CIMA

Intermediate Level

Business Taxation

5

IBTX

23 November 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

Question One

1.1 On 1 September 2003, K Ltd places an order with L Ltd for a machine costing £12,000 exclusive of VAT for delivery before 30 September 2003. L Ltd completes the machine on 28 September, but does not deliver it to K Ltd until 2 October 2003. K Ltd pays the full amount due (including VAT) into L Ltd's bank account by direct transfer on 7 October 2003 and L Ltd issues a VAT invoice three days later.

The VAT tax point is

A 1 September 2003.

B 2 October 2003.

C 7 October 2003.

D 10 October 2003.

1.2 A company has been making up its accounts annually at 31 May for many years. For the year ended 31 May 2003 it did not submit its Annual Return (CT600) until 31 October 2004.

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

A 31 October 2005

B 31 January 2006

C 31 May 2005

D 31 December 2005

1.3 Class 1A National Insurance Contributions in respect of 2003/2004 must be paid by

A 19 May 2004.

B 5 July 2004.

C 19 July 2004.

D 31 July 2004.

1.4 X Ltd had been making up accounts annually to 31 May for several years. Early in 2003, the directors decided to make up accounts to 31 August 2003 (instead of 31 May 2003) and annually thereafter at 31 August.

The **two** chargeable accounting periods for CT purposes will be

A	1 June 2002 – 31 March 2003	and	1 April 2003 – 31 August 2003.
B	1 June 2002 – 31 May 2003	and	1 June 2003 – 31 August 2003.
C	1 June 2002 – 31 December 2002	and	1 January 2003 – 31 August 2003.
D	1 June 2002 – 31 August 2002	and	1 September 2002 – 31 August 2003.

1.5 H Ltd, a UK resident company with no associated companies, made up accounts for the **nine**-month period to 30 September 2003. The total taxable profits for this period were £40,000, including £5,000 of FII.

The CT liability for the period will be

A £6,650.

B £6,235.

C £10,500.

D £10,085.

1.6 J Ltd, a large company for CT quarterly payment purposes, made up accounts for the **eight**-month period to 31 August 2003.

The **final** payment under the quarterly system (ignoring any balance payable on the usual due date) will be payable by

A 14 July 2003.

B 14 October 2003.

C 14 December 2003.

D 14 January 2004.

1.7 During its accounting year ended 31 March 2004, K Ltd sold a painting that had been hanging in the boardroom for several years. The selling price was £7,200 and the cost plus indexation allowance amounted to £4,800.

The chargeable gain will be

A £2,400

B £1,200

C £400

D £2,000

1.8 K Ltd incurred legal fees during its twelve-month accounting period ended 31 December 2003 on the following:

Directors' service contracts	£12,000
On a loan to be used to purchase new business premises	£9,000
Defending an action for faulty workmanship	£6,000
Bringing a Tax appeal to the High Court	£16,000
Obtaining planning permission to extend a factory	£8,000

In arriving at the company's Schedule DI profit, the amount to be added back will be

A £16,000.

B £22,000.

C £27,000.

D £37,000.

1.9 An employee paying higher rate tax is provided with a motor car throughout 2003/04 and the assessable benefit is agreed at £3,300. The employee has underpaid tax for the year 2002/03 of £80, which is to be collected via his PAYE code number for 2003/04.

The correct code number for 2003/04 is

A 461L

B 131L

C 95L

D 111L

1.10 S Ltd is a company which is partially exempt for VAT purposes. For its quarter ended 30 June 2003, its unattributable input VAT, which cannot be linked directly to its chargeable supplies or exempt supplies, is £8,000.

Its sales for the quarter comprised:

Zero rated –	£20,000
Standard rated	£7,000 (excluding VAT)
Exempt	£9,000

The amount of the **unattributable** input VAT of £8,000 it may recover for the quarter is

A £2,000.

B £2,483.

C £5,517.

D £6,000.

(Total = 20 marks)

End of Section A

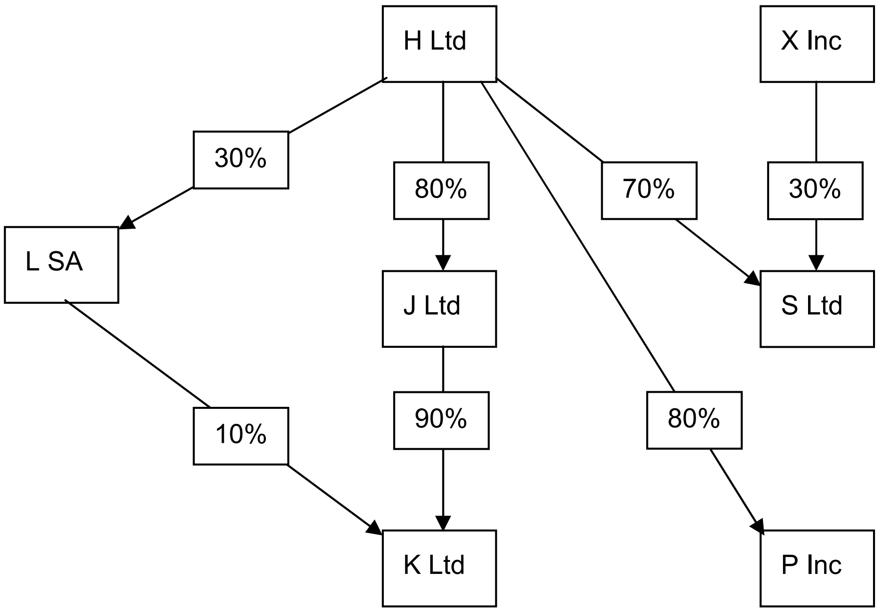
SECTION B – 40 MARKS

ANSWER THIS QUESTION

Question Two

For the purpose of this scenario you are the chief accountant of H Ltd, a UK resident company with a number of interests in UK and overseas companies.

Your assistant has prepared the following diagram of the structure of the group together with some explanatory notes. The figures represent the percentages of the voting shares held in each case. Apart from H Ltd's acquisition of 80% of P Inc on 1 January 2004, all of the holdings were acquired several years ago.



Notes:

1 Apart from L SA and X Inc and P Inc, all of the companies were incorporated in and trade in, the UK.

2 P Inc is centrally managed and controlled from the UK. It operates in a country where the only rate of CT is 10%.

3 L SA is incorporated abroad and is wholly managed abroad in a country where the rate of CT is 12%. 30% of its shares are owned by UK resident individuals.

During discussions with your managing director he raised the following points:

(i) He indicated that H Ltd is considering operating a number of new profitable businesses in overseas countries. He wishes to know about the taxation implications of running them as branches of H Ltd or as separate subsidiaries, incorporated and managed overseas.

(ii) He advised you that the board of H Ltd is considering transferring the management of P Inc to its country of operation and he wishes to know the tax consequences of this decision. It is anticipated that P Inc will sustain trading losses for at least the next accounting year, but will thereafter become profitable.

Shortly after 31 March 2004, the date to which all of the companies make up accounts for twelve months, your assistants collate the results which are shown in the following table:

	H Ltd	*S Ltd*	*P Inc*	*J Ltd*	*K Ltd*	*L SA*
	£000	*£000*	*£000*	*£000*	*£000*	*£000*
Schedule DI profit	320				110	120
Schedule DI Loss		(240)	(280)	(200)		
Schedule A	100		20		30	
Capital gain		80		60		
Capital loss					(90)	

Notes:

1 The capital gain arising in J Ltd was on an asset sold on 30 April 2003 and the capital loss in K Ltd arose from a sale in September 2003. S Ltd's gain arose on an asset sold in November 2003. All these sales were to third parties.

2 The profit in L SA has been computed in accordance with UK tax law.

3 None of the companies paid any dividends.

4 For the year ended 31 March 2003, H Ltd had chargeable profits of £400,000 and K Ltd and L SA both had profits of less than £200,000.

Required:

(a) Draft a report to the board of directors showing the final corporation tax liabilities for the profit making companies in the group in respect of the year ended 31 March 2004, indicating in each case when the liabilities have been or will be paid. Your report should explain:

- The application of the associated companies rules in the case of the group.
- The nature of the reliefs which have been claimed, indicating why you chose to claim the reliefs in the manner in which you did.
- The nature of any elections which were required to be made to minimise the liabilities of group companies.
- The effect of the presence of L SA on the CT liability of H Ltd.

Your calculations of the liabilities of the various group companies should be included in an appendix to your report and references to the figures in the appendix should be shown in the body of your report.

The report (including *3 marks* for presentation)	*(20 marks)*
Your appendix	*(12 marks)*

(Total for requirement (a) = 32 marks)

(b)

Draft a separate report to the managing director on the two points raised by him in his discussion with you.

Point (i)	*(5 marks)*
Point (ii)	*(2 marks)*
Presentation	*(1 mark)*

(Total for requirement (b) = 8 marks)

(Total marks for question = 40 marks)

End of Section B

SECTION C – 40 MARKS
ANSWER TWO QUESTIONS ONLY

Question Three

All of the ordinary share capital of A Ltd, a UK resident company, had, until 30 September 2003 been owned by M Ltd, also a UK resident company which had two other wholly owned UK resident subsidiaries – N Ltd and O Ltd. On that date, M Ltd sold 30% of the shares of A Ltd to a company resident in Germany.

You establish that, in August 1999, M Ltd had transferred a building to A Ltd under group arrangements on a no gain/no loss basis. At the date of transfer the building had a market value of £240,000. It had cost M Ltd £100,000 in August 1987 and an extension was added in June 1994 at a cost of £40,000.

During the year to 31 March 2004, N Ltd had incurred a capital loss of £40,000 and O Ltd a capital loss of £20,000.

A Ltd had the following disposals during its accounting year to 31 March 2004:

1 June 2003
Sold rights to shares for £25,000. This arose from a holding of 30,000 ordinary shares in C Ltd which A Ltd had purchased in October 1994 for £160,000. When C Ltd made a rights issue in June 2003, A Ltd did not wish to exercise its rights and these were sold for £25,000. The market value of the 30,000 shares still held by A Ltd on the day following the rights issue was £280,000.

2 September 2003
An office building held by A Ltd as an investment and not used for its trade was sold for £250,000. This building had originally been purchased in June 1972 for £30,000 and since then the following capital expenditure had been incurred on the building:

December 1977	£25,000
October 1981	£30,000
June 1991	£20,000
August 2000	£10,000

A global election was in place and the agreed market value of the building at 31 March 1982 was £75,000.

Required:

(a) Compute the chargeable gains on A Ltd for the year ended 31 March 2004, arising from **each** of the above transactions assuming all relevant claims are made.

(16 marks)

(b) Assuming A Ltd had other chargeable income for the year amounting to £13,500, compute the **total** CT payable by A Ltd and state when this will be payable.

(4 marks)

(Total = 20 marks)

Relevant Indexation Factors are:

March 1982 – September 2003	1·297	August 1987 – August 1999	0·622
June 1994 – August 1999	0·144	October 1994 – June 2003	0·249
August 2000 – September 2003	0·070	June 1991 – September 2003	0·361

Question Four

(a) For the quarter ended 30 June 2003, T Ltd, a company registered for VAT, had turnover comprising £210,000 of supplies which were standard rated, £20,000 which were zero rated and £50,000 which were exempt.

The input VAT on expenditure during the quarter was allocated as follows:

	£
Attributable to standard rated sales	24,000
Attributable to exempt sales	10,000
Attributable to Zero rated sales	1,000
Unattributable	15,000

Required:

Compute the amount of input VAT that T Ltd may recover in respect of the quarter ended 30 June 2003, explaining clearly how you arrived at your answer. There is no special method being applied.

State what adjustment may be required at the end of the company's normal accounting year.

(8 marks)

(b) You are the chief accountant of R Ltd, a rapidly growing successful company engaged in software engineering. The company employs a number of highly skilled workers who have all been provided with motors cars by the company, with unrestricted private use. The managing director has read that the company and the employees could be better off, from a tax point of view, if the employees were to provide their own cars for business use and claim mileage rates.

Required:

Prepare a report for the managing director explaining the operation of the car benefits arrangements, including fuel benefits, which will apply in 2003/04. Your answer should deal with both

(i) employees who have to do over 20,000 business miles per year and with a very small amount of private mileage.

(ii) employees who do less than 4,000 business miles per year with a large amount of private mileage.

(12 marks)

(Total = 20 marks)

Question Five

TG Ltd, a UK manufacturing company making up accounts at 31 March each year, had the following Industrial Buildings in use at 1 April 2003:

Building A
This building had been purchased new on 1 April 1978 at a total cost of £80,000, excluding the cost of land.

Building B
This building had been purchased new on 1 April 1987 at a cost of £140,000 including £33,000 for the cost of the land and £36,000 in respect of administration offices.

Building C
This building had been purchased second hand from Q Ltd on 1 April 1991 for £180,000, excluding the cost of land. It had originally cost Q Ltd £115,000 new on 1 April 1983.

All of the above buildings had been brought into use immediately on purchase and had been used at all times for qualifying purposes for Industrial Buildings allowance.

Building D
This building, situated in an Enterprise Zone, had been purchased by TG Ltd on 1 April 2001 for £140,000 excluding the cost of land, and the company had claimed Initial Allowance of 55% in the year ended 31 March 2002 and thereafter had claimed the maximum allowances available.

During the year ended 31 March 2003, the directors of TG Ltd were planning the purchase, on 1 April 2003, of one additional secondhand qualifying building on which they were prepared to spend £160,000. They had narrowed the choice down to the following three buildings, each of which would be suitable for the business and each of which would cost £160,000, excluding the cost of land.

(i) Originally purchased by the previous owner for £110,000 on 1 April 1976.

(ii) Originally purchased by the previous owner for £140,000 on 1 April 1979.

(iii) Originally purchased by the previous owner for £170,000 on 1 April 2001.

All of the above prices are exclusive of the cost of the land.

All of the above buildings were brought into use by the original owners on the date of purchase and have always been used for industrial purposes.

Required:

Compute the maximum Industrial Buildings Allowances that may be claimed by TG Ltd for the year ended 31 March 2004, assuming the most tax efficient choice was made concerning the building which was purchased on 1 April 2003.

(20 marks)

Question Six

(a) X Ltd, a UK resident company, controls 80% of the ordinary shares of Y Ltd, also UK resident.

Both companies make up accounts to 31 March 2004.

In May 2003, W Ltd, a major supplier of raw materials to both X Ltd and Y Ltd, was experiencing serious cash flow problems. Had this company ceased to trade it would have created serious problems for X Ltd. After careful consideration and after having a valuation report on W Ltd prepared by a firm of accountants at a cost of £6,000, X Ltd made a loan to W Ltd of £70,000.

In December 2003, W Ltd paid X Ltd interest on the loan of £5,000 which was credited to X Ltd's profit and loss account. In February 2004, one of W Ltd's major customers became insolvent. As a result, W Ltd was unable to pay back any of the loan from X Ltd who wrote it off in its profit and loss account.

The results for the year ended 31 March 2004 were:

X Ltd	Profit of £60,000 – after writing off the above loan and related costs and crediting the interest received from W Ltd.
Y Ltd	Profit of £280,000.

Required:

Demonstrate how the above transactions would be dealt with by X Ltd for taxation purposes and indicate how the group of X Ltd and Y Ltd can gain maximum relief under the loan relationship rules. You should show how much CT has been saved by your treatment.

(10 marks)

(b) You are the Financial Controller of D Ltd, a small UK resident manufacturing company engaged in the software industry. The recent taxable profits have been between £250,000 to £280,000 per year.

Your chairman calls you to a meeting at which he informs you that 90% of the company's share capital, which is currently owned by the four directors in equal amounts, is about to be acquired by an American resident company. This company already has thirty five European subsidiaries, including four resident in the UK.

Required:

Draft a brief report to the chairman, setting out the UK tax implications for D Ltd as a result of the takeover. You should also discuss the effect on the CT liability of D Ltd.

(10 marks)

(Total = 20 marks)

End of paper

The Taxation Table is on the next page

The Chartered Institute of Management Accountants

Intermediate Level	November 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	$^{10}/_{9}$

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 TAX:
The relevant indexation factors are given in **Question Three**.

VALUE ADDED TAX:
The 2003/04 registration threshold is £56,000.

PERSONAL TAXATION:
Personal Allowance 2003/04 £4,615

NIC CLASS 1A and 1B - 2003/04 12·8%