

Intermediate Level

Business Taxation

5

IBTX

18 November 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.

Write your examination number, your contact ID and your name on a double-sided card, which must be attached to your 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 included with 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 contact ID 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 N Ltd, a manufacturing company, started trading on 1 October 2002. Its turnover was:

	£
For each of the first four months	7,000
Monthly turnover thereafter	10,000

The company must be registered for VAT no later than

- A** 1 May 2003
- B** 1 June 2003
- C** 1 July 2003
- D** 1 August 2003

1.2 A basic rate taxpayer, aged 45, is employed by a UK company. He has unpaid tax of £220 in respect of 2001/02 and he has asked for this to be collected through his code number for 2002/03. During each year he pays an allowable professional subscription of £200. The personal allowance for 2002/03 is £4,615.

His code number, for PAYE purposes, for 2002/03 is

- A** 61L
 - B** 261L
 - C** 381L
 - D** 379L
-

Business Taxation

NOVEMBER 2003 EXAMINATION

SPECIAL ANSWER SHEET FOR SECTION A

Write here your full examination number:				
Centre Code				
Hall Code				
Desk Number				

1.1	A	B	C	D
1.2	A	B	C	D
1.3	A	B	C	D
1.4	A	B	C	D
1.5	A	B	C	D
1.6	A	B	C	D
1.7	A	B	C	D
1.8	A	B	C	D
1.9	A	B	C	D
1.10	A	B	C	D

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

- 1.3** D Ltd is a large company that pays its corporation tax (CT) quarterly. For the year ended 31 March 2003, the directors had estimated the total CT at £600,000 and, by 14 January 2003, £300,000 had been paid. During February 2003, the company lost a major customer and the directors revised the estimated CT to £500,000.

How much should the company pay on 14 April 2003?

- A** £75,000
 - B** £125,000
 - C** £150,000
 - D** £175,000
-

- 1.4** During its accounting period of 12 months ended 31 December 2002, L Ltd had the following transactions:

- (i) It paid debenture interest of £20,000 (gross). The debentures had been issued last year to fund the building of business premises.
- (ii) It paid loan interest of £15,000 (gross) on a loan raised during 2002 to fund the purchase of a French subsidiary. Costs of securing the loan were £2,000.
- (iii) Received loan interest of £8,000 (gross) on a loan made to a supplier company.
- (iv) Suffered a bad debt of £50,000 as a result of the above loan in (iii) proving irrecoverable. Costs of unsuccessfully pursuing the loan were £3,000.

The non-trade loan deficit available to L Ltd will be

- A** £12,000
 - B** £62,000
 - C** £70,000
 - D** £82,000
-

- 1.5** A Ltd, a UK resident company with one associated company, had chargeable profits for its year ended 31 March 2003 of £160,000. In addition, it had FII of £10,000.

Its CT liability for the above period is

- A** £14,500
 - B** £30,400
 - C** £32,000
 - D** £32,988
-

- 1.6** M Ltd, a very small company, made up accounts for the period of twelve months ended 31 December 2002.

During this period, it bought machinery costing £16,000 and a computer system costing £12,000. In June 2002, it purchased a new Low Emissions car costing £14,000 and sold the expensive car for £8,000.

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

Pool	£36,000;	Expensive car	£13,000
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The maximum capital allowances claimable for the above period are

- A** £32,600
 - B** £43,400
 - C** £46,400
 - D** £53,000
-

- 1.7** During its year ended 31 March 2003, V Ltd, a VAT registered company, paid a fire insurance premium of £10,000.

For VAT purposes this payment is

- A** exempt.
 - B** standard rated.
 - C** zero rated.
 - D** outside the scope.
-

- 1.8** On 1 January 2003, G Ltd made interest free loans of £4,000 to EACH of its ten employees.

The amount of Class 1A National Insurance Contributions the company will be required to pay for 2002/03 in respect of these loans will be

- A** Nil
 - B** £75
 - C** £175
 - D** £283
-

- 1.9** T Ltd makes up its accounts to 30 June each year. It submitted its CT 600 Corporation Tax return for the year to 30 June 2002 on 10 October 2003.

The company will be required to pay a penalty of

- A** £100
 - B** £200
 - C** £500
 - D** £1,000
-

1.10 An employer pays 15p per mile to an employee who does 20,000 business miles in his own car during 2002/03.

How much can the employee claim as a deduction against his taxable income for the tax year 2002/03?

- A** £3,000
- B** £3,400
- C** £3,500
- D** £6,500

(Total = 20 marks)

End of Section A

SECTION B – 40 MARKS
ANSWER THIS QUESTION

Question Two

R Ltd is a UK resident company, engaged in manufacturing and distributing optical equipment, whose turnover has ranged between £6 million and £8 million in recent years. Its workforce has never exceeded 150. The turnover of R Ltd's group has never exceeded £15 million and the number of group employees has not exceeded 200.

The directors of R Ltd had estimated that, at September 2002, its total chargeable profits for the year ended 31 March 2003 would be £600,000 and based its quarterly payments on this amount. During the quarter to December 2002, the directors revised this figure to £800,000. Your computations, based on other information contained in the attached appendix, will enable you to establish the actual chargeable profits and the final CT liability for the year ended 31 March 2003. You may assume that the figures were finalised and agreed in May 2003.

The Inland Revenue has written to the company enquiring into its operation of the quarterly payment system. R Ltd was required to pay its CT liability for the year ended 31 March 2002 on a quarterly basis.

R Ltd is considering paying a substantial dividend in the near future. You establish that the company has been carrying forward surplus ACT of £60,000 since 1999.

At 1 April 2002, R Ltd had the following percentage holdings of voting shares in other UK resident companies:

S Ltd – 80%

These shares had been acquired in 1994 and were held throughout the year ended 31 March 2003. For that year, S Ltd had chargeable profits of £300,000 and it had capital losses of £50,000 brought forward from earlier (post-acquisition) years.

T SA – 80%

These shares were acquired in 1996 and were also held throughout the year ended 31 March 2003. This company was incorporated in Switzerland, but was *wholly* managed in the UK. The directors of R Ltd are currently considering moving the management to Switzerland. T SA had total chargeable income for the year ended 31 March 2003 of £200,000. Most of its profits were earned in mainland Europe.

V Ltd – 90%

These shares had been acquired in March 1997 for £240,000 and, on 30 September 2002, R Ltd sold one third of its holding for £120,000. You establish that V Ltd had transferred a property to R Ltd in December 2000 when its market value (MV) was agreed at £300,000 and which had cost V Ltd £220,000 in May 1995. V Ltd had chargeable income of less than £1,000 for the year ended 31 March 2003.

Assume an indexation factor from March 1997 to September 2002 of 0.143.

Required:

Prepare a report for the directors of R Ltd dealing with each of the following matters:

- (i) The final Corporation Tax (CT) liability of R Ltd for the year ended 31 March 2003, explaining your treatment of

- any capital gains (including any reliefs claimed, where beneficial);
- and Research and Development (R&D) expenditure.

Your CT computation should appear in an appendix.

(13 marks)

- (ii) An explanation of the operation of the quarterly payment system in the case of R Ltd. Note that a generalised answer is *not* acceptable – you must refer to the **actual** liability of R Ltd and the due dates of payment. Your answer must include a schedule of payments actually made based on the estimates and final liability (arrived at in (i) above).

The schedule of payments computation should appear in an appendix.

(10 marks)

- (iii) The effect of the proposal to move the management of T SA to Switzerland.

(6 marks)

- (iv) An explanation of the operation of surplus ACT and its impact on the decision to pay dividends.

(6 marks)

Presentation marks for clarity, layout and logic

(5 marks)

(Total = 40 marks)

Appendix for question two – Information relating to R Ltd

The total profits chargeable to corporation tax (PCTCT) for the year ended 31 March 2003 were £730,000 before taking the following matters into account:

- 1 Any chargeable gains arising as a result of the information given on the previous page.
- 2 During the year, R Ltd spent £40,000 on qualifying revenue expenditure on R&D. The above figure does not reflect **any** deduction for R&D.
- 3 R Ltd received Franked Investment Income (FII) of £10,000 during the year.
- 4 Patent fees paid during the year of £8,000 have been shown in R Ltd's balance sheet as an intangible asset and had NOT been deducted in arriving at the above profit.
- 5 A loan of £20,000 to a major supplier proved irrecoverable and was written off. This is not yet reflected in the above profit.

End of Section B

SECTION C – 40 MARKS

ANSWER TWO QUESTIONS ONLY

Question Three

CCD Ltd, a UK resident manufacturing company, made up accounts for its year ended 31 March 2003. All of the following items of expenditure and income have been included, where appropriate, in the company's operating profit and loss account in arriving at the net profit.

Expenditure items

- (a) £45,000 was spent on installing a roof on a second-hand factory purchased during the year. This factory had its roof destroyed in a fire when it was being used by the previous owner.
- (b) Costs, amounting to £3,000, of raising a loan to provide funds to acquire an investment property which will be let.
- (c) Gross interest of £8,000 paid on the above loan.
- (d) Costs of leasing motor cars used by directors:

	Car	List price	Annual lease cost
		£	£
(i)	Lexus 300	32,000	7,200
(ii)	Audi A2 – Low emissions	15,000	4,800

- (e) Ten employees were made redundant on the closure of a trade run by the company. Each employee was paid £10,000 compared to their statutory redundancy entitlement of £2,000 each.
- (f) £4,000 was charged in the profit and loss account in respect of the annual instalment of a premium of £20,000 paid last year to secure a five-year lease of office premises at an annual rental of £10,000 per year.

Income items

- (g) As a result of a fire which occurred last year, repair costs were recovered from the insurers during the year ended 31 March 2002 as follows:
 - (i) In respect of factory premises owned and used by CCD Ltd £9,600
 - (ii) In respect of damages to property let out by CCD Ltd £5,400These repair costs were paid and allowed as deductions, where appropriate, last year.
- (h) Gross interest of £6,000 was received on a loan made to a major supplier company.

Required:

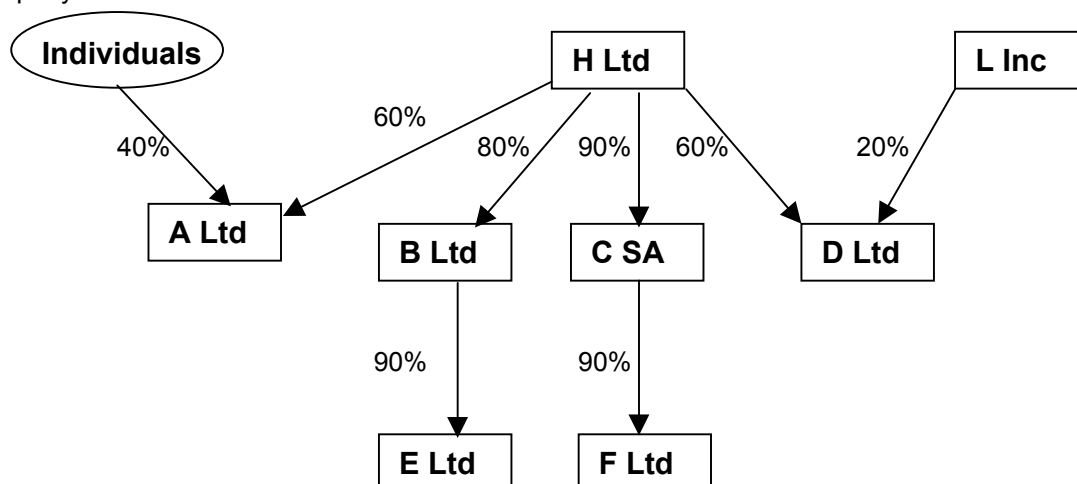
State how each of the above items would be dealt with in arriving at the adjusted Schedule D Case I profit or loss of CCD Ltd for its year ended 31 March 2003. In each case, you should give reasons for your treatment of **each** item. You are reminded that, for expenditure items, you must either add them back or leave them (explaining clearly why you have not adjusted an item) and, for income items, you must either subtract them or leave them.

For each of those items you have adjusted for, you must explain how they will **finally** be treated in the company's CT computation. You are **not** required to compute an adjusted profit figure.

(20 marks)

Question Four

The diagram below shows the structure of a number of connected companies with a UK parent company H Ltd:



All of the companies, apart from L Inc and C SA, are UK resident for tax purposes. All of the holdings were owned at 1 April 2002, apart from the holding in F Ltd which C SA acquired on 1 October 2002. The group has experienced poor trading results in recent years, with the parent company, H Ltd, sustaining substantial losses as have some of the UK subsidiaries.

All of the companies make up accounts to 31 March each year and the trading results for the year ended 31 March 2003 were as follows:

		£	
H Ltd	Trading losses	(480,000)	
L Inc	Trading profits	120,000	(Sterling)
A Ltd	Trading losses	(60,000)	
B Ltd	Trading profits	420,000	
C SA	Trading profits	260,000	(Sterling)
D Ltd	Trading profits	140,000	
E Ltd	Trading losses	(90,000)	
F Ltd	Trading profits	110,000	

Required:

(a) Interpret the above structure identifying:

- the associated companies and revised thresholds for CT purposes;
- groups that exist for group relief purposes;
- any consortia that exist.

Explain which company may surrender losses to which other company and describe the role played by the non-UK resident companies.

(12 marks)

(b) Using the above trading results, compute **the income chargeable to CT** for each UK resident profit-making company, assuming the most efficient group reliefs are claimed.

(8 marks)

(Total = 20 marks)

Question Five

Mr D, aged 45, is a director of MD Ltd, an advertising company, and receives a salary of £54,000 for the tax year 2002/03.

In addition, he is provided with an attractive package of Benefits in Kind for this year as follows:

- 1 He is provided with a Mercedes car (petrol version) with a list price of £45,000. The CO₂ emissions of the car produce a benefit percentage of 32%. The company pays for all of the fuel and the assessable fuel benefit on this car is £4,200.
- 2 His wife, who does not work for the company, is provided with a Ford Mondeo diesel car with a list price of £17,000. The benefit percentage for the petrol version of this car is 25%. She personally pays for all of the fuel used by this car.
- 3 Mr D is provided with the use of two business suits during 2002/03. One suit cost the company £700 and the other £500.
- 4 The company pays Mr D's annual subscription of £350 to the Institute of Sales and Marketing.
- 5 On 6 April 2000, Mr D was given the use of a home cinema system, for his private use, which cost the company £3,600. On 6 April 2002, Mr D took this into his personal ownership when its market value was agreed at £1,500. He paid nothing to the company.
- 6 The company paid the school fees of £2,100 for each of his two children.
- 7 The company purchased garden furniture for £2,800, which it gave to Mr D for no cost.
- 8 Mr D, accompanied by his wife, attended a professional conference in Australia at a cost to the company of £6,000. Included in this figure was the agreed cost of his wife's travel and accommodation of £2,200.

Required:

- (a) Compute the total benefits assessable on Mr D for the year 2002/03, explaining how you arrived at the assessable benefit in each case.
(12 marks)
- (b) On the assumption that all the above information was known before 6 April 2002, what would Mr D's correct Code Number be for the tax year 2002/03? How will this affect Mr D's monthly PAYE deduction?
(5 marks)
- (c) Calculate any additional costs which the company will bear as a result of the above benefits and state when this will be paid.
(3 marks)

Note: For 2002/03, the rate of Class 1A National Insurance Contributions is 11.8%.

(Total = 20 marks)

Question Six

Until 30 September 2002, all of the share capital of J Ltd, a UK resident company, had been owned by a UK holding company, HC Ltd. On that date, HC Ltd sold 30% of the shares of J Ltd to private UK individuals. HC Ltd continued to have two other wholly-owned UK resident subsidiaries, one of which had capital losses brought forward of £100,000.

You establish that, in May 1998, HC Ltd transferred a property to J Ltd under group arrangements on a no gain/no loss basis. At the date of transfer, the property had a market value (MV) of £180,000 and it had cost HC Ltd £75,000 in July 1992. The legal fees arising on the transfer were £3,000.

During its year ended 31 March 2003, J Ltd had two other disposals for capital gains purposes.

Transaction 1 December 2002

Sold rights to shares for £20,000. This arose from a holding of 30,000 ordinary shares in G plc (out of total share capital of 100,000 shares) which J Ltd had purchased in September 1992 for £180,000. When the rights issue was announced, J Ltd did not wish to take up the rights and these were sold for £20,000. The MV of the 30,000 shares still owned by J Ltd, on the day following the rights issue, was £280,000. These were the only shares in any company held by J Ltd.

Transaction 2 January 2003

Sold an office building for £190,000. This had been purchased in May 1976 for £40,000 and, since then, the following additional capital expenditure was incurred on the building:

May 1980	£8,000
September 1992	£20,000
July 2001	£24,000

No global election is in place and the MV at 31 March 1982 was agreed at £60,000.

Required:

- (a) Calculate the gain arising when J Ltd ceased to be a group member. Explain the relief which is now available for such gains on de-grouping. (8 marks)
- (b) Compute the gains arising as a result of transactions 1 and 2 above and, assuming J Ltd had *other* chargeable income for the year ended 31 March 2003 of £200,000, compute the CT which arises as a result of the **chargeable gains** arising. You are **not** asked to calculate the total CT payable. (12 marks)

Indexation Factors which may be used in answering this question

July 1992	–	May 1998	0.179
September 1992	–	December 2002	0.280
March 1982	–	January 2003	1.257
September 1992	–	January 2003	0.286
July 2001	–	January 2003	0.035

(Total = 20 marks)

End of paper

The Taxation Table follows

The Chartered Institute of Management Accountants

Intermediate Level

November 2003 examination

Business Taxation

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

	<i>Financial year 2000 (year ended 31 03 2001)</i>		<i>Financial year 2002 (year ended 31 03 2003)</i>
	and		
	<i>Financial year 2001 (year ended 31 03 2002)</i>		
CORPORATION TAX:			
Large companies – total profits over	£1.5 million		£1.5 million
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
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	$(M - P) \times I/P \times \text{appropriate fraction above}$		
Rate for grossing up dividends received	$\frac{10}{9}$		
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%
<i>Note:</i> 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 **questions two and six**.

VALUE ADDED TAX:

The current registration threshold is £55,000.

The official rate of interest is 6%
