CIMA

Intermediate Level

Business Taxation

5

IBTX

20 May 2003

Tuesday afternoon

INSTRUCTIONS TO CANDIDATES

Read this page before you look at the questions

You are allowed three hours to answer this question paper.
Answer the ONE question in section A (this has 10 sub-questions). Answer the ONE question in section B. Answer TWO questions ONLY from section C.
A Taxation Table is provided at the end of the questions.
Write your examination number in the boxes provided on the front of the answer book. Write IBTX on the line marked "Subject" on the front of the answer book. Write your examination number on the special answer sheet for section A which is on page 3 of this question paper booklet. Detach the sheet from the booklet and insert it into your answer book before you hand this in.
Do NOT write your name or your student registration number anywhere on your answer book.
Tick the appropriate boxes on the front of the answer book to indicate which questions you have answered.

SECTION A — 20 MARKS

ANSWER *ALL* TEN SUB-QUESTIONS – 2 MARKS EACH

Each of the sub-questions numbered from **1.1** to **1.10** inclusive, given below, has only ONE correct answer.

REQUIRED:

On the SPECIAL ANSWER SHEET opposite, place a circle "O" around the letter that gives the correct answer to each sub-question.

If you wish to change your mind about an answer, block out your first answer completely and then circle another letter. You will not receive marks if more than one letter is circled.

Please note that you will not receive marks for any workings to these sub-questions.

You must detach the special answer sheet from the question paper and attach it inside the front cover of your answer book before you hand it to the invigilators at the end of the examination.

Question One

1.1 In order to attract a high-calibre sales director, R Ltd agreed to provide her from 6 April 2002 with a new house which had cost the company £200,000. The annual value of the house was £15,000 and the director is to pay rent of £500 per month to the company. The company will pay the Council Tax of £2,500 and all other running costs will be paid by the director. You may assume an official rate of interest of 6%.

Her assessable benefit in kind for 2002/03 will be

A £19,000

B £22,500

C £23,500

D £25,000

1.2 A customer of X Ltd, a machine manufacturer, orders a machine on 31 October 2002. On 5 November 2002, the customer sends a cheque for the full amount and this is credited to X Ltd's bank account on 8 November 2002. The machine is delivered by X Ltd on 15 November 2002 together with an invoice dated the same date.

For VAT purposes the tax point is

A 31 October 2002

B 5 November 2002

C 8 November 2002

D 15 November 2002

1.3 MG Ltd provided its sales manager with the use of a motor car throughout 2002/03. The car was a diesel car with CO_2 emissions of 215 grams per kilometre (resulting in a standard benefit of 25%). The list price of the car was £25,000 and the company spent a further £3,000 on extras before providing it to the manager. During 2002/03 his total mileage was 30,000 of which 24,000 was business mileage.

The taxable benefit in kind for 2002/03 is

A £6,250

B £6,272

C £7,000

D £7,840

1.4 An employee paying higher rate tax is provided with a motor car throughout 2002/03 and the assessable benefit is agreed at £3,300. The employee has underpaid tax for the year 2001/02 of £80, which is to be collected via his PAYE code number for 2002/03.

The correct code number for 2002/03 is

A 461L

B 131L

C 123L

D 111L

Note that the personal allowance for 2002/03 is £4,615.

1.5 A company has been making up its accounts annually to 31 March for many years. During 2002 it decided to change its accounting date and made up accounts for the nine months ended 31 December 2002. The company failed to submit its Corporation Tax Annual Return (CT600) for this period until 24 April 2004.

What is the latest date by which the Inland Revenue can commence an investigation into the company's Annual Return?

A 31 December 2004

B 24 April 2005

C 30 April 2005

D 31 July 2005

1.6 K Ltd is a UK company which made up accounts for the twelve-month period to 31 March 2003.

In its profit and loss account, it had listed the following amounts under an expense heading "Charges":

		£
(i)	Patent royalties paid to an individual (gross amount)	7,800
(ii)	Patent royalties paid to a UK company (including an accrued amount of £5,000)	20,000
(iii)	Debenture interest paid (debenture used to acquire business premises)	30,000
(iv)	Loan interest payable (including £5,000 accrued) Loan used to finance acquisition of a subsidiary company	25,000

The amount to be added back in arriving at the company's adjusted Schedule D Case I profit is

A £25,000

B £52,800

C £55,000

D £82,500

1.7 STD Ltd is a company which is liable to pay its corporation tax by quarterly instalments. It prepared accounts for the eight-month chargeable accounting period ended on 31 August 2002 and the agreed CT liability for this period is £240,000.

The final instalment will be

A £80,000 due on 14 January 2002.

B £60,000 due on 14 December 2002.

C £80,000 due on 14 December 2002.

D £60,000 due on 14 January 2003.

1.8 S Ltd is a company which is partially exempt for VAT purposes. For its quarter ended 30 June 2002, its unattributable input VAT for the quarter which cannot be linked directly to its chargeable supplies or exempt supplies is £6,000. Its sales for the quarter comprised:

	£
Zero rated	20,000
Standard rated	10,000 (excluding VAT)
Exempt	6,000

The amount of the **unattributable** input VAT of £6,000 it may recover for the quarter is

A £1,000

B £1,200

C £1,667

D £5,000

1.9 B Ltd is a UK-resident company with a turnover of £20 million for its year ended 31 March 2003. It never had fewer than six hundred employees during that year.

The balances brought forward at 1 April 2002 for capital allowances purposes were:

	£
General pool	840,000
Jaguar car	11,000 (cost £24,000)
Bentley car	48,000

During the year to 31 March 2003, the Bentley car was sold for £24,000 and three new cars conforming to the new low $C0_2$ emissions regulations were purchased on 24 April 2002 at a cost of £15,000 **each.**

The company may claim maximum capital allowances for the year to 31 March 2003 of

A £230,750

B £231,000

C £251,750

D £281,750

1.10 W Ltd, a UK company, had chargeable profits of £9,000 for its chargeable accounting period of **nine months** ended 30 September 2002.

Its CT liability is

A £599

B £900

C £1,140

D £1,710

(Total = 20 marks)

SECTION B – 40 MARKS

ANSWER THIS QUESTION

Question Two

For the purpose of this question you are the chief accountant of BJD Ltd and the report you will produce is required early in 2003.

BJD Ltd is a company resident in the United Kingdom. It is involved in the manufacture and supply of telecommunications equipment to both UK and overseas customers. Mr D formed the company in 1997 and he holds 60% of the ordinary shares in the company. His wife, Mrs D, holds 30% and both are full-time directors. The other 10% is held by his son SD who also works full time in the business as the sales manager.

Mr D also holds 75% of the shares of TEC Ltd, a UK-resident company that supplies components to BJD Ltd. It is currently sustaining substantial trading losses and Mr D hopes to claim relief for these against BJD Ltd's CT liability.

Mr D calls you to a meeting early in January 2003 and asks you to produce a report by the end of January 2003 dealing with the following matters:

(1) The CT liability of BJD Ltd for its chargeable accounting period of 12 months ended 31 December 2002. The required information is shown in the Appendix opposite.

(2) The taxation implications of his son receiving from the company a short-term interest-free loan of £40,000, which will be repaid sometime during 2003.

(3) The tax advantages which will be available to the company if it spends £50,000 on research and development during 2003.

(4) The tax implications of operating a proposed overseas manufacturing unit based in a country where the rate of corporation tax is currently slightly higher than the UK rate but could fall in the near future. Mr D seeks advice on the tax differences between running this operation as a branch or as a subsidiary. The unit is likely to break even in its first year and Mr D asks whether he should set it up before 31 December 2003.

(5) He also wishes BJD Ltd to acquire a 40% interest in an existing foreign company resident in a country where the rate of CT is 12%. If this proceeds, 40% of the shares in the foreign company will be held by BJD Ltd, 40% by Z Ltd (a non-UK-resident company) and the other 20% will be held by individuals resident in the foreign country. He seeks your advice on the CT implications of this plan.

Required:

Prepare a suitable report for Mr D, in professional style, dealing with each of the above matters. Any calculations should be included in an appendix and referred to in your report.

The allocation of the marks for this question is as follows:

Content	*Item (1) (including computation)*	*12 marks*
	Item (2)	*6 marks*
	Item (3)	*4 marks*
	Item (4)	*7 marks*
	Item (5)	*6 marks*
	Sub-total	*35 marks*
	Presentation	*5 marks*

(Total = 40 marks)

Appendix for question two

The following information relates to BJD Ltd's accounting period of 12 months ended 31 December 2002:

Turnover		£2·1 million
Number of employees		30
		£
***Income*:**		
Draft adjusted Schedule D Case I profit	*(note (i) below)*	254,000
Rents receivable		18,000
Interest receivable	*(note (ii) below)*	6,000
Dividends from UK companies (gross FII figure)		20,000
Capital gain	*(note (iii) below)*	80,000
***Expenditure*:**		
Dividends paid		30,000
Gift Aid payments		12,000

Notes

(i) The adjusted profit figure includes patent royalties of £20,000 (gross) received net from individuals during the year.

(ii) The interest was receivable in respect of a loan of £30,000 to a supplier company. During the year, this company went into liquidation and BJD Ltd wrote off the £30,000. The adjusted profit of £254,000 is after adding back this £30,000.

(iii) There were capital losses of £95,000 brought forward at 1 January 2002.

(iv) TEC Ltd had trading losses of £100,000 for the year ended 31 December 2002.

(v) You may assume an official rate of interest of 6%.

SECTION C – 40 MARKS

ANSWER TWO QUESTIONS ONLY

Question Three

Before the introduction at 6 April 2002 of the new method of assessing car and fuel benefits, G Ltd employed a sales manager and provided him with a motor car which was used for both business and private use. The employee had been assessed on the appropriate car and fuel benefit for all years up to 2001/02.

From 6 April 2002, new rules on CO_2 emissions and new approved mileage allowance payments (AMAP) were introduced. AMAPs are tax-free amounts which can be paid to employees who use their own car for an employer's business (see below). As a result of these new rules, the company considered it appropriate to offer the manager the alternative of taking a salary increase instead of taking a company car.

As company accountant, you have been asked to prepare statements for both the manager and the directors of the company showing the implications of this suggested approach for both the employee and the company. You should assume that you are doing this work prior to 6 April 2002 and trying to make the correct decisions.

The following details are relevant to the question:

- The manager is a higher rate taxpayer (40%).
- The car chosen by the manager is a VW Passat (petrol) – list price £18,000 – with an engine capacity of 1,800 cc.
- The appropriate fuel benefit for 2002/03 is £2,850.
- Based on the CO_2 emissions, the taxable percentage of the car's list price is 24%.
- The new AMAP tax-free rates from 6 April 2002 are 40p per mile for the first 10,000 business miles and 25p per mile for any additional business miles. The company will pay the manager 20p for each business mile travelled.
- You may assume the following:
  - *(1)* the manager's total mileage for the year 2002/03 will be 24,000 miles including 4,000 private miles;
  - *(2)* the car will do, on average, 35 miles per gallon and the price of petrol will, on average, be £3·50 per gallon;
  - *(3)* the manager will, if providing his own car, be able to lease it for £3,600 per annum. Insurance and repairs will cost him about £1,200 in a year;
  - *(4)* instead of providing a car, the company will increase the manager's salary by £300 per month (gross);
  - *(5)* the company will be paying its CT at 20%;
  - *(6)* the rate of Class 1A NIC is 11·8%.

Required:

(a) Prepare a computation for the manager showing him the differences between the cash position which will arise in respect of 2002/03

- if he provides the car himself and claims the AMAP rates; and
- if the employer provides him with a car and applies a car and fuel benefit.

(12 marks)

(b) Prepare a computation for the directors showing the effect on the company's cash position under each of the above alternatives advising them as to which alternative should be chosen.

(8 marks)

(Total = 20 marks)

Question Four

CCD Ltd, a UK-resident manufacturing company with no subsidiaries, made up its accounts for the **ten-month** period to 31 October 2002. Its turnover for this period was £8 million and it had, on average, 100 employees.

On 30 June 2002, the company sold a factory for £180,000 which it had bought new in January 1998 for £210,000 and used for qualifying purposes until 31 December 1999. Thereafter, up to 31 December 2001, the building did not qualify for Industrial Buildings Allowance (IBA) but did qualify from 1 January 2002 until it was sold. The company replaced this building on 1 July 2002 with a second-hand qualifying factory that cost £220,000. This had cost the original owner £140,000, new, on 1 January 1989.

In May 2002, the company converted the area above one of its storage facilities, at a cost of £120,000, into two apartments which were then residentially let.

The following balances for capital allowances purposes were brought forward at 1 January 2002:

	£
General pool	740,000
Jaguar car	18,000
BMW car	34,000
Short-life asset (SLA) – computer	25,000

During the ten-month period to 31 October 2002, the following transactions took place:

Disposals		***Sold for***
		£
10 April 2002	Jaguar car	12,000
12 April 2002	BMW car	28,000
30 June 2002	Plant (original cost £14,000)	6,000
30 September 2002	SLA (computer)	4,000
10 October 2002	Low emissions car (A)	15,000

Purchases		***Cost***
		£
8 January 2002	Energy-saving heating system	45,000
11 April 2002	Low emissions car (A)	16,000
24 April 2002	Low emissions car (B)	18,000
26 September 2002	New computer system	60,000

Required:

(a) Compute the maximum capital allowances (including Industrial Buildings Allowances) which can be claimed by CCD Ltd for the **ten-month** period ended 31 October 2002.

(16 marks)

(b) Explain your treatment of the low emissions cars and the new computer.

(4 marks)

(Total = 20 marks)

Question Five

Until 30 September 2002, 80% of the shares of PGD Ltd, a UK-resident company, were held by MD Ltd, another UK company. On that date, MD Ltd disposed of half of its shares in PGD Ltd. In October 1998, MD Ltd had transferred a building to PGD Ltd on a no gain no loss basis. The building had originally cost MD Ltd £140,000 in May 1994 and its market value at October 1998 was agreed at £200,000.

In March 2003, PGD Ltd purchased a further building for £210,000.

During its 12-month accounting period to 31 March 2003, PGD Ltd made the following disposals:

August 2002

(1) Sold 10,000 ordinary shares of 50p each in TD Ltd for £36,000.
These shares had been acquired in May 1997 as a result of a re-organisation of the share capital of TD Ltd.
PGD Ltd had originally bought 2,000 ordinary shares in TD Ltd in April 1987 at £1·20 each.

In May 1997, these were converted and PGD Ltd received the following holdings:

Holding	*Value on first day of trading*
12,000 ordinary shares of 50p each	£2·20 per share
5,000 preference shares of 25p each	60p per share
£1,000 5% debentures – total value	£2,000

November 2002

(2) Sold for £4,800 a marble statue which had been standing in the entrance to PGD Ltd's premises.
This had cost £8,000 in May 1986.

December 2002

(3) Sold part of the landscaped gardens surrounding the business premises to a house builder for £280,000.
The whole of this land had an original cost of £60,000 allocated to it when the site was purchased in May 1984 and the agreed value of the gardens retained is £160,000.

Required:

(a) Compute the total gains which will be included in the CT computation of PGD Ltd for the year ended 31 March 2003.

(16 marks)

(b) Explain the extent to which the CT on any of the above gains may be deferred.

(4 marks)

(Total = 20 marks)

Indexation Factors which may be used in answering this question

May 1986	–	November 2002	0·815
April 1987	–	August 2002	0·732
May 1994	–	October 1998	0·137
May 1984	–	December 2002	0·998

Question Six

O Ltd, a UK-resident company, had four wholly-owned subsidiaries, two of which were resident in the UK and the other two resident overseas. It made up accounts for the twelve months ended 31 March 2003.

It also had interests in three other non-UK resident companies, details of which, for the year ended 31 March 2003, were as follows:

Company	*Shareholding*	*Rate of withholding tax*	*Post-tax profits*	*Foreign tax paid*
	%	%	£	£
X SA	7	10	480,000	50,000
Y Inc	9	28	800,000	200,000
Z PG	15	20	960,000	240,000

O Ltd is in a period of poor trading and, for the year ended 31 March 2003, it made a trading loss of £150,000. Its other taxable UK income in that year comprised rental income of £25,000 and a chargeable gain of £30,000. During the year, the company made a Gift Aid payment of £5,000.

During the year, O Ltd received dividends from its overseas holdings shown above. None of the companies had made any distributions for several years and they were able to make the following payments to O Ltd from undistributed profits:

Company	£
X SA	162,000
Y Inc	144,000
Z PG	120,000

It is assumed that O Ltd will make the most efficient claim for loss relief at the earliest opportunity.

Required:

(a) Compute the CT payable by O Ltd for the year ended 31 March 2003. Your answer should show clearly, in *columnar* layout (treating each item of overseas income in a separate column), your treatment of the trading losses and the Gift Aid payment. You should explain why you have chosen to make any deductions from particular items of income.

(15 marks)

(b) State briefly the circumstances in which any of the three identified foreign companies above would be treated as a controlled foreign company.

(5 marks)

(Total = 20 marks)

End of paper

Taxation Table follows

The Chartered Institute of Management Accountants

Intermediate Level — May 2003 examination

Business Taxation

In answering the questions in this paper, the following tax rates and reliefs should be used.

CORPORATION TAX:	*Financial year 2000 (year ended 31 03 2001)* ***and*** *Financial year 2001 (year ended 31 03 2002)*	*Financial year 2002 (year ended 31 03 2003)*
Large companies – total profits over	£1,500,000	£1,500,000
Rate of tax for large companies	30%	30%
Small companies – total profits up to	£300,000	£300,000
Rate of tax for small companies	20%	19%
Threshold for new small company rate – total profits up to	£10,000	£10,000
Rate of tax	10%	0%
Starting point for small company rate of 20%	£50,000 (total profits)	£50,000 (total profits)
Taper relief fractions	$\frac{1}{40}$	
£10,000 – £50,000		$\frac{19}{400}$
£300,000 – £1,500,000		$\frac{11}{400}$
Taper relief formula – all years	(M-P) x $\frac{I}{P}$ x appropriate fraction above	
Rate for grossing up dividends received (all years)	$\frac{10}{9}$	
Rate of shadow ACT – all years	20% (of gross dividend paid)	

INCOME TAX:	*2002/2003* ***and*** *2001/2002*
Rate of income tax on interest received and paid	20%
Rate of income tax suffered / retained on charges received / paid	22%

Note: Interest and charges paid to and received from UK **companies** from 1 April 2001 are **gross**

CAPITAL GAINS TAX:

The relevant Indexation Factors are given in **question five**.

VALUE ADDED TAX:

The current registration threshold is £55,000.