Association of Taxation Technicians

Examination

May 2008

PAPER 2 – PART II

BUSINESS TAXATION & ACCOUNTING PRINCIPLES

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. Pietran Ltd is a trading company manufacturing widgets which qualifies as a small company for capital allowances purposes. It has no associated companies. Richard Mubberry is managing director and owns 25% of the share capital. His wife, Tracey, is sales director and owns 20% of the share capital; the remaining 55% of the share capital is owned by Michael Station. Michael is unrelated to Richard and Tracey and takes no part in the day to day management of the company.

Pietran Ltd has the following draft results for the year ended 30 June 2007:

	£	£
Turnover		3,975,000
Cost of sales		2,500,000
		1,475,000
Rental income		50,000
Administrative expenses		
Salaries and wages	225,000	
Property overheads	230,000	
Travel and entertaining	35,000	
Interest payable	155,000	
Depreciation	30,000	(675,000)
Profit		£850,000

1) Salaries and wages include an accrual for a bonus of £45,000 payable to Richard. The accounts were not approved until 20 April 2008 and the bonus was paid on 30 April 2008.

2) Under property overheads is a charge for legal fees of £5,000 in respect of a 20 year lease on new offices first occupied on 1 May 2007.

3) Travel and entertaining includes the £10,000 annual cost of a box at a Premiership football club which is used for entertaining customers.

4) Interest payable is made up as follows:

	£
Accrued 1 July 2006	20,000
Paid in year	135,000
Accrued 30 June 2007	40,000

5) Due to continued expansion of the business a newly built factory was purchased on 1 January 2007 for £2 million. The cost of the land included in this sum was £400,000. The building was occupied immediately.

6) One half of the building has been used by Pietran Ltd for the purposes of its trade throughout. As the other half was temporarily surplus to requirements, it was rented out on a short lease as warehousing from 1 January 2007 at a rental of £12,500 per quarter payable in advance. A rent deposit of £25,000 was also received at the same time as the first quarter's rent was paid and has been included in rental income in the accounts.

7) The tax written down value of the pool at 1 July 2006 was £28,000. In March 2007 the company purchased new computer equipment at a cost of £20,000, which included £3,000 for the operating system software. In June 2007 it purchased a new van at a cost of £24,000.

8) On 1 March 2007 the company made a loan to Richard of £50,000 interest free. The loan is due to be repaid on 31 May 2008.

Michael is unhappy about the way Richard and Tracey are running the company and has asked you for advice regarding his position.

(Continued)

1. (*Continuation)*

You are required to:

1) Calculate the Corporation Tax due for the year ended 30 June 2007 and state the due date of payment. (9)

2) Explain briefly whether or not the company is a close company. (1)

3) Explain the Corporation Tax implications for the company of the loan to Richard and its subsequent repayment. No calculations are required. (3)

4) Explain who, as a matter of company law, exercises control in respect of Pietran Ltd's affairs. What steps might Michael take to protect his interests? (2)

Total (15)

2. Edward Jones, who is 63, commenced trading on 1 October 2002. He made accounts up to 30 September each year until 30 June 2007, when he ceased trading.

The results adjusted for tax purposes were as follows:

	£
30 September 2003	18,000
30 September 2004	6,000
30 September 2005	9,000
30 September 2006	3,000
30 June 2007	(12,000)

Since 2000, Edward had been receiving a pension of £3,000 per annum from his former employer.

Edward's trading problems arose after a dispute with a major customer in December 2005. The customer owes £30,000 and Edward has taken court action to recover this amount. A full bad debt provision was made in the accounts for the year ended 30 September 2006. A court hearing is due later this year. It is unlikely that any sum will be received until sometime in 2009, but Edward is anticipating recovering the amount in full.

During the course of preparing Edward's accounts, you discover that he has been receiving rents from a rental property since 6 April 2005. The net rental income is around £500 per annum and has not been disclosed on Edward's tax return. You have mentioned this to Edward but he appears to take the view that nothing should be done about it.

You are required to:

1) Calculate the trading income assessments for the years 2002/03 to 2007/08, before giving relief for the trading loss. (3)

2) Calculate the amount available for terminal loss relief. (3)

3) Show the most beneficial use of the losses considering all available types of loss relief. (2)

4) Explain the treatment for taxation purposes of any receipt following the court's action to recover the debt. (4)

5) Explain the course of action you should take regarding the discovery of the rental income. (3)

Total (15)

3. Dayton Ltd has presented you with the following information regarding the year ended 31 December 2007:

Trial Balance	£	£
Bank account	345,000	
Share capital (£1 nominal)		125,000
Profit and loss account		470,000
Share premium account		225,000
Long term bank loan repayment due 2010		500,000
Land and buildings – cost	1,000,000	
Plant and machinery – cost	1,200,000	
Plant and machinery – depreciation		400,000
Stock	480,000	
PAYE		45,000
VAT		270,000
Creditors		815,000
Debtors	1,650,000	
Prepayments	25,000	
Accruals		30,000
Sales invoiced		5,500,000
Cost of sales	2,200,000	
Distribution costs	200,000	
Wages and salaries	485,000	
Legal and professional fees	250,000	
Property and office costs	490,000	
Interest paid	55,000	
	£8,380,000	£8,380,000

At 1 January 2007, the share capital of the company was 50,000 £1 ordinary shares. On 1 March 2007 a rights issue of 1 for 1 at £1.50 per share was made. All shareholders took up their rights and the funds received were credited to the share capital account.

No adjustment has yet been made in respect of the following:

1) The amounts shown for prepayments and accruals are the balances brought forward at 1 January 2007 as follows:

Prepayments	£
Rent	15,000
Insurance	5,000
Telephone and internet	5,000
	£25,000

Accruals	£
Wages and salaries	8,000
Legal and professional	12,000
Rates	10,000
	£30,000

2) Property and office costs includes £20,000 rent paid in advance on 16 December 2007 for the quarter commencing 1 January 2008. Insurance and telephone expenses were invoiced to 31 December 2007.

3) Bonuses for the year ended 31 December 2007, totalling £15,000, were paid to staff in February 2008.

(Continued)

3. (*Continuation)*

4) The company is in dispute with the local authority regarding the amount of business rates levied. They have received a demand for outstanding rates for the two years to 31 December 2007 amounting to £25,000.

5) Accountancy and legal fees unbilled at 31 December 2007 are estimated at £15,000.

6) Depreciation on plant and machinery is charged at 25% on a reducing balance.

You are required to:

1) Prepare the profit and loss account for the year ended 31 December 2007. (10)

2) Prepare the balance sheet as at 31 December 2007. (10)

Total (20)

4. Bubblefish Ltd has been a 75% subsidiary of Sharkpool Ltd for many years and had the following disposals of assets during its year ended 31 December 2007.

1) On 1 September 2007 a lease on offices was assigned for £28,000. The offices had been taken on a 10-year lease on 1 September 2005 at a premium of £30,000.

2) On 31 October 2007 a freehold office building was sold for £400,000. The freehold had been purchased on 31 October 1981 for £50,000. The value remained the same for at least two years.

3) On 1 December 2007 shares in an unquoted investment company were sold for £90,000. The shares were purchased on 1 December 2004 for £25,000.

Sharkpool Ltd has capital losses brought forward at 1 January 2007 of £200,000, and has signed a contract to purchase an office building for £300,000 which will be leased to Bubblefish Ltd.

Bubblefish Ltd has trading losses for the year ended 31 December 2007 of £150,000. Sharkpool Ltd had trading profits of £75,000 for that year.

You are required to:

1) Calculate the gains arising on the above disposals. (5)

2) Explain the options available to Bubblefish Ltd and Sharkpool Ltd to reduce the amount of profits or gains chargeable to Corporation Tax and state the time limits for making any relevant claims or elections. You are not required to compute the profits chargeable to Corporation Tax of either company. (5)

Total (10)