Association of Taxation Technicians

Examination

November 2007

PAPER 3 – PART II

BUSINESS TAXATION: HIGHER SKILLS

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

- You are required to answer **all** questions in Part I (printed separately) and 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 new sheet of paper.
- 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. Jessica, Melissa and Liam set up a partnership and began to trade on 1 July 2004. Accounts are made up to 30 June every year. Their business, called Pooch Accessories, sells specialist items for pets, including collars and pet coats, and has been very successful. Jessica, Melissa and Liam have always shared profits equally after deducting salaries of £10,000 and £13,500 and £6,000 respectively, and interest on capital of 10% per annum.

The capital provided at the commencement of trade was £15,000 by Jessica, £18,000 by Melissa and £5,000 by Liam.

With effect from 1 January 2006, the partners agreed that the profit sharing ratio would be changed. The new agreement provided that profits would be divided in the ratio of 2:2:1 being:

2/5ths to Jessica
2/5ths to Melissa
1/5th to Liam
(salaries and interest on capital remain the same).

The adjusted trading profit for the year ended 30 June 2006 (before any adjustments for capital allowances) was £125,925. The following information is also relevant:

Capital allowances

For the year ended 30 June 2006, the partnership purchased the following:

5 August 2005	A computer system for £4,375.
7 December 2005	A second hand diamante making machine was purchased from Liam for £2,500, being the agreed open market value.
12 January 2006	A car for use by Liam, costing £18,000. The car will have 45% private use.

The partnership sold the following items during the year:

31 December 2005	Office machinery for £4,000 (which was bought originally for £5,000).
1 April 2006	Office furniture for £3,000 (which had been bought originally for £2,000).

The tax written down value of the general pool on 1 July 2005 was £13,600.

You are required to:

1) **Calculate the trading income assessments of each of the partners for 2006/07.** (10)

2) **Briefly explain how a partnership would conduct its affairs in the absence of a partnership agreement.** (2)

Total (12)

2. Bessy Boo Ltd is a successful company which manufactures and sells exclusive ladies' clubwear. The company's gross profits for the year ended 31 December 2006 were £2.5 million.

On 1 February 2006, Bessy Boo Ltd purchased a 70% shareholding in Ding Dong Inc (DDI), a company resident in Ruritania. For the year ended 31 December 2006, the profits of DDI were £200,000. The profits were subject to Ruritanian Corporation Tax at the rate of 24%. DDI is planning to pay a dividend of £35,000 out of these profits. The dividend will be subject to withholding tax at the rate of 5%.

You are required to:

1) **Explain the difference between withholding tax and underlying tax, and describe how the dividend from DDI will be reflected in Bessy Boo Ltd's Corporation Tax computation for the year ended 31 December 2006.** (6)

Bessy Boo Ltd had a new factory constructed during the year at a cost of £750,000. The factory was brought into industrial use on 1 April 2006. The cost is made up as follows:

	£
Land	450,000
Legal costs for acquisition of the land	25,000
Preparation of land for building	50,000
Building costs	175,000
General offices	50,000

2) **Calculate the Industrial Building Allowances for Bessy Boo Ltd for the year ended 31 December 2006.** (3)

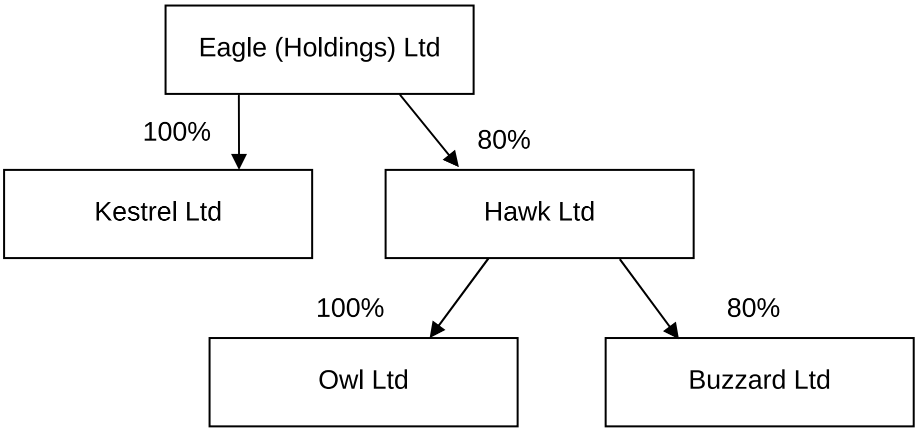
3) **You are a tax adviser working for Megnum Accountants and have recently been approached to act for Bessy Boo Ltd. Bessy, the managing director, has requested clarification on the concept of Professional Privilege. She has heard that as her tax adviser, you can share information with anyone and she is very concerned about breaches of confidentiality.**

Explain the concept of professional privilege and state under which circumstances information may be shared when client authority has not been given. (3)

4) **Bessy has also heard that there is a difference between tax evasion and tax avoidance, but is uncertain of the meaning of each concept. She has asked you to briefly outline the differences.** (3)

Total (15)

3. Peter owns all of the shares in Eagle (Holdings) Ltd. This company is dormant apart from the holding of shares in other companies as follows:



Each of the companies has a 31 December accounting date. All of the shares in the subsidiary companies have been held for many years, except for the shares in Owl Ltd. These shares were acquired on 1 June 2006.

During the year ended 31 December 2006, the following capital transactions arose in the subsidiary companies.

1) In July 2006, Owl Ltd disposed of its trading premises for £850,000. The property had been acquired in January 1975 for £50,000, an extension had been built in January 1986 for £125,000 and the property was valued at 31 March 1982 at £100,000.

2) In January 2006, Buzzard Ltd purchased new trading premises for £750,000. It was estimated, however, that 30% of these premises would be surplus to the company's requirements and would be let to an unconnected third party.

3) On 1 October 2006, Hawk Ltd purchased a new business for total consideration of £350,000 allocated as to:

	£
Goodwill	100,000
Freehold property	200,000
Fixed plant and machinery	50,000

The expected useful life of the goodwill is 10 years. It is the group's policy to write off goodwill over its useful life on a straight-line monthly basis.

4) On 30 November 2006, Kestrel Ltd sold its business and assets for £145,000 with the consideration allocated as follows and ceased to trade:

Goodwill	£100,000 (acquired on 31 May 2002 for £72,000 with an estimated useful life of 12 years).
Leasehold property	£45,000 (acquired on 31 May 2002 for £60,000 with twelve years left to run).

The results of each of the companies (before any adjustments arising in respect of the above items) for the period ended 31 December 2006 were:

(Continued)

3. *(Continuation)*

	Owl	Buzzard	Kestrel	Hawk
	£	£	£	£
Trading Profits	365,000	60,000	345,000	76,800
Dividends received (from quoted investments)	9,000	18,000		

You are required to calculate the tax liabilities of each company for the period ended 31 December 2006 on the basis that the most beneficial claims and elections are made. Your answer should also state any future tax implications of the claims and elections made. (18)

4. South West Properties Ltd was incorporated on 1 February 2006. On the same date, the initial shares were allotted at par and the shareholders loaned the company £250,000 pro-rata to their shareholdings which were as follows:

Mr Arthur Black	40 ordinary £1 shares
Mrs Ann Black	20 ordinary £1 shares
Mr Colin Douglas	30 ordinary £1 shares
Mr Edward Francis	10 ordinary £1 shares

The monies were initially placed into an interest bearing bank account pending the purchase of two newly built office buildings.

These two buildings were subsequently acquired as follows:

	Property 1	Property 2
Date purchased	1 July 2006	1 December 2006
Total cost	£300,000	£500,000
Cash deposit paid from company funds	£90,000	£150,000
Bank loan	£210,000	£350,000
Rate of interest on loan (Payable monthly in arrears)	8% p.a.	9% p.a.
Repayable over	5 years	8 years
Cost of qualifying plant and machinery included in above purchase price	£51,000	£78,000
Date property first let	1 August 2006	1 January 2007
Rent per annum (Payable quarterly in advance)	£30,000	£45,000

The buildings were depreciated at the rate of 4% per annum on a straight line basis.

The company accounts were prepared for the period ended 31 January 2007. The only other income and expenses in the profit and loss account for the period, other than any arising in relation to the above, were as follows:

	£
Bank interest received	8,000
Annual filing fee	15
Accountancy fees	2,000
Company formation fees	500
Property management fees	5,000
Arrangement fees on loans at 2% of capital	11,200

1) You are required to calculate the taxable profits or losses of the company. (10)

The shareholders have also now asked for your advice on the tax implications of either paying themselves interest on their personal loans or paying dividends on their shareholdings.

2) You are required to summarise how interest on their personal loans would be paid and the tax implications thereof for the company. Your answer should also explain the legal requirements of paying dividends and the tax implications thereof for the company. (5)

Total (15)