Association of Taxation Technicians

Examination

May 2007

PAPER 2

BUSINESS TAXATION & ACCOUNTING PRINCIPLES

ANSWERS
(without marking guide)

Part 1

1 Assessment

Tax Year	*Basis*	*Calculation*		*amount*
2005/06	1/3/2006 to 5/4/2006	£24,350	x 1/16	£1,522
2006/07	6/4/2006 to 5/4/2007	£24,350	x12/16	£18,262
2007/08	1/7/2006 to 30/6/2007	£24,350	x12/16	£18,262

Overlap profits

1/7/2006 to 5/4/2007 = 9 months

£24,350 x 9/16 £13,696

2 Industrial Buildings Allowance

A claim of 4% per annum on the straight line basis can be made over the 25 year tax life of the building on the "allowable cost".

The allowable cost excludes land.

It also excludes administration offices
(but not drawing offices)
unless they account for no more than 25% of the total allowable costs.

3 Payments on account

Payments on account are based on the previous year's
Income tax and class 4 NIC, net of tax deducted at source.

If the taxpayer believes they are likely to overpay their liability for the year, they can either obtain a repayment of any tax overpaid when their tax return is submitted or

submit an application to reduce their POAs (form SA303)
to their expected liability for the year

4 Interest due

(£1,322 + £661) x 5% x 1/12 £8.26
(£300 + £150) x 5% x 2/12 £3.75

Penalties

Surcharge for the 2005/06 amount of £1,322 - paid after 28/2/2006
Calculated (fixed) 5% x £1,322 £66.10

5. One mark for any **four** of the following:

- i) Period of engagement – to state the date of commencement of work/responsibility
- ii) Service to client – to cover the type of work to be done.
- iii) Responsibilities of client – to cover information to be provided by client
- iv) Investment business – to state whether authorised or not authorised to do such work
- v) Excluded services – to cover work which will not be done
- vi) Retention of records – to explain who keeps records and for how long
- vii) Quality of Service – how to make a complaint if there is a problem
- viii) Fees – basis of charging fees
- ix) Limitation of liability – not responsible for errors due to client's actions

6. One mark for each of the following:

- i) A company is distinct from its members (shareholders) and will continue in existence until wound up. The business of a sole trader will cease when he dies.
- ii) A company has liability limited to its net assets; a sole trader is personally liable for the business debts.
- iii) A company owns its own property which cannot be appropriated by a shareholder; a sole trader can use the business property without restriction.
- iv) A company is taxed separately from its members; a sole trader is taxed on his full profits, not just what is withdrawn from the business.

7.

WDV 1.4.06	5,000
Disposal proceeds (restricted to cost)	15,000
Balancing charge	£(10,000)

Proceeds	20,000
Cost	15,000
Gain	5,000
Taper – 75%	3,750
	£1,250

8 Business chattel

(a) Chattel exemption as sold for under £6,000

(b) Chattel special rules. Take **lower** gain of:-

Normal calculation	
£6,100 less cost £3,000, no indexation	£3,100
or	
Special calculation	
£6,100 less £6,000 x 5/3	£167

9 Roll-over relief

The gain can be deferred by rollover relief provided that:

(1) Both the old and the new assets are qualifying assets (e.g. land and buildings, fixed plant, etc) and are used for business purposes.
(2) The reinvestment takes place in the period beginning one year before the disposal and ending three years afterwards.
(3) The new asset must be brought into business use at the time it is acquired.

10 Groups

(i) For "group relief" purposes one company must have at least 75% (ordinary share capital, distributable income and net assets on a winding up) held either directly or indirectly, of another company.

(ii) For chargeable gains "groups" the definition is extended to include companies where the top company has at least an effective 50% holding of any subsidiary

11. Mary must notify H M Revenue & Customs by **31 October 2006** as her turnover will exceed the £61,000 limit for registration by the end of September 2006 (£16,000 x 4 = £64,000). Her registration will take effect from **1 November 2006**.

12 Postage is treated as being part of the supply of goods. Therefore **VAT must be charged to a customer** if the supply is standard rated, but **will not be charged if the supply of the goods is zero rated** (eg to an overseas customer).

13.

	Debit	Credit
Prepayments	750	
Insurances		750
Water charges	250	
Accruals		250
Salaries & wages	1,250	
Accruals		1,250
Accountancy	1,500	
Accruals		1,500

Part 2

1.

			Total	S	H	M
2003/04	6/9 x 36,000	24,000	24,000	12,000	12,000	
2004/05		36,000				
	3/12 x 60,000	15,000	51,000	25,500	25,500	
2005/06	Y/E 30.6.05		60,000	30,000	30,000	
	Y/E 30.6.06	110,000				
	Less: salary	20,000				
		90,000				
Mark's share 1/3 x 9/12						22,500
2006/07	Y/E 30.6.06		110,000			
	Less: salary		20,000	10,000	10,000	
			90,000	30,000	30,000	30,000
Overlap	6/9 x 36,000	24,000				
	3/12 x 60,000	15,000				
		39,000	x ½		(19,500)	
				40,000	20,500	30,000

2. (i) "Wages" to Brown are, in fact, drawings. These should be included on the balance sheet as a deduction from Brown's capital account.
The equipment should be capitalised and depreciated in accordance with FRS15. A suitable policy should be adopted to reflect the useful economic life of the depreciated asset. The depreciation charge will be a deduction in the profit and loss account.

(ii) The wages paid to Brown's wife are NOT commercial and should be disallowed as not "wholly and exclusively" for the purpose of the trade.
The cost of the equipment (and any depreciation charge) should be added back to profits. A capital allowance claim may be possible on the equipment.
The private proportion of home telephone and motor expenses should be added back to profits. For motor expenses, the adjustment will normally be based on private miles as a proportion of total miles. Alternatively, if Brown's turnover is below the VAT threshold, he may use the Revenue's authorised mileage rates instead.
For the telephone, a proportion of the rental and any private call costs must be added back.
Only the 'extra' cost of running a business from home can be allowed
Therefore he will need to estimate the increase in the electricity and gas bills due to the cost of running the business from home.
The restaurant costs relates to entertaining a potential customer and should be disallowed.

(iii) Capital allowance claims could be made on the equipment - a First Year Allowance currently at 50% for a small enterprise.
A written down allowance on the motor car at 25% restricted for a private use percentage.

3. (a) Charger Ltd – 2 accounting periods

	12 months to 30/6/06	6 months to 31/12/06
Trading profits		
(315,000 x 12/18 x 6/18)	210,000	105,000
Less : capital allowances	-9,750	-3,656
(39,000 x 25%/29250 x 25% x 6/12)		
	200,250	101,344
Profits from rental properties		
(1,500 x 12 & 1500 x 3)	18,000	4,500
Loan relationship-non trade		
(accruals basis)		
-6,000 + 10500 +8200+3,000	15,700	
-3,000 + 6,000 +6,300		9,300
Chargeable gain		212,000
	233,950	327,144
Charges	-20,000	
PCTCT	213,950	327,144
(b) Dividends (for "Profits")		20,000
		347,144

AP 1/7/05 to 30/6/06
£213,950 x 19% = £40,650

AP 1/7/06 to 31/12/06
£327,144 x 30% = £98,143
Less: marginal relief
(750,000-347,144) x 327,144/347,144
x 11/400 = £(10,440)
£87,703

Relevant rates between FYs have not changed- breakdown ignored

(c) Due dates for submission of CT600
AP to 30/6/06 - 31/12/07 or 3 months from date of notice if later
AP to 31/12/06 - as above
Due dates for payment of Corporation Tax
AP to 30/6/06 - 1/4/07
AP to 31/12/06 - 1/10/07

(d) Pass a board resolution
Notify the Registrar of Companies
Notification within time limit – period of time for laying and filing

4.
i)

Motor Vehicle

Capital	5,000	Disposal	5,000
Capital	8,000		

Disposal Account

Motor vehicle	5,000	Capital	4,680
		Loss on disposal (P&L)	320

Capital account

		Motor vehicle	5,000
Disposal	4,680	Motor vehicle	8,000

ii)

Kevin Johns
Profit & Loss Account for the year ended 31 December 2006

Sales (52,600 + 7,000)		59,600
Cost of sales		
Purchases (5,000 + 3,000)	8,000	
Closing stock	1,200	(6,800)
		52,800
Bank interest received		320
Wages	2,600	
Motor running expenses	4,290	
Accountancy (400 x 117.5%)		470
Advertising (1,200 x 6/12)	600	
Depreciation (8,000 x 25%)	2,000	
Loss on disposal of motor vehicle (5,000 – 4,680)	320	
		10,280
Net profit		£42,840

Answer to question 2 (continued)

Kevin Johns

Balance Sheet as at 31 December 2006

Fixed asset		8,000
Depreciation		2,000
		6,000
Current assets:		
Stock	1,200	
Debtors and prepayments (7,000 + 600)	7,600	
Bank	3,720	
	12,520	
Less: current liabilities		
Creditors	3,000	
Accruals	470	
	3,470	
Net current assets		9,050
		£15,050
Represented by:		
Capital account:		
Introduced (5,000 + 8,000)	13,000	
Profit for year	42,840	
	55,840	
Drawings (36,110 + 4,680)	40,790	£15,050

iii

The net profit is the starting point for calculating the amount assessable for tax purposes.
Disallowable expenses, such as depreciation, must be added back.
Non-trading income, such as interest received, must be deducted.
A deduction for capital allowances (on the car) must be made.
Accounting profits (and therefore the amount assessable for tax purposes) are calculated on the accruals basis, not on the amount of cash received.
Drawings, however, are based on the amount of money available in the bank account, which is dependent on when customers pay and suppliers are paid.
The amount of money withdrawn by a sole trader has no impact on the amount of their assessable profit.