if you would be classed as an employee if you worked for your client directly and not through your company.

If you can answer `yes' to the following questions, you would probably have been an employee of your client for the contract in question and therefore within the rules.

Do you work set hours, or a given number of hours a week or a month?

Do you have to do the work yourself rather than hire someone else to do the work for you?

Can someone tell you at any time what to do or when and how to do it?

Are you paid by the hour, week or month?

Can you get overtime pay?

Do you work at the premises of the person you work for, or at a place or places he or she decides?

Do you generally work for one client at a time, rather than having a number of contracts?

Are you give paid holiday and sickness leave?

Based upon the above questionnaire, I would consider that your engagement with Save IT falls within the rules. You will have to pay an additional amount of tax and NICs, based on the payments received by Nelly IT Ltd from Save IT for your services at the end of the tax year. Nelly IT Ltd will also pay employer's NICs on the same amount. I have enclosed a schedule showing the calculation of the deemed payment upon which the tax and NIC are calculated for the year ended 31 March 2006.

If you have any queries regarding the above, please do not hesitate to contact me.

Kind regards

A Jones

Question 3

Alan & Vincent

1 Assessable profits

Year ended 30 April 2005

Profit before capital allowances	28,250
Less: Capital Allowances	4,512
Profit	23,738

Apportionment:	**Alan**	**Vincent**	**Total**
Salary	5,000	3,000	8,000
Balance - 1:2	5,246	10,492	15,738
	10,246	13,492	23,738

Year ended 30 April 2006

Profit before capital allowances	55,750
Less: Capital Allowances	3,378
Profit	52,372

Apportionment:-	**Alan**	**Vincent**	**James**	**Total**
to 31/5/05				
Salary	417	250		667
Balance - 1:2:0	1,232	2,465		3,697
from 1/6/05				
Salary		2,750	3,667	6,417
Balance - 0:70:30		29,114	12,477	41,591
	1,649	34,579	16,144	52,372

Capital allowances		**Pool**	**Exp Car**	**CA's**	
Year ended 30 April 2005					
Additions					
50% FYA (5,750 + 3,275)					
	9,025				
FYA	4,512	4,513		4,512	
WDV c/fwd		4,513	-	4,512	
Year ended 30 April 2006					
WDV b/fwd		4,513			
Additions					
Ford Mondeo			12,500		
WDA @ 25%		1,128	3,000	4,128	
– restricted for exp car to £3,000				750	Less: 25% Pte Use
WDV c/fwd		3,385	9,500	3,378	

2

2005/06

Class 1 Primary Contributions

Salary per month 2,083.33		Accept calculations based on 8 weeks of NI (per tax tables)
Class I primary per month = (2,083-408)*11% = 184.25		
No. of months employed	2	
Total Class I primary contributions	368	
Class2		
£2.10 pw from 1/6/05		
From 1/6/05 to 5/4/06, no. of weeks	44	
Total Class 2 contributions	92	
Class 4		
Profit for period 1/6/05 to 5/4/06		
$16{,}144 \times {}^{10}\!/_{11}$ = £14,676		
(14,676 – 4,895) = 9,781 @ 8% =	782	
	1,286	

3

Date

The Partners
Address

XYZ Advisers
Address

Dear Vincent and James

VAT exempt supplies

Further to our recent conversation, I have outlined below the VAT implications of your decision to provide “educational services”.

1. **Partial exemption**
   Your VAT registration will be deemed to be partially exempt, and therefore the amount of input tax you can reclaim would be restricted. Accordingly, for each VAT return you will need to calculate your input VAT using special rules, and then annually an adjustment will need to be made to ensure the appropriate amount of input VAT has been reclaimed.

2. **De minimis Limit**
   If the calculation of the input VAT reclaimable shows the input VAT relating to exempt supplies is less than 50% of the total input VAT and less than on average £625 per month then you will be able to reclaim all the input VAT

3. **Flat rate scheme**
   If you are using the flat rate scheme, you will still need to apply the appropriate flat rate scheme % to all your income, not just the standard rated services. This may mean the flat rate scheme is an “expensive” method of calculating your VAT.

I trust the above is a useful note of the implications. Please do not hesitate to call me if you would like to discuss the issue in more detail.

Kind regards

A Jones

Question 4 – Rochester Consulting Limited

Our Address

Date

Mr J Rochester
Address

Dear John

ROCHESTER CONSULTING LTD – VARIOUS TAX QUERIES

Further to our recent meeting you raised a number of queries concerning corporation tax and National Insurance Contributions compliance together with a VAT query concerning a potential office purchase. I have set out below the information you require.

1) <u>Corporation Tax Compliance</u>

Rochester Consulting Limited is required to submit a corporation tax return under what is known as Corporation Tax Self Assessment for the 12 month period ended 31 August 2006. Basically, this will require the company to file a tax return signed by an authorised signatory self assessing the tax position for the company for the period. . The return is normally sent to HMRC along with the signed accounts and a detailed tax computation.

<u>Filing Deadline</u>

The tax return must be submitted 12 months after the return period, which for Rochester Consulting Limited means by 31 August 2007.

If the company fails to make a self assessment return, the Inspector may make a determination, which is treated as a self-assessment.

<u>Enquiries</u>

The Revenue can give written notice of its intention to enquire into the return within twelve months from the filing date. This time limit can be extended if the return is late, or is amended after the filing date.

The Revenue must give written notice that the enquiry is closed and state its conclusion. The company then has 30 days to amend its self-assessment. If no amendment is made, or the Revenue disagrees with the amendment made, the Revenue has 30 days to amend the self-assessment itself.

<u>Penalties for late returns</u>

The following penalties apply if tax returns are filed late;

1. £100 up to 3 months after the filing deadline
2. £200 any later than 3 months
3. 18 to 24 months after the return period, 10% of the tax unpaid at the 18 month point
4. 20% of unpaid tax at the 18 month point, if over 24 months from end of the return period.

<u>Corporate tax payments and interest charges</u>

As Rochester is not regarded as a 'large' company for corporate tax purposes, it must pay its corporate tax 9 months and one day after the accounting period end (i.e. 1 June 2007).

Interest will be charged on any underpaid tax from the above due date.

2) Compliance for National Insurance contributions

I have summarised these and the reporting requirements in the table below;

Type	Charged on	Reporting requirements	Date when payments due	Implications of late payment:
Class 1	Earnings from employment	The contributions are summarised on Form P35, which must be submitted by 19 May following the end of the tax year.	Payments should be made on 19th of each month throughout the tax year and final payment is due on 19 April following the end of the tax year	Interest runs from 19 April following end of tax year to date paid.
Class 1A	Cash equivalent of benefits as calculated for income tax purposes	The amount of the contribution is calculated on form P11D(b) and must be submitted by 6 July following the end of the tax year.	19 July following the end of the tax year	Interest runs from 19 July following end of tax year to date paid

3) UVAT considerations of office purchase

The supply to Rochester (i.e. the purchase of the new office block by Rochester) will be regarded as an exempt supply (i.e. no VAT will be charged). This assumes the seller of the building has not made a so-called 'Option to tax'.

Without taking any active course of action, the lease of the excess space by Rochester will also be regarded as an exempt supply for VAT purposes meaning that no VAT should be charged on the rent. The implication of this is that any input VAT associated with the alterations and purchase (e.g. VAT on lawyers' or architects fees) will not be recoverable and so there will be a cost to Rochester.

However, Rochester could opt to tax the building which would convert this otherwise exempt supply of the lease to a standard rated taxable supply which would mean that associated input VAT would be recoverable in the usual way.

The important points to consider before opting to tax are;

- it is made on a building by building basis and applies to the whole building, not just the part being leased out. The key implication of this is that when Rochester ultimately sells the building it would need to charge VAT on the entire price. This may limit the marketability of the office block.

- If the lessee is not VAT registered or is an exempt business the VAT charged on the rent will be a cost to them and so this will either limit the ability to get a lessee and/or mean that Rochester have to take a lower rental in return.

I trust the above answers your queries, but if you have any further questions please do not hesitate to call me.

Yours sincerely

A Downing

Question 5 – Plum Limited

Our Address

Date

Ms J Dury
Plum Ltd
Address

Dear Jessica

PLUM LTD

Further to our recent meeting you raised a number of queries concerning corporation tax and I trust the above answers your queries, but if you have any further questions please do not hesitate to call me.

1) Schedule A loss

The Schedule A loss incurred by Mustard Ltd can be utilised as follows;

- Set off against non Schedule A income and gains of Mustard for the same accounting period (This is mandatory and must be followed);

If any excess Schedule A loss was made this can be:

- Carried forward against future profits of any description; or
- Surrendered as group relief

2) Taxable profits for year ended 30 June 2006

The implications of the fixed asset acquisitions and disposals on the taxable profits are as follows;

Inter-company transfer

Transfers of chargeable assets between companies in the group are regarded as transferred at a value which gives rise to neither a gain nor a loss. Therefore, on the transfer of the small processing workshop to Mustard Ltd no gain or loss arises.

Sale of old processing plant and new acquisition

The sale of the building is chargeable disposal and will give rise to a chargeable gain of £185,400. See calculation in Appendix 1.

However, because Plum Ltd has reinvested a proportion of the proceeds in acquiring a new qualifying asset an element of the gain on the disposal of the building to the unrelated party can be 'rolled over' into the acquisition cost. The amount of gain that will be chargeable is the lower of (1) the actual gain and (2) the proceeds not reinvested.

Accordingly, the gain that will be taxed in Plum Ltd's taxable profits for the year ended 30 June 2006 is £50,000.

In summary the taxable profits for Plum Ltd and Mustard Ltd are:

	Plum Ltd	**Mustard Ltd**
	£	**£**
Schedule D Case I	950,000	850,000
Schedule A loss offset	-	(20,000)
Chargeable gain	50,000	-
Taxable profits	1,000,000	830,000

3) Disposal of shares in Juice Ltd

A gain on the disposal of the Juice Ltd will be exempt provided certain conditions are met. The exemption is known as the 'Substantial Shareholder Exemption'.

The conditions to be satisfied are;

1. The investing company (i.e. Plum Ltd) must have held the substantial shareholding in the company invested in (i.e. Juice Ltd) for at least twelve months out of the two years immediately prior to disposal.
2. The shareholding is substantial if Plum Ltd
   - Holds at least 10% of the ordinary share capital
   - Is entitled to at least 10% of the profits available for distribution; and
   - Is entitled to at least 10% of the assets on a winding up
3. The investing company must be a sole trading company or a member of a trading group from the start of the twelve month period mentioned in 1 above and immediately after the disposal;
4. The company invested in must be a trading company

Accordingly, based on your set of facts the only condition that is not currently satisfied is the 12 months ownership period. In order that any gain on the sale of the shares is not chargeable, Plum Ltd must dispose of the shares after February 2007 (i.e. more than twelve months after Plum Ltd acquired the shares).

4) Payments of corporation tax

The UK tax payment rules for companies require companies that are regarded as 'large' to make quarterly instalment payments of corporation tax.

A company is regarded as large if its taxable profits exceed £1.5m for its 12 month accounting period.

A company is not required to make instalment payments in the first year it exceeds the limit, unless its profits exceed £10m. The £1.5m limit and £10m limit need to be scaled down proportionately for shorter accounting periods and for associated companies (the number of associates being based on the number at the end of the previous accounting period).

Historically, neither Plum Ltd nor Mustard Ltd has exceeded the limit, which will be £750,000 for each company. (i.e. £1.5m divided by 2).

The first year that the limit has been exceeded is 30 June 2006, but payment of tax will not be due in instalments for that year, but instead will be payable 9 months and 1 day after 30 June 2006 (i.e. 1 April 2007).

Based on the estimated taxable profits for 30 June 2007, this limit will be exceeded by both companies and instalments will be due.

The instalments are due on the 14^{th} day of months 7 and 10, and of months 1 and 4 of the following period, with each instalment being 25% of the estimated tax liability at that particular time.

Accordingly, you will be required to estimate the total liability for both Plum Ltd and Mustard Ltd before the accounting period has ended and revise the estimate each quarter.

Based on your estimate of taxable profits for 30 June 2007 the following instalments are due for Plum Ltd ;

	UUUUPlum Ltd
Taxable profit	£1,050,000
Corporate tax @ 30%	£315,000
Instalments:	
14 January 2007	£78,750
14 April 2007	£78,750
14 July 2007	£78,750
14 October 2007	£78,750

Yours sincerely

Anne Adviser

Appendix 1

Disposal of property

Disposal proceeds	450,000
Cost	(225,000)
Unindexed gain	225,000
Indexation $\frac{192.2-163.5}{163.5}$ 0.176 × 225,000	(39,600)
Gain	£185,400

Rollover relief

Since proceeds received on disposal are not fully reinvested, the gain that crystallises is the lower of the proceeds not reinvested and the actual gain.

Therefore, the taxable chargeable gain is £50,000