Intermediate Level

Business Taxation

5

IBTX

25 May 2004

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.

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 M Ltd, a VAT registered manufacturing company, ordered a machine from K Ltd on 1 October 2003 at a cost of £20,000 plus VAT. To obtain this price, M Ltd paid the full amount directly into K Ltd's bank account on 25 October 2003. The machine was delivered on 31 October 2003 and K Ltd issued an invoice on 10 November 2003 for the full amount.

The actual tax point for VAT purposes was

A 1 October 2003.

B 25 October 2003.

C 31 October 2003.

D 10 November 2003.

1.2 T Ltd makes up its accounts for the **sixteen months** to 30 April 2004.

Its **two** CT 600 Corporation Tax returns must be submitted by the following deadlines:

A Both returns by 31 December 2004.

B Both returns by 30 April 2005.

C The first return by 31 December 2004 and the second by 30 April 2005.

D The first return by 31 March 2004 and the second by 31 March 2005.

1.3 V Ltd charged the following legal fees in its profit and loss account for the year ended 31 March 2004:

	£
For collecting trading debts	4,000
For collecting loans to customers	2,400
For purchase of factory	3,500
Re loan to buy factory	1,200
For directors' service contracts	800

The amount which will be added back in arriving at the adjusted Schedule DI trading profit is

A £2,000.

B £2,400.

C £3,200.

D £5,900.

1.4 On 31 December 2003, B Ltd, a UK-resident company, acquired a controlling interest in P Ltd (also UK-resident). For its nine-month accounting period to 31 March 2004, B Ltd had chargeable profits of £540,000.

Its CT liability for the above chargeable accounting period is

A £161,381.

B £162,000.

C £156,225.

D £160,931.

1.5 During its accounting year ended 31 December 2003, X Ltd leased the following cars for the use of the directors:

1 A Volvo diesel car with a retail value of £24,000 – annual lease cost £4,800

2 An Audi A2 car with a low emissions engine and a retail value of £16,000 – annual lease cost £3,600

The maximum amount of leasing costs which X Ltd can deduct in arriving at its Schedule DI profit for 2003 is

A £3,600.

B £4,800.

C £6,650.

D £7,200.

1.6 K Ltd, a small company, made up accounts for the year ended 31 December 2003.

The balances brought forward at 1 January 2003 were:

Pool	£280,000;	Expensive car	£8,400

In June 2003, it purchased a new Ford car costing £18,000 and sold the expensive car for £9,000.

The maximum capital allowances claimable for the above period total

A £70,600.

B £72,400.

C £73,600.

D £73,900.

1.7 A basic rate taxpayer is provided, on 6 April 2003, with the use of a diesel car costing £14,000 (the percentage charge for the petrol version is 22%). He has unpaid tax of £55 in respect of 2002/03 and he has asked for this to be collected through his code number for 2003/04. During each year, his employer pays his golf club subscription of £600.

His code number for 2003/04 is

A 26L.

B 66L.

C 86L.

D 111L.

Note: The Personal allowance for 2003/04 is £4,615.

1.8 H Ltd has recently formed a new subsidiary company, S Ltd, which started to trade on 1 January 2003. S Ltd's turnover in the early periods of trading was:

For **each** of the first **six** months	£4,000
Monthly turnover thereafter	£5,000

S Ltd must be registered for VAT no later than

A 31 December 2003.

B 31 January 2004.

C 1 February 2004.

D 1 March 2004.

1.9 At 30 June 2003, Y Ltd estimated its CT liability for the year ended 31 December 2003 at £600,000 for quarterly instalment payment purposes. At 31 December 2003, this estimated liability was reduced to £440,000.

What amount should be paid on 14 January 2004?

A £30,000

B £110,000

C £175,000

D £260,000

1.10 An employer pays 50p per mile to an employee who did 20,000 business miles in his own car during 2003/04. The employee's salary for that year is £50,000.

How much extra tax will the employee pay under this arrangement for 2003/04?

A £800

B £1,400

C £1,600

D £1,800

(Total = 20 marks)

End of Section A

SECTION B – 40 MARKS
ANSWER THIS QUESTION

Question Two

(a)

For the purposes of this scenario, you are the chief accountant of P Ltd, a successful UK-resident trading company engaged in the manufacture and installation of conservatories in domestic dwelling houses. The directors of the company are Mr P, who owns 55% of the shares, his wife, who owns 25% and their son who owns 20%. Neither P Ltd, nor any of the directors, own shares in any other company.

For the year ended 31 December 2002 (the company's normal accounting date), P Ltd had profits chargeable to corporation tax (CT) of £1,800,000 resulting in a CT liability of £540,000. In June 2003, your staff estimated that, for the year ended 31 December 2003, the chargeable profits, excluding any capital gains, would be £800,000.

During the month of July 2003, the directors asked you to attend a meeting at which they outlined their plans to expand the business. They proposed to acquire, on 1 October 2003, control of two companies, details of which are as follows:

1 X Ltd, an unlisted UK-resident company engaged in the manufacture of garden furniture and its distribution to garden centres. This company had formerly been profitable but, as a result of losing some major contracts, had recently incurred trading losses. The directors of this company are Mr B and his wife who own all of the shares in equal holdings. This company also makes up accounts annually at 31 December and, at 1 January 2003, it had trading losses brought forward of £35,000. The directors have estimated, at July 2003, that there will be trading losses of £30,000 for the year ended 31 December 2003. The directors of P Ltd have decided that X Ltd has excellent future prospects and are keen to acquire control of it.

2 Y Ltd is a small, newly-established company which manufactures luxury stone flooring and, as a result of advertising on the Internet, has secured a growing number of orders from residents of other countries, including some in the European Union. For its year ended 31 December 2003, its directors have estimated that 80% of the company's turnover will be export supplies. As a result of heavy start-up costs, the directors have estimated that the chargeable profit for the year to 31 December 2003 will be £40,000. The only shareholders and directors of this company are also a married couple – Mr and Mrs Y – who hold equal amounts of shares.

The directors of P Ltd have advised you that they intend that P Ltd will acquire all of the share capital of X Ltd and Y Ltd from the existing shareholders, who will be retained as managers in their existing companies on long-term contracts. They asked you to consider the tax implications of this approach.

At the meeting, the directors advised you that the funds required to acquire control of X Ltd and Y Ltd will amount to approximately £400,000. They proposed to raise this partly by borrowing, and partly by selling, in July 2003, a plot of land for housing development. This is a plot of land that had been used for parking the company's delivery vehicles. It had been acquired in March 1993 for £75,000 and was to be sold for £300,000. The directors wished to establish how much of the acquisition price of £400,000 will need to be borrowed.

All of the companies are registered for VAT.

Required: (at July 2003)

Based on the information and estimates made available to you at July 2003, prepare a report for your board of directors on the following:

(i) The amount of funds generated by the sale of the land **after** any corporation tax payable on the gain. This will enable the directors to arrange to borrow the balance of the acquisition price. Advise the directors of the tax treatment of any interest and costs of the loans raised.

(9 marks)

The estimated corporation tax liabilities of P Ltd and Y Ltd for the year ended 31 December 2003 on the assumptions that the share acquisitions take place on 1 October 2003 and that all possible loss reliefs are claimed. State when the CT liabilities will be payable.

(9 marks)

(ii) The matters to be considered in deciding how to organise the VAT arrangements for the group.

(6 marks)

Presentation marks for this section. *(4 marks)*

(Total for Part (a) = 28 marks)

Note: The indexation factor for the period from March 1993 to July 2003 is 0·614.

(b)

On completion of the accounts, the following figures for the year ended 31 December 2003 are finalised and agreed with the Inland Revenue in March 2004:

Results: P Ltd – a chargeable profit of £900,000 (including the chargeable gain)

X Ltd – a trading loss of £48,000

Y Ltd – a trading profit of £24,000

Required: (post-March 2004)

(i) Prepare a short report for the directors showing the correct CT liabilities of the companies with taxable profits.

(5 marks)

(ii) The directors are considering acquiring a controlling interest in three separate overseas companies that manufacture components used in the construction of conservatories. Prepare a short report to the directors setting out the important differences, from a UK corporation tax point of view, between having overseas subsidiaries as opposed to having UK subsidiaries. Your answer should **not** include any references to associated companies.

(7 marks)

(Total for Part (b) = 12 marks)

(Total for Question Two= 40 marks)

Note: Any detailed calculations should be shown in appendices attached to your reports.

End of Section B.

SECTION C – 40 MARKS

ANSWER TWO QUESTIONS ONLY

Question Three

E Ltd is a UK-resident company which operates a chain of coffee shops in railway stations. Up until 31 December 2002, most of the food sold in the shops was processed and packaged in rented factory premises. On 1 January 2003, the company acquired and immediately brought into industrial use a factory which had been owned by one of its competitors, C Ltd, which had gone into liquidation. The price paid was £180,000, which included a payment of £20,000 for processing and wrapping machinery already installed in this factory. C Ltd had bought the factory new for £220,000 (excluding any machinery) and brought it into use on 1 January 1990. E Ltd's turnover for the year ended 31 December 2003 was £1·6 million and it had 40 employees.

The capital allowances values brought forward at 1 January 2003 were:

General Pool	*Mercedes car*	*Computer (SLA)*
£70,000	£13,000	£3,150

E Ltd had the following additional transactions in assets during its year ended 31 December 2003:

Purchases during the year ended 31 December 2003		**Cost**
30 January	Three Ford cars for managers @ £11,000 each	£33,000
	(One of the cars was classified as low emissions)	
20 March	Two new packaging machines	£30,000
	New computer with software to operate packaging machines	£12,000
31 March	Three delivery vehicles	£42,000
31 October	New shop fronts for two of the shops	£12,000
	Three coffee making machines	£9,000
	A second-hand Lexus car for a director	£28,000

Disposals during the year ended 31 December 2003		**Sold for**
20 April	Four packaging machines which had cost £12,000 in total	£5,000
	A coffee machine which had cost £3,500	£4,000
	Original computer system purchased in March 1999. This was bought for £7,000 (treated as short life asset)	£2,000
	The Mercedes car purchased in 1997 for £31,000	£9,000
31 October	A low emissions car purchased in May 2002 for £12,000	£10,000
31 December	**All** of the inexpensive owned cars were sold for £35,000. (These were not replaced, the directors having decided that all such cars should, in future, be leased.)	£35,000

Required:

(a) Compute the maximum capital allowances which may be claimed by E Ltd in respect of its year ended 31 December 2003. Explain clearly your treatment of the computer systems, the motor cars and the shop fronts.

(17 marks)

(b) Describe the circumstances in which it may be more tax efficient to include, in the general pool, an asset which had been purchased which could otherwise be treated as a short life asset.

(3 marks)

(Total = 20 marks)

Question Four

D Ltd is an unlisted UK-resident trading company with no associated companies. During its twelve-month accounting period to 31 March 2004, it made the following disposals:

1 *April 2003*
A warehouse was sold for £130,000. This had been purchased in June 1996 for £80,000 as an investment property. It was immediately rented to a major supplier and was never used for the purpose of D Ltd's trade.

2 *May 2003*
Two offices were sold for £60,000. These offices were part of a group of six offices purchased by the company for £80,000 in June 1993. All of the offices had been used for the purpose of D Ltd's trade up to May 2003. The agreed value of the four offices retained by the company was £160,000.

3 *October 2003*
10,000 £1 ordinary shares in R Ltd were sold for £10 each. These shares were part of a holding of 12,800 shares acquired as follows:

May 1979	5,000 shares purchased at £1·80 each (Market value at 31 March 1982 was £1·50 per share – adjusted for the bonus issue)
May 1983	4,000 shares purchased at £2·10 each
June 1985	A bonus issue of one share for every five held was made
August 2001	2,000 shares were purchased at £7 each

Note: A global election for market value at 31 March 1982 was made on the occasion of a disposal of another asset made by D Ltd in 1996.

Required:

(a) Compute the chargeable gains arising as a result of each of the above disposals.

(12 marks)

(b) Prepare a report to the directors of D Ltd setting out **all** of the opportunities for deferring the corporation tax payable on each of the above gains.

(8 marks)

(Total = 20 marks)

Indexation Factors which may be used in answering this question

March 1982	–	October 2003	1·299
May 1983	–	April 1985	0·120
April 1985	–	August 2001	0·836
June 1993	–	May 2003	0·287
June 1996	–	April 2003	0·184
August 2001	–	October 2003	0·049

Question Five

(a)

TC Ltd is a rapidly growing UK company in the highly competitive computer games industry. In recent times, it has had a high turnover of technical staff who have left to join competitor companies. The board is keen to introduce new methods of rewarding staff in an effort to retain them and asks you, as the company accountant, to prepare notes to form the basis for discussion on this matter at the next board meeting.

Required:

Prepare **brief notes** identifying **three** methods of rewarding staff (**apart** from salary, bonuses, share schemes and cars). In each case, provide a brief description of the benefit and how it is quantified and indicate the tax and NIC implications for both the company and the employee.

(10 marks)

(b)

BG Ltd is a UK-resident company manufacturing furniture that has, in recent years, been earning profits in the region of £200,000 each year. Larsson Inc, a company resident in Sweden, has held 56% of the share capital of BG Ltd for several years. The other shares are held by UK resident individuals. Larsson Inc has been making profits equivalent, in £ sterling, to around £550,000 each year.

The directors of Larsson Inc have written to the board of BG Ltd informing it that they are arranging for **three** UK resident companies, in the same trade, to **each** acquire 10% of the total shares in BG Ltd. These shares are currently held by UK resident individuals. It is anticipated that **two** of these companies will make losses of approximately £25,000 each year for the next three years before becoming profitable. The other UK resident company is making small profits each year.

Required:

Prepare a report to the board of BG Ltd

(i) explaining the significance, from a taxation point of view, of this proposal;

(6 marks)

(ii) advising how this proposal will affect the taxation liabilities of BG Ltd and Larsson Inc over the next three years.

(4 marks)

(Total = 20 marks)

Question Six

The following items appear in the profit and loss account of M Ltd, a UK manufacturing company, for the year ended 31 March 2004.

Expenditure

1 Loan interest paid of £30,000 on money borrowed to acquire a controlling interest in a company engaged in the same trade as M Ltd.

2 £28,000 was spent on installing new windows in a recently acquired factory, which had been badly damaged in a fire shortly before its acquisition by M Ltd.

3 Debenture interest of £50,000 gross was paid in respect of debentures issued during the year to raise funds to construct additional business premises. Legal fees of £18,000 were incurred in connection with the debenture issue.

4 A charge of £10,000 was made in respect of the amortisation of a patent that had been acquired by M Ltd on 20 April 2002 for £90,000. Previously, the company's accounting policy was to write off patents over ten years.

5 A management charge of £55,000 was made by M Ltd's parent company, V Ltd, in respect of the salary cost of a senior manager of V Ltd, who worked for nine months at M Ltd's premises engaged solely on contracts completed by V Ltd.

(12 marks)

Income

1 M Ltd's premises suffered damage as a result of flooding during its year ended 31 March 2003. The company paid the repair costs of £52,000 during that year, and these were allowed as a deduction in arriving at the Schedule DI profit figure for that year. In May 2003, the company received £45,000 from its insurers in final settlement, comprising £40,000 in respect of damage to its business premises and £5,000 in respect of damages to property which it let to a supplier. The £45,000 was credited to the profit and loss account for the year ended 31 March 2004.

2 Interest of £8,000 (gross) was received during the year in respect of a loan made to a supplier and included in the profit and loss account. In addition, there was £2,000 interest accrued, but not shown in the profit and loss account.

(8 marks)

Required:

State how **each** of the above items would be dealt with in arriving at the adjusted Schedule DI profit for the year, explaining clearly your reasons for your treatment of each item. You must state whether the item would be **added** to the reported profit figure or **deducted** from it, or whether **no action** is required.

In respect of those items on which action is required, you should indicate the subsequent taxation treatment of **each** of these items.

(Total for Question Six = 20 marks)

End of paper

The Taxation Table is on the next page

The Chartered Institute of Management Accountants

Intermediate Level — May 2004 examination

Business Taxation

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

CORPORATION TAX:	*Financial year 2002 (year ended 31 03 2003)* ***and*** *Financial year 2003 (year ended 31 03 2004)*
Large companies – total profits over	£1·5 million
Rate of tax for large companies	30%
Small companies – total profits up to	£300,000
Rate of tax for small companies	19%
Threshold for new small company rate – total profits up to	£10,000
Rate of tax for a new small company	0%
Starting point for small company rate of 19%	£50,000 (total profits)
Taper relief fractions:	
£10,000 – £50,000	$^{19}/_{400}$
£300,000 – £1·5 million	$^{11}/_{400}$
Taper relief formula – all years	(M - P) x I/P x appropriate fraction above
Rate for grossing up dividends – all years	$^{10}/_{9}$
Rate of shadow ACT – all years	20% (of gross dividend paid)

INCOME TAX:	*2002/2003* ***and*** *2003/2004*
Rate of income tax on interest received and paid	20% (to and from individuals)
Rate of income tax on charges paid/received	22% (to and from individuals)

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

CAPITAL GAINS:

The relevant indexation factors are given in questions **Two** and **Four**.

VALUE ADDED TAX:

The current registration threshold is £56,000.

PERSONAL TAXATION:

Personal Allowance £4,615

NIC CLASS 1A and 1B 12·8%