Association of Taxation Technicians

Examination

May 2007

PAPER 3

BUSINESS TAXATION: HIGHER SKILLS

ANSWERS
(without marking guide)

(marks in bold)

Answer 1

	Pool	Van	Private Use	Allowance
	£	£	£	£
WDV b/fwd	8,000			
Additions		13,000		
	8,000	13,000		
WDA 25% x 6/12	(1,000)			1,000
FYA – 50%		(6,500)	650	5,850
WDV c/fwd	7,000	6,500		
				6,850

Answer 2

	2004/05	2005/06	2006/07
	£	£	£
Trading profits	8,000	-	7,000
S385 loss claim	-	-	(4,000)
	8,000	-	3,000
Property income	2,000	2,000	2,000
Statutory Total income	10,000	2,000	5,000
S380 loss claim	(10,000)	-	-
Revised STI	Nil	2,000	5,000

Answer 3

1. Dr Prepayments	2,500
Cr Rent expense	2,500
2. Dr Material costs	2,500
Cr Accruals	2,500
3. Dr Sales	3,000
Cr Deferred Income	3,000

Answer 4

There are two tests for compulsory VAT registration

Test One

At the end of **any** month, if the value of taxable supplies in the past 12 months (or since the commencement of trade, if shorter) has exceeded £61,000, (unless Customs are satisfied that the value of taxable supplies in the ensuing 12 months will not exceed £59,000); or

Test Two

At any time, if there are reasonable grounds for believing that the value of taxable supplies in the next 30 days alone will exceed £61,000.

A trader may consider voluntary registration in order to recover input VAT on purchases or to give the impression of being a more substantial business**.**

Answer 5 – Bunny Hops' VAT calculation

		£
Output VAT £30,000 x 17.5%		5,250
Input VAT £20,143 x 7/47	3,000	
Less VAT on Entertaining 470 x 7/47	(70)	(2,930)
		———
VAT due		2,320
		=====

VAT on motor car is not recoverable.

Answer 6 – Hedgerow Limited

Movement on deferred tax provision account

		£
(70,000 – 60,000) x 32.75%		3,275

Double entry to record movement

Dr Corporation Tax charge	3,275	
Cr Deferred Tax provision		3,275

Answer 7 – Tom, Dom and Ron

Ron Capital account

£		£
-	1/7/06 Capital introduced	50,000

Ron Current account

-	Profit 120,000 x 6/12 ÷ 3	20,000

Tom Current account

-	Profits 120,000 x 6/12 ÷ 2	30,000
	Profits 120,000 x 6/12 ÷ 3	20,000

Dom Current account

-	Profits 120,000 x 6/12 ÷ 2	30,000
	Profits 120,000 x 6/12 ÷ 3	20,000

Answer 8

UK legislation seeks to allow foreign tax as a credit against the UK tax liability which is attributable to the overseas income

The amount of credit cannot exceed the lower of the UK or foreign tax

UK tax on Utopian interest (30% x £1,000) -	£300
Less: relief for overseas tax (25% x £1,000) –	(£250)

UK tax payable	£50

Answer 9

A company will be regarded as UK resident if

a) it is incorporated in the UK
b) if, whilst not incorporated in the UK, it is centrally managed and controlled from the UK**.** The place of central management and control is generally regarded as the place where the directors' board meetings are held.

A company resident in the UK will be subject to corporation tax on its worldwide profits

A non resident company will pay UK corporation tax on its trading and other profits arising in the UK from a permanent establishment situated in the UK.

Answer 10

Cumulus Limited

Trading profits	125,000
Rental income	30,000
Chargeable gain	100,000
PCTCT	255,000

Profit limit for small companies rate = 300,000 x 9/12 = £225,000

Corporation tax liability

255,000 x 30%	76,500
Less marginal relief	
(1,500,000 x 9/12) -255,000 x 11/400	(23,925)
Tax liability	£52,575

Answer 11

Large companies are required to pay corporation tax liabilities via instalments.

Large companies are those companies which pay tax at the full rate of corporation tax. However, a large company will not be liable to pay its tax instalments if it was not a large company in the previous year or its corporation tax liability is below £10,000**.**

Payments are made

6 months 13 days after the start of an accounting period
9 months 13 days after the start of an accounting period
14 days after the end of an accounting period
3 months 14 days after the end of an accounting period.

Answer 12 –

A small or medium sized enterprise which has qualifying research and development expenditure of not less than £10,000 per annum is entitled to a tax credit.

An amount equivalent to 150% of the qualifying expenditure is available as a deduction against trading profits.
Or
The company can claim a repayment equivalent to 16% of the unrelieved trading loss for the period or 150% of the qualifying R&D expenditure whichever is lower.

Answer 13

An accounting period ends

1. At the end of a period of account or after 12 months if the period of account is longer than 12 months
2. When a company ceases to trade
3. When a company ceases to be UK resident
4. When a company ceases to be within the charge of corporation tax

Answer 14

Directors have the following duties

1. Fiduciary duty i.e. they must act honestly and in good faith for the benefit of the company.
2. Duty of care and skill.
3. Duty to exercise powers for a proper purpose.
4. Duty not to make a secret profit.

Answer 1

1. A person considering incorporation or sale of a business can defer potential capital gains. The whole of the assets (except cash) must be transferred and the business must be a going concern.
   Under s 162 TCGA 1992 any gains made on assets of the business are automatically rolled over.
   S162 TCGA 1992 treatment is mandatory if all conditions are met.
   Consideration must be wholly or mainly in the form of shares.
   If consideration is only partly shares, only the proportion of the gain attributable to shares can be rolled over.

   The proportion of the gain which is attributable to the cash element of consideration will be taxable.

   $$43{,}000 \times \frac{15{,}000}{100{,}000} = £6{,}450$$

The remainder of the gain £36,550 will be rolled over against the cost of the shares/

	£
Value of shares	85,000
Less gained rolled over	(36,550)
Revised Base Cost	48,450

Answer 2

Rates of Tax

Sole Trader – All profits of a trade are assessed on a sole trader to income tax. The personal allowance of £5,035 is first deducted and any remaining profits are assessed as £2,150 at 10%, between £2,150 - £33,300 at 22%, with the balance assessed at 40%.

Company – Profits of the trade are assessed to corporation tax. A small company with profits up to £300,000 will be assessed at 19%. Profits between £300,000 and £1.5m are assessed at the marginal rate of 32.75%. Any profits exceeding £1.5m are assessed at the full rate of 30%.

National Insurance

Sole Trader – A sole trader will be required to pay Class 2 and Class 4 NICs. Class 2 is a flat rate of £2.10 per week if earning over £4,465 per annum.

Class 4 is 8% on profits between £5,035 and £33,540 and a further 1% on profits above £33,540.

Company – Directors will be treated as employees of the company. Class 1 primary deductions will be made from salary. Weekly earnings between £97 - £645 attract a deduction of 11%.

Any earnings over £645 per week will attract a further 1% rate of Class 1.

A company makes secondary contributions at 12.8% based on salary (in excess of £5,035) with no upper limit.

Payment Dates

Sole Trader – Income tax is due as payments on account on 31 January in the tax year and 31 July following the tax year. The payments made are based on the previous year's liability.

Amounts are based on the prior year position and a balancing payment will be made on 31 January following the tax year.

Company – Corporation tax is due nine months and one day after the year end. If the company is large, it will fall within the quarterly payments regime.

Answer 3

Memorandum of Association

The Memorandum of Association should be filed with Companies House. It contains such clauses as; the name of the company, registered office address, the objects of the company, the fact that members liability will be limited and the amount of authorised share capital.

The Memorandum regulates the external relationships of the company and defines the purpose / objects of the company.

Articles of Association

The Articles of Association form a contract between the company and its members and its members inter se. The Articles are the internal regulations of the company.

The Articles contain rules such as procedures to be followed at Board Meetings and how often these should be held. It states the way in which a company may exercise its powers.

Table A is a model form of articles for a company limited by shares which is contained in The Companies Act 1985. In the absence of specific articles, Table A will automatically apply.

Articles may be changed subject to a 75% special resolution.

Answer 2

1)

	£
Net Profit per accounts	68,000
Addback	
Depreciation	6,025
Light & heat (flat portion 50% x 2100)	1,050
Motor expenses (private part 2,000/10,000 x3,200)	640
Professional fees (legal)	1,000
Repairs & renewals (decorating in flat)	550

Adjusted Trading Profit **£77,265**
Less Capital Allowances **(£20,900) (Working 1)**
$\boxed{\textbf{£56,365}}$

Working 1

Year ended 30 April 2007

	FYA	Gen Pool	Expensive Car	Business Use 80%	Total Allowances
Addition not qualifying for FYA Car 1.8.06			£13,000		
WDA @ 25% restricted			£(3,000)	x 80%	£2,400
Additions qualifying for FYA (8.4.06) 1.5.06**	£35,000				
10.9.06	£ 2,000				
	£37,000				
FYA @ 50%	**(£18,500)**				£18,500
Tax WDV c/f	**£18,500**	**£18,500**	**£10,000**		**£20,900**

**Pre-trading capital expenditure in the 7 years prior to commencement qualifies for capital allowances and is treated as if it had been purchased on the first day of trading.

2)

Charlie – Income tax computation 2006/07

Earned Income	
Trading Income	£
1.5.06-31.3.07: 11/12 x £56,365)	51,668
Investment Income	
Dividends	
(2,250 x 100/90)	2,500
Statutory Total Income	$\boxed{\textbf{£54,168}}$
Less Personal Allowance	(5,035)
Taxable Income	**49,133**
Income tax – non savings	
£2,150 @ 10%	215
£31,150@22%	6,853
On excess	
£13,333@40%	5,333
	$\boxed{\textbf{£12,401}}$
Income tax savings	
Dividends	
£2,500@ 32.5%	813
Income tax liability	13,214
Less tax deducted at source	(250)
Income Tax Payable	$\boxed{\textbf{£ £12,964}}$

Answer to long question 3 a).

			Devon Dumplings Limited	Dorset Farmers Limited	
Schedule D1			200,000	450,000	
Less: Losses b/fwd			-20,000	0	
			180,000	450,000	
Schedule A			35,000	40,000	
Capital gains			0	20,000	
less:losses			0	-10,000	
PCTCT before group relief			215,000	500,000	
Group Relief					
Cornish Trading losses			-80,000	0	
Dorset Schedule DIII Deficit			-30,000	0	
PCTCT after group relief			105,000	500,000	
Memo losses to carry forward					90,000
Faraway Inc non-res losses unavailable for relief					
Corporation Tax Computation:					
Limits					
Normal	300,000	1,500,000			
No of companies	4	4			
	75,000	375,000			
Tax @ 30%			31,500	150,000	
Less:Marginal relief					
(375,000 - 105,000)*11/400			-7,425		
			24,075		

An alternative would have been to elect to notionally transfer both chargeable assets to Cornish Pixies, thus allowing the net gain to be taxed at 19%. Credit would have been given for this approach.

Answer to long question 3 b).

The loss arising in the accounting year ended 31 August 2007 will overlap with the other company year ends of 31 March 2008.Whilst the period does overlap with the year to 31 March 2007 the shares were not acquired until 31 May 2007, after the end of this period, and group relief is not therefore available.

The group relief will, however, be restricted for the period that Somerset Scrumpy was in the group. The maximum level of group relief therefore would be 3/12 * £100,000 = £25,000 being the period of overlap.
The maximum offset may however be further restricted dependent on the level of profits against which group relief is claimed. For example if company claiming group relief only has £50,000 profits available for offset, .
the limit will be £50,000 * 3/12
(

The loss arising in the accounting year to 31 August 2008 will partially overlap with 31 March 2008 year and partially with 31 March 2009 year. The losses will be matched as to :
7/12 * £60,000 = £35,000 to 31 March 2008 year and
5/12* £60,000 = £25,000 to 31 March 2009 year end
Again comparison with same proportion of profit will also be required to potentially restrict relief.

Answer to long question 3 c).

The change of accounting date must be notified to Companies House on form 225.

The date cannot extend a period beyond 18 months of the previous period end.

The date cannot be changed after the due date for filing the accounts of the existing period.

May not extend more than once in any five years.

Long Question 4 - Answer

a.

Amberhouse Limited

Net Profit per accounts	410,000
Add:	
Accrued pension contribution	10,000
Legal fees re:premises purchase	2,000
Legal fees re:company formation	3,000
Repair costs re: electrical works	3,000
Car hire charge restriction	
£4,000 less £4000*(12,000+24,000)/48,000	1,000
Accrued interest not paid within 12 months	20,000
Less: Dividend received	-9,000
Schedule DI/PCTCT	440,000

		12 months to 31/12/06
	Basic Profits	440,000
	Franked investment inc	10,000
	Profits	450,000
Small company lower limit		300,000
Small company upper limit		1,500,000
Corporation Tax computation		
	Basic Profits * 30%	132,000
	Less:Marginal Relief	
	((1500000-450000)*(440000/450000)*11/400)	28,233
	(375000-84000)*11/400	
		103,767

Part b)

Mr Foster

The dividend is liable at the higher rate of 32.5% of the gross amount less 10 % tax credit = 25% times net dividend.

The salary is liable to both income tax and national insurance + employers' 12.8% NIC.

The salary is tax deductible for the company, but the dividend is not.

Interest subject to deduction of 20% at source, with higher rate tax payable by self assessment. Deductible by company. No NIC

Mrs Foster

No further tax is due on the dividend, provided the gross dividend keeps within the basic rate band.

Salary also liable to tax and NIC but personal allowance NIC free for both employee and company

The salary is tax deductible for the company, but the dividend is not.

Tax deducted on interest can be reclaimed.

Answer to Question 4(c).

The only income of Amberhouse (Storage) Limited will be derived from the letting of a property to a connected company. As a result it will be classified as a Close Investment Holding company and all profits will be liable to corporation tax at the rate of 30%.

Mr and Mrs Foster will now own and control two companies and as a result the companies will be associated for tax purposes. Amberhouse Limited may therefore pay a higher rate of tax as the small company limits will be divided by two (the number of associates).

The annual £300,000 and £1,500,000 limits will be reduced to £150,000 and £750,000.