

PUBLIC POLICY AND TAXATION

**Professional 2
June 2003**

MARKING SCHEME



Question 1

- (a) The following criteria come from the OLM and textbook.

Federal or Unitary

In unitary states, power is concentrated in one supreme body. 1

In federal states power is devolved to a number of coordinate agencies and the courts are used to resolve conflict between these bodies. 1

Codified or Uncodified

Countries with codified constitutions encapsulate (or codify) the main body of their constitutional law in a single document. 1

Countries with uncodified constitutions may have many elements of their constitutional law recorded in writing, but this is not codified into a single document. 1

(Note: candidates who use alternative descriptions such as written and unwritten should be given full credit).

Flexible and Inflexible

Written/codified constitutions are usually more inflexible than unwritten/uncodified ones. 1

This is because the procedure for amending written/codified constitutions normally involves special procedures whereas unwritten/uncodified constitutions can normally be amended by the same process as ordinary law. 1

Evaluation of UK Constitution

The UK constitution is unitary, even though the national sub-divisions of the UK lend themselves in theory to a federal constitution.

The UK constitution is uncodified– there is no single authoritative document that encapsulates the country’s constitutional rules.

The UK constitution is flexible – uncodified constitutions such as that of the UK can be amended by the same process as the ordinary law.

1 mark for each plausible point made up to a maximum of 3 (9)

- (b) The following sources come from the OLM and textbook.

Legislation

The main source. It comprises Acts of Parliament and subordinate legislation such as orders in council and rules/regulations made by ministers. Key constitutional matters regulated by legislation include such things as the conduct of elections and devolution to Scotland and Wales. 2

Common Law

Law derived from court cases and from custom. Includes the general principle of parliamentary sovereignty, the exercise of residual crown powers and decisions of courts in judicial review. 2

Conventions

Conventions are rules of constitutional behavior which are regarded as binding upon those who operate the Constitution, but which are not enforced by the law courts. Conventions act as the “glue” in the system and make an uncodified/unwritten constitution workable. Conventions include matters such as the dissolution of parliament by the monarch at the request of the prime minister. 2

EU law

Some EU law is directly applicable to the UK. Such law includes judgements of European Court of Justice and regulations from the EC and Council of Ministers. 2

Law and Custom of Parliament

These relate to the running of parliament and cover the organisation of parliament’s work (eg duty of impartiality by the Speaker and allocation of time to the Opposition). 2

Works of authority

Authoritative commentators on the constitution such as Bagehot and Dicey. On the law and custom of Parliament, Erskine May’s treatise on Law, Privileges, Proceedings and Usage of Parliament is definitive. 2

(12)

- (c) Parliamentary Sovereignty refers to a country’s parliament as being its ultimate legal authority and, in its external relations, parliaments ability to function as an independent entity. 1

European Communities Act (1972) gave the force of law within the UK to obligations arising under the EU treaties. EU law now has general and binding authority in the UK. 1

EU law takes precedence over all inconsistent UK law. It precludes the UK parliament from legislating on matters within EU competence, where the EU has formulated rules to “occupy the field”. 1

Overall, the present constitutional position is that the UK’s membership of the EU has impaired the doctrine of parliamentary sovereignty. Parliamentary sovereignty, vis-à- vis the EU can only be fully restored by the UK’s withdrawal from the EU by repealing the 1972 European Communities Act. 1

(4)

(25)

Question 2

(a) Monetary Union

Involved creation of a single European currency (the Euro). 1

A single central bank (the ECB) and a single, common short-term interest rate replaced the individual central banks and short-term interest rates of member countries. 1

(2)

(b) For full participation (ie joining the Euro)

It reduces transaction costs, facilitating trade amongst Eurozone members. 1

It introduces greater price transparency, encouraging the minimisation of production costs in order to remain competitive. 1

Offers prospect of substantial economic, monetary and political stability. 1

Against full participation (ie against joining the Euro)

Concerns over the surrender of the political sovereignty of the UK government and that the Eurozone is not an optimal single-currency zone. 1

Concerns over the surrender of the economic sovereignty of the Bank of England (monetary policy) (and possibly the UK government – fiscal policy). 1

Fears of greater and more harmonized regulation (business, social and employment) in more unified Europe. 1

(6)

Note

There are many other arguments, both for and against single-currency participation, that students may mention. Full credit should be given for all plausible arguments, including reference to the UK Chancellor's five tests for membership of the Euro. But the maximum available mark for Section (b) remains at 6 marks.

(c) (i) The European Council of Ministers

1 mark for each relevant point, up to a maximum of 3

Its central function is to decide EU law on the basis of proposals received from the European Commission.

It is supported in its work by permanent delegations of diplomats (COREPER) from each member country.

The Council's work is divided up into 23 policy areas and decisions are made by unanimous, qualified majority or simple majority votes, depending on the issue under discussion.

(ii) The European Parliament

1 mark for each relevant point, up to a maximum of 3

It is not a parliament in the traditional sense – it does not produce a government or any pro-active legislation but instead is part of the EU's consultative process.

It offers opinions on EU legislation proposed by the EC prior to consideration by the Council and also after initial Council consideration.

Its main real powers are to dismiss the Commission (but this has never been exercised and may be a formal rather than a real power); confront the Commission over budget proposals; and to reject draft budgets.

(iii) The European Commission

1 mark for each relevant point, up to a maximum of 3

It ensures EU legislation is upheld in nation states (a watchdog role).

It initiates EU policy by formulating proposals that go to the Council of Ministers.

It has a broad executive role in terms of supervising and implementing EU policies, and in managing the EU budget.

(iv) The European Court of Justice.

1 mark for each relevant point, up to a maximum of 4

The Court is the EU's judicial authority.

It ensures uniformity in the interpretation and application of Community Law.

It reviews the legality of acts adopted by the Council and the Commission.

It rules on questions of Community law referred to it by national courts.

It rules on complaints by natural and legal persons who wish to challenge decisions affecting them taken by the Community.

(d)

1 mark for each relevant point, up to a maximum of 3

Democratic Deficit is concerned with a low level of democratic accountability in governmental institutions.

In the EU, the only institution that is directly accountable to the electorate (through direct elections) is the European Parliament. But the EU parliament, though able to amend/reject draft law and influence the EU Budget, has little/no democratic control over either EU policymakers (the EU Commission) or EU decision makers (the Council of Ministers).

The key decision-making institution (the Council of Ministers) does suffer from a democratic deficit. Although it comprises elected Ministers from member countries, such members are indirectly rather than directly elected to the Council.

Furthermore the Council's voting system (unanimity, qualified majority and simple majority, dependent on the issue under consideration) means that Council members from individual countries may often be unable to translate the interests and wishes of their home electorate into EU policy decisions.

4

(25)

Question 3

- (a) (i) Traditional conservatism sees society in hierarchical terms as a command structure, held together by people exercising their allotted duties.

Capitalism is seen as the optimum economic system because of its ability to generate wealth and its close link with political freedom.

Generally opposed to radical and/or rapid change.

Is intensely patriotic and nationalistic, seeing preservation of nation's integrity against internal and external threats as the first task of political leadership.

Has an unqualified regard for private ownership of property – is unconcerned by social inequality as this is seen as a result of differences in energy and ability.

Strong emphasis is placed on the rule of law and law enforcement. But believes in limited (but authoritative) government.

1 mark for each plausible and explained point, up to a maximum of 5

- (ii) Conservative Party's ideological stance under Thatcher often called "New Right".

Features included:

Support for a free market economy. State's economic role is limited to ensuring "sound money" (ie controlling inflation), security of property and enforceability of contracts).

Socio-economic aspects include cutting direct taxes, reducing public expenditure, privatising publicly owned assets, ending corporatist relationships with producer groups and curbing the power of trades unions.

Nationalist desire to protect British sovereignty against European integration.

Elimination of social dependency culture.

Strong state role in maintaining internal order, external defence and protection of national interests.

1 mark for each plausible and explained point, up to a maximum of 5

- (iii) Under Hague and Duncan-Smith the Conservative party has repositioned its ideology ("New Conservatism").

Main features include:

Neo-liberal economics

Social libertarianism

Nationalist resistance to European integration

Constitutional conservatism

1 mark for each plausible and explained point, up to a maximum of 4

- (b) *There are likely to be a wide variety of answers to this question, including some/all of the examples of likely points shown below.*
1 mark should be awarded for each plausible point, up to a maximum of 6

Skeletal summary of features of New Labour ideology include:

The competition state

A solid belief in the role of the market economy in wealth creation and distribution – the state is a facilitator of competition in world markets.

The idea of community

A balance is sought between the Thatcherite focus on individuals or consumers, and the “old Labour” focus on collectivism – New Labour aims to stress the ideas of social interdependence and responsibility (the “Third Way”).

The stakeholder society

Individuals have rights, assets and opportunities, but need to fulfill certain obligations – governments should develop policies to promote “inclusion” and combat “exclusion”.

Constitutional radicalism

Commitment to constitutional reform (devolution, bill of rights, freedom of information, electoral and parliamentary reform).

- (c) Marketisation and Privatisation both seek to improve the efficiency and effectiveness of the economy. Marketisation attempts to achieve this by introducing private-sector principles into the public sector; privatisation by transferring public-sector assets to the private sector.

2

Flexibility is needed when marking the remainder of 3(c) – plausible comments should all be given credit. But no more than 3 marks must be awarded for this part of 3(c), and no more than 5 marks for 3(c) as a whole.

The competition state.

New Labour, though not active in privatisation (but more so in marketisation) policies, has done little to reverse the Thatcherite initiatives of 1979 – 1997. This approach is consistent with the *competition state* ideology. The telecommunications and other utility markets have increasing numbers of providers and hence wider competition and choice, albeit partly due to the regulatory framework.

The idea of community.

It is questionable whether there are sufficient controls/regulations in place to ensure that privatised companies consider or comply with the notion of *community* in their decision-making process.

The stakeholder society.

It is debatable whether the greater freedom created by private ownership is consistent with the notion of a *stakeholder society*. Regulation of privatised utilities does not influence the extent to which companies apply the principles of stake holding as the power of regulator does not extend this far.

Constitutional radicalism

Not relevant in the context of this question.

(25)

Question 4

(a)

	£	£	
Profit before taxation per accounts		431,200	½
Add: Depreciation		76,560	½
Loss on sale of machinery		2,700	½
Customer entertaining		11,630	½
Gift Aid donation		2,500	½
Xmas gifts to customers		1,000	½
Increase in general provision		3,500	½
Employee loan written off		500	½
Professional fees		2,500	½
Repairs		1,300	½
		<u>533,390</u>	
Less: Income from property	24,000		½
Investment income	<u>72,000</u>	96,000	½
Schedule D Case I profit (before capital allowances)		<u>437,390</u>	

(6)

(b)

	General Pool £	Jaguar £	Total allowances £	
y/e 31/3/2002				
WDV b/f	123,460	28,420		
Disposals	<u>(11,500)</u>			1
	111,960			
WDA @ 25%	27,990		27,990	1
WDA (restricted)		3,000	3,000	1
	<u>83,970</u>			
Additions	16,000			
FYA @ 40%	<u>6,400</u>		6,400	1
WDV c/f	93,570	<u>25,420</u>		
Total allowances			<u>37,390</u>	

(There is no restriction for private use of an asset by an employee.) 1
(5)

(c) Rent of £8,000 x 6/12 = £4,000 is assessable under Schedule A. The premium of £20,000 less 5 x 2% = £18,000 is also assessable, giving a total Schedule A figure of £22,000.

(3)

(d)*S104 Holding:*

	No. of shares	Cost £	Indexed cost £	
Bought August 1989	2,000	7,000	7,000	1
Indexation to March 1998 (160.8 – 115.8)/115.8 x £7,000			2,720	1
Bought March 1998	1,000	8,000	8,000	1
	3,000	15,000	17,720	
Indexation to November 2001 (174.6 – 160.8)/160.8 x £17,720			1,521	1
			<u>19,241</u>	
Sold November 2001	<u>2,000</u>	<u>10,000</u>	<u>12,827</u>	1
c/f	<u>1,000</u>	<u>5,000</u>	<u>6,414</u>	
The gain on the disposal is £17,173 (£30,000 - £12,827).				1 (6)

(e)

	£	
Schedule D Case I	437,390	½
Less: Capital allowances	<u>(37,390)</u>	½
	400,000	
Schedule A	22,000	½
Chargeable gains	<u>17,173</u>	½
	439,173	
Less: Charges	<u>2,500</u>	½
PCTCT	436,673	
FII (£45,000 + £5000)	<u>50,000</u>	½
Profits	<u>486,673</u>	
£436,673 @ 30%	131,002	½
Less: Marginal relief:		
1/40 x (£1,500,000 - £486,673)	22,730	1½
x (£436,673/£486,673)		
Corporation tax due	<u>108,272</u>	
		(5)
		(25)

Question 5

(a)

	£	£	
Salary		60,000	
Employer pension contributions		-	½
Expenses allowance		5,000	½
Private medical insurance		630	½
Free use of workplace sports facilities		-	½
Beneficial loan £10,000 @ 6.25%		625	½
		<u>66,255</u>	
Less: Pension contributions 7% of £60,000	4,200		½
Necessary travel and subsistence expenses	4,000		½
Mileage allowance deficit:			
4,000 @ 45p + 1,000 @ 25p - £1,500	550		1
Allowable subscription	250	9,000	½
Schedule E income		<u>57,255</u>	

(5)

- (b) Fiona and Frank have a qualifying child living with them in 2001/02. Therefore CTC is potentially available. ½
- However, Fiona is obviously a higher-rate taxpayer whilst Frank is not, so the CTC must be claimed by Fiona. ½
- £2 of the CTC is lost for every £3 of taxable income taxed at the higher rate or Schedule F upper rate. Since the full CTC is £5,200 this means that the tax credit is entirely lost when £7,800 or more of taxable income is taxed at higher rates. This is clearly the case for Fiona. Therefore neither she nor her husband will benefit from the CTC in 2001/02. 2

(3)

(c)

	Fiona £	Frank £	
Schedule E	57,255	14,420	1
Schedule F:			
£918 + £102	1,020		½
£603 + £67		670	½
Building society interest:			
£3,072 x 100/80	3,840		½
£4,144 x 100/80		5,180	½
	<u>62,115</u>	<u>20,270</u>	
Personal allowance:			
Age 0-64	4,535		½
Age 65-74: £5,990 - (1/2 x £2,670)		4,655	1
Taxable income	<u>57,580</u>	<u>15,615</u>	

Income tax due:

		Fiona		Frank	
Fiona	Frank	£	£		
£	£				
1,880	1,880	@ 10%	188	188	½
28,370	7,885	@ 22%	6,241	1,735	1½
26,310	-	@ 40%	10,524	-	½
-	5,180	@ 20%	-	1,036	½
-	670	@ 10%	-	67	½
1,020	-	@ 32.5%	331	-	½
<u>57,580</u>	<u>15,615</u>		<u>17,284</u>	<u>3,026</u>	
<i>Less: MCA £5,365 @ 10%</i>			-	537	½
			<u>17,284</u>	<u>2,489</u>	
<i>Less: Tax deducted at source from BSI</i>			768	1,036	½
			<u>16,516</u>	<u>1,453</u>	
<i>Less: Tax credits attached to dividends</i>			102	67	½
<i>Tax payable (before deducting PAYE)</i>			<u>16,414</u>	<u>1,386</u>	

Notes:

- (i) Fiona's basic rate band is extended by £850 (£663 x 100/78) because of the Gift Aid donations.
- (ii) MCA may be claimed by virtue of Frank's age. This is available in full since the reduction required because of the size of his income has been made in full against his own personal allowance.
- (10)

(d)

	£
Primary Class 1 contributions:	
8.4% x (£29,900 – £4,535)	<u>2,131</u>

(1)

- (e) The main purpose of the PAYE system is to collect income tax (and NIC's) at source from employment income. The system was introduced during the Second World War to deal with the greatly increased number of employees who were then paying income tax.

The system provides a smooth flow of revenue for the Government throughout the tax year and avoids the need for employees to put money aside each week or month to pay a year-end tax bill. The system is also cheap to run, since employers act (in effect) as unpaid tax collectors on behalf of the Inland Revenue.

The main features of the PAYE system are as follows:

- Employers deduct income tax and NIC's from employees when paying their wages and salaries. The sums deducted in a tax month (together with the employer's secondary NIC's) must be paid over to the Inland Revenue within 14 days of the end of that month.

- The PAYE system applies to all payments assessable under Schedule E, including "payments" taking the form of assets which are readily convertible into cash.
- Each employee is issued with a tax code by the Inland Revenue. This code reflects the employee's entitlement to allowances and relief's. The tax code may be adjusted to collect tax due on benefits-in-kind or to account for tax under-paid or over-paid in previous years.
- The system is cumulative in nature. With the aid of tax tables provided by the Inland Revenue, the employer uses the tax code to determine the amount of tax-free pay to which an employee is entitled for the tax year to date. This amount is then subtracted from the employee's gross pay to date, giving the taxable pay to date. A further table look-up then determines the amount of tax due for the year to date. The tax already paid for the year (if any) is then subtracted, giving the tax due for the current week or month.
- The aim is that, at any time of year, the tax paid so far during the year should accord with the amount due so far for that year. At the end of the year, the system should have automatically collected the correct amount of tax and it should not be necessary to issue the employee with a further tax demand or make a tax repayment.
- At the end of each tax year, employers are required to submit an end-of-year return to the Inland Revenue, summarising all employees' gross pay and tax paid for the year. A certificate of gross pay and tax deducted must also be provided to each employee at the end of the tax year on form P60.
- The system as originally designed revolves around the use of printed tax tables and forms. However, many employers now run computer-based payroll systems in which disk files have replaced the printed tables. Similarly, there is an increasing trend for end-of-year PAYE returns to be submitted to the Inland Revenue by electronic means.

1 mark for each valid point up to a maximum of (6)

(25)

Question 6

(a) (i) The badges of trade are:

- the subject matter of the transaction
- the length of the period of ownership
- the frequency of transactions
- supplementary work
- the reason for the sale
- motive for acquiring the asset.

½ mark for each and further ½ mark for explanation

(6)

(ii) Although trading profits and chargeable gains are both assessed to corporation tax, it is important to distinguish between them for the following main reasons:

- The rules of computation are different. In particular, the rules on allowable deductions differ and chargeable gains attract indexation allowance. 1
- Trading profits can be used to relieve trading losses brought forward, whilst capital gains can be used to relieve capital losses brought forward. 1

(2)

(b) A registered person may join the cash accounting scheme so long as:

- the person's taxable turnover (excluding sales of capital items) is not expected to exceed £600,000 in the next 12 months, and 1
- the person's VAT returns are up to date, and ½
- all amounts of VAT due to be paid to Customs and Excise (including any penalties and interest) have in fact been paid, or the person has come to an arrangement for such payments to be made by instalments, and ½
- within the previous 12 months, the person has not been convicted of a VAT offence or assessed to a penalty for VAT evasion involving dishonest conduct. ½

The main consequences of joining the scheme are:

- output tax is accounted for in the tax period in which payment is received from the customer 1
- automatic bad debt relief ½
- input tax is reclaimed in the tax period in which payment is made to the supplier. 1

(5)

- (c) (i)** Exempt supplies include insurances and most education and health services. Zero-rated supplies include food, water and books. 2
- (ii)** A person who makes only exempt supplies is not making taxable supplies and cannot register for VAT. The person must not charge VAT to customers and cannot reclaim input tax.
A person who makes only zero-rated supplies is making taxable supplies and must register for VAT if turnover exceeds the prescribed threshold. The person may register voluntarily if turnover does not exceed the threshold. Having registered, the person charges VAT (at 0%) to customers and may reclaim input tax. 2
- (d) (i)** A person whose annual taxable turnover exceeds the registration threshold must register for VAT. Registration is also required if there are grounds for believing that turnover in the next 30 days alone will exceed the threshold. A person who is liable to register but who fails to do so is still a taxable person and is personally responsible for the output tax due in relation to supplies made since the date on which registration should have occurred.
When deciding whether or not the registration threshold has been exceeded, it is necessary to aggregate the taxable turnover from all of a person's business activities. The registration relates to the person, *not* to an individual business. 2
- (ii)** A person may register voluntarily so as to be able to reclaim input tax. It will be necessary to charge output tax to customers but this will not entail a loss of custom if the person makes only zero-rated supplies or makes supplies only to other registered persons (who can reclaim any VAT which is charged to them).
Another reason for registering voluntarily might be to give the impression of an established business. 2
- (e)** Tax evasion (which is illegal) involves dishonest conduct and includes actions such as concealing a source of income or claiming allowances and reliefs to which the taxpayer is not entitled. The courts take a serious view of tax evasion and can inflict substantial fines and/or terms of imprisonment on the perpetrators. 2
Tax avoidance (which is legal) involves the sensible arrangement of a taxpayer's financial affairs so as to minimise his or her tax liability. Since tax avoidance is not illegal it cannot be punished by the courts. However, in recent years the courts have taken the view that totally artificial tax avoidance schemes consisting of a preconceived series of transactions which have no aim other than tax avoidance should be ineffective for tax purposes. 2

(25)