PUBLIC POLICY AND TAXATION

Professional 2
December 2003

MARKING SCHEME

Question 1

(a) Prime Ministerial Government

Prime Minister dominates government decision-making, using the powers of office to decide policy in any area/manner desired and with whomsoever chosen, to decide key issues and to set the ideological framework for ministerial policies. *2*

(b) Sources of Power

(1 mark for each plausible point up to a maximum of 5 marks)

Powers of appointment and dismissal of Ministers.
Control over government business.
Special responsibilities in areas of strategic economic matters, defence, foreign policy and security.
Command of government information and media relations.
Power to request dissolution of parliament. *5*

(c) Examples of issues illustrating extent of ministerial power.

Few and short cabinet meetings.
Large Prime Minister's Office (and importance of Policy Unit).
PM's position as lead negotiator on EU and other international issues (eg Iraq war).
PM's position at centre of Cabinet Committee system and thus ability to build up power blocs.

Examples of issues illustrating constraints on prime ministerial power.

PM power is a function of personal disposition rather than of institutional frameworks.
Ability to appoint/dismiss Ministers is constrained by political influence of individuals/sections within governing Party.
Content of manifesto constrains policy and thus PM's power.
Many examples of PMs not getting their own way in Cabinet (some resulting in PM resignations).
PM is dependent on Ministers and Whitehall to implement policy – as a result, PM is often a bargainer rather than a powerful leader.
Power constrained by PM's frequent absence as part of a hectic business schedule (eg overseas visit/negotiations).
PM's special areas of responsibility (economics, security, foreign affairs) are especially vulnerable to events outside the PM's control and sphere of influence.

1 mark for each plausible point, up to a maximum of 11 marks.

(d) The doctrine of collective responsibility is a convention of Government that requires all ministers to support publicly decisions of Cabinet and its committees, or alternatively to resign. *1*

Practical implications of the doctrine are:

Cabinet solidarity – ministers may disagree until a decision is made, but are then expected to support it publicly or, at least, not express their lack of support for it.

If they feel they must dissent publicly, they are expected to resign – if they fail to resign, it falls to the Prime Minister to "dismiss" them. The purpose of this is to create and maintain the authority of the government which would otherwise be damaged by the public squabbling between ministers. *2*

Cabinet secrecy – a precondition of Cabinet solidarity is that Cabinet discussion is secret. Ministers need to feel free to speak their minds, secure in the knowledge that their views will not be divulged to the media. Ministers who are known to disagree with policy may be expected to have little commitment to it, with well-publicised disagreements having potential damaging consequences for public confidence in government. *2*

Cabinet resignation if defeated on a Commons' vote of no confidence. The convention requires that the Cabinet (and thus entire government) should resign if defeated in the Commons on a vote of no confidence. This aspect of the convention still operates unambiguously, such as when the Labour Government dissolved parliament in March 1979 immediately following defeat on a vote of confidence. But such events are rare because governments only infrequently lack an overall majority in the Commons. *2*

(7)

(25)

Question 2

(a) *Answers are likely to include a wide range of "actors". 1-2 marks per plausible "actor" with illustrative comments, up to a maximum of 9 marks.*

Parliament

Parliament debates and votes upon Government's annual tax and spending plans.
Its power to influence economic policy is dependent on size of the Government majority in the Commons.
It is argued that Parliamentary scrutiny of government policy proposals is being steadily reduced. This reflects the increased role of the media in policy debate; and the fact that many of the more detailed aspects of policy implementation and change occur without parliamentary scrutiny.

Core Executive

Much economic policy is initiated by the core executive, led by the Prime Minister and Chancellor of the Exchequer.
The adequacy of the core executive in formulating and implementing economic policy is normally a key issue in general elections, and usually dominates election manifestos.

Civil Service

The Treasury and many of the major spending Departments (education, health and social security) usually have a major impact on economic policy formulation and management.
Departmental spending is determined via the Comprehensive Spending Review, hence, the Treasury is very powerful in determining economic priorities and resource allocation.

Pressure Groups

This category can include sectional groups (eg, the TUC, CBI, BMA, NUT) and cause groups (eg Greenpeace).
Pressure groups which are "insider groups" have far more influence than those which are "outsider groups".
Amongst these groups, the unions used to be highly influential, but have over the past 15 years suffered a significant loss of power and standing.
Industry lobby groups tend to be influential. For example, the CBI is believed to be having a major impact on the Blair Government's attitude towards the UK's future membership of the Euro.

Quangos

A good example is the Bank of England which, although having to achieve inflation targets set by the Government, has independence in terms of formulating and implementing monetary policy aimed at meeting the inflation target.

Media

The national press in particular frequently initiates/sustains campaigns on economic issues. Good examples here are Government attitudes towards pensions and Euro-membership. The media, as commentators on government policy proposals and implementation, frequently influence change in official policy.

(b) *Maximum of 2 marks for each clearly explained and plausible point made. Maximum of 1 mark for each plausible point made without explanation. Overall maximum of 12 marks.*

Intervention and Direct Controls
Examples have included Prices and Incomes Policies, Pay Pauses, aid to economically depressed regions.

Fiscal Policy
Involves management of the economy through the manipulation of taxation and public spending.

It is the UK Government (largely the Treasury/Chancellor of the Exchequer) that determines fiscal policy.

It is associated with demand-management (Keynesian) policies whereby governments intervene in the economy to correct such problems as high unemployment, excessive inflation and balance of payments deficits.

Monetary Policy
Involves management of liquidity and inflation in the UK economy through the adjustment of interest rates.

It is the Bank of England, through its Monetary Policy Committee, that decides upon monetary policy, though it is the government that sets policy targets (currently an RPIX target range of 2.5% +/-1%).

(c) Since the early-1980s, the role of intervention and fiscal policy has been significantly reduced. *1*

Virtually all interventionist bodies (eg NEDC, IRC, NEB) had been abolished by the 1990s. *1*

The role of fiscal policy, since the early 1980s, has been “relegated”/limited to securing a balanced budget over the medium term. *1*

Since the early-1980s, monetary policy has become the dominant tool of UK economic management and a core element of government’s supply side, non-interventionist policies designed to promote the influence of market forces. *1*

(4)

(25)

Question 3

(a) Seven Principles of Public Life

Selflessness - decisions should reflect only public-interest considerations. *1*

Integrity - holders of public office should not place themselves under any financial/other obligation that might affect the performance of their public duties. *1*

Objectivity – when carrying out public business, holders of public office should make choices based solely on merit. *1*

Accountability – public office holders are accountable for their decisions and actions, and are open to appropriate scrutiny. *1*

Openness – public office holders must be as open as possible about all of their decisions and actions – information should only be withheld when to do so is clearly in the public interest. *1*

Honesty – public office holders must declare any private interests relating to their public duties and take steps to resolve any conflicts that arise between their private interests and public duties. *1*

Leadership – holders of public office should support and promote the above principles by example and leadership. *1*

(7)

(b) **Standards of Conduct of Officeholders** *2*
Ethical principles given prominence in Questions of Procedures for Ministers.
Highest standards of constitutional and personal conduct expected.
No conflict of interest.
Keep party and ministerial roles separate.
Must not mislead parliament.

A Civil Service Code. *2*
Facilitate "whistle blowing".
Investigation of Civil Service concerns by senior officials.
Complaints upheld reported to parliament.

Transfer of Ministers to Outside Appointments *2*
Cabinet Ministers to wait a minimum of three months and maximum of two years before taking up a private-sector job in areas where they have had direct ministerial interest.
Ministers subject to appointment rules in the same way as Civil Service business appointments.

(6)

(c) **(i)** Ministerial responsibility is a ministerial convention by which each minister is responsible to Parliament for the conduct of his/her department. *1*

The convention implies and assumes that civil servants are anonymous, responsible to their ministers alone and without any wider accountability to Parliament or general public, and that their advice to ministers is secret. *1*

The convention denotes that:

Ministers have an obligation to explain and defend the work of their Departments in Parliament (answerability). *1*

Ministers are responsible for their own and their officials' conduct and for departmental policy and should resign if serious faults are revealed in any of these matters (accountability). *1*

(4)

(ii) Individual ministers remain **answerable** to Parliament. They constantly explain and defend department policy at Question Time, during the committee stage of legislation, before select committees and privately to MPs. However, ministerial answers to political questions are not always entirely full or satisfactory and sometimes are very evasive. *2*

The extent to which ministers are **accountable** for personal misconduct, political misjudgments and mistakes, and faults within their departments is less clear cut. *½*

Personal misconduct has been the largest single category of ministerial resignation over 1962 – 97. Most of these cases relate to sexual impropriety, associating with unsavoury associates and financial irregularity (eg Hamilton, Mellor). *1½*

There have also been several examples of ministerial accountability (and resignation) for political misjudgments and mistakes eg Lord Carrington (Falklands crisis), Leon Britton (Westland), Edwina Currie (salmonella in eggs)). *1½*

It is unusual for ministers to be accountable (and resign) for policy errors. In most such cases, the Cabinet usually comes to the rescue of a beleaguered colleague, expressing support for them in public. The most recent textbook example of accountability in this sense was Norman Lamont's resignation in 1993 over the devaluation of sterling following the pound's withdrawal from the ERM. *1½*

It is even more unusual for ministers to be held accountable (and resign) for the mistakes/behaviour of officials in their Departments. (The textbook gives no examples of ministerial resignations in this catergory). *1*

(8)

(25)

Question 4

(a)

		£	£	
Operating profit per accounts			1,981,400	
Add:	Depreciation of distribution vehicles		85,980	*½*
	Loss on disposal of distribution vehicle		4,170	*½*
	Depreciation of office equipment		51,490	*½*
	Depreciation of motor cars		37,510	*½*
	Loss on disposal of motor car		2,390	*½*
	Customer entertaining		7,690	*½*
	Gift Aid donation		2,400	*½*
	Professional fees re tax appeal		2,500	*½*
	Expenses re let property		59,600	*1*
			2,235,130	
Less:	Income from property	120,000		*1*
	Profit on disposal of distribution vehicle	1,230		*½*
	Profit on disposal of oil painting	7,300	128,530	*½*
Schedule D Case I profit (before capital allowances)			2,106,600	

(7)

(b) Plant and machinery:

		Pool	Daimler	BMW	Audi	Total	
y/e 31/3/2003							
WDV b/f		379,440	27,550	31,910			
Additions					42,500		*½*
Disposals		(15,400)	(25,000)				*1*
Balancing allowance			2,550			2,550	*½*
		364,040					
WDA 25%		91,010				91,010	*1*
WDA restricted				3,000	3,000	6,000	*1*
		273,030					
Additions	17,600						
FYA 40%	7,040	10,560				7,040	*1*
WDV c/f		283,590		28,910	39,500		
Total allowances						106,600	

(Capital allowances are not restricted because of private use by an employee). *(5)*

(c) Disposal of oil painting:

	£	
Disposal proceeds	8,400	½
Less: Incidental disposal costs	840	½
	7,560	
Less: Acquisition cost	260	½
	7,300	
Less: Indexation allowance (176.0-116.6)/116.6 = 0.509		
0.509 x £260	132	1
	7168	

The gain is restricted to (£8,400 - £6,000) x 5/3 = £4,000. *1½*

(4)

(d)

	£	
Schedule D Case I	2,106,600	½
Less: Capital allowances	106,600	½
	2,000,000	
Schedule A (£120,000 - £59,600)	60,400	1
Schedule D Case III	15,000	1
Chargeable gains (£4,000 - losses b/f £4,000)	-	1
Note: Capital losses c/f are £28,110 - £4,000 = £24,110		1
	2,075,400	
Less: Charges	2,400	1
PCTCT	2,073,000	

(6)

(e) Corporation tax is due at 30%, giving a liability of £621,900. Since GNC Ltd is paying tax at the full rate (and also did so in the previous year) the company is required to pay by instalments, according to the following schedule: *1*

	£	
14 October 2002	155,475	½
14 January 2003	155,475	½
14 April 2003	155,475	½
14 July 2003	155,475	½
	621,900	

(3)

(25)

Question 5

(a)

	£	£	
Salary		32,000	
Bonus (receipts basis)		-	½
Car benefit:			
15% + 9% + 3% = 27% x £11,600 = £3,132 x 8/12	2,088		2
Less: Contribution towards running costs £25 x 8	200		½
Partial contribution towards private fuel	-	1,888	½
Car fuel benefit £2,850 x 8/12		1,900	½
Beneficial loan (£5,400 +£3,000)/2 = £4,200 @ 5%		210	1
Loan of computer £3,000 @ 20% less £500 exempt		100	1
Living accommodation:			
Annual value	7,500		
5% x (£125,000 - £75,000)	2,500		
Council tax	1,500		
	11,500		
Less: Rent paid to employer	6,000	5,500	2
Schedule E income		41,598	
			(8)

(b) It would have been more tax-effective if Graham had not paid £40 per month towards private fuel (since this is not a 100% contribution and so does not attract tax relief). He should instead have increased his monthly contribution towards non-fuel running costs from £25 to £65. He would then have obtained tax relief on the full £65 per month. *1½*

Since his beneficial loan exceeds £5,000 only slightly (and then for only the first two months of the tax year) he could have saved tax by borrowing exactly £5,000 rather than £5,400. The loan would then have been tax-free. *1½*

(3)

(c) Expenses are deductible under Schedule E only if they fall into one of the following categories:

- contributions to an approved occupational pension scheme *½*
- subscriptions to relevant professional bodies *½*
- payroll giving scheme donations *½*
- necessary travel and subsistence expenses *½*
- other expenses incurred wholly, exclusively and necessarily in the performance of the duties of the employment. *1*

(3)

(d)

	£	
Schedule E	41,598	½
Personal allowance	4,615	*1*
Taxable income	36,983	
Income tax due:		
1,920 @ 10%	192.00	½
27,980 @ 22%	6,155.60	½
7,083 @ 40%	2,833.20	½
	9,180.80	

(3)

(e)

		£	
Schedule A:			
Rents		61,280	½
Lease premium £10,000 - 19 x 2%		6,200	½
		67,480	
Less: Expenses (£37,380 - £15,000)	22,380		½
Wear and Tear allowance			
10% x (£61,280 - £7,420 - £5,860)	4,800	27,180	½
		40,300	
Less: Losses b/f		2,300	½
		38,000	
Schedule F £30,600 + £3,400		34,000	½
		72,000	
Personal allowance		4,615	½
Taxable income		67,385	
Income tax due:			
1,920 @ 10%		192.00	½
(27,980 + (1,755 x 100/78)) = £30,230 @ 22%		6,650.60	½
1,235 @ 40%		494.00	½
34,000 @ 32.5%		11,050.00	½
		18,386.60	
Less: Tax credit on dividends		3,400.00	½
		14,986.60	

(6)

(f) When Graham retires he will at first be unable to use his personal allowance, his starting rate band or his basic rate band, all of which will go to waste. When he reaches the age of 65 he will use his personal allowance and starting rate band but will waste most of his basic rate band. Throughout this time his wife will continue to be a higher-rate taxpayer.

This waste could be avoided (and the couple's tax liability reduced) if Georgina were to give part of her property portfolio and/or share portfolio to her husband, so that the income derived from these sources becomes his. This would be an entirely legal way of reducing their combined tax liability and so is an example of tax avoidance rather than tax evasion (which involves reducing a tax liability by illegal means). *(2)*

(25)

Question 6

(a) (i) For each month, the cumulative taxable turnover for the previous 12 months (or since the start of trade, if less) ignoring sales of capital assets is as follows:

2002	**£**	**2003**	**£**
January	1,900	January	51,300
February	3,900	February	58,400
March	6,600	March	66,200
April	9,300		
May	11,900		
June	14,900		
July	18,200		
August	22,000		
September	26,500		
October	31,700		
November	38,000		
December	44,900		

The registration threshold of £55,000 is passed at the end of February 2003. Gordon must notify Customs and Excise of this fact by 30 March 2003 and his registration will probably take effect as from 1 April 2003. *(2)*

(ii) Gordon may wish to avoid VAT registration for the following main reasons:

- His customers are wholly or mainly not VAT-registered themselves and so will be unable to recover output VAT charged by Gordon. This may cause him to lose trade as his customers seek out other suppliers who do not charge VAT. *1*

- He may wish to avoid the administrative overheads of maintaining VAT records, issuing VAT invoices, completing VAT returns etc. and he may also wish to avoid receiving regular control visits from Customs and Excise officials who will check these records. *½*

- *O*ther traders may be keen to register for the following main reasons:

- In order to recover input tax. This will be a very powerful motive if the trader pays substantial amounts of input tax and if charging output tax to customers will not cause a problem (because the customers are also VAT-registered and can therefore reclaim this tax). *1*

- To give the impression of an established business. *½*

(3)

(iii) Splitting the business into two separate businesses each owned by Gordon will not help since all of a person's business activities are aggregated for the purposes of determining whether or not that person should register for VAT.

If one of the separate businesses was owned by Gordon and the other was owned by his wife (and they each had a taxable turnover not exceeding the registration threshold) this would at first appear promising. However, Customs and Excise are empowered to treat such artificially split businesses as one for VAT purposes and would almost certainly do so in these circumstances. *(2)*

(b) A default occurs if a taxable person submits a late VAT return or makes a late payment of VAT. In these circumstances, Customs and Excise may issue a surcharge liability notice specifying a surcharge period. If the taxable person defaults again within this period, a default surcharge is levied. This surcharge is equal to the greater of £30 and a percentage of the tax which is paid late. The surcharge percentage is 2% for the first default within the surcharge period, 5% for the second default, 10% for the third default and 15% for the fourth and any subsequent default. A surcharge period comes to an end only when no defaults have occurred for a continuous 12-month period. *(2)*

(c) (i) Gillian's output tax is £129,250 x 17.5/117.5 = £19,250 and so her supplies of standard rated items (excluding VAT) are £110,000. Her total taxable supplies, including zero-rated supplies, are £170,000 and her total supplies of all types, including exempt supplies, are £200,000. Therefore 85% of her total supplies are taxable supplies. *2*

When computing the amount payable to Customs and Excise, she may deduct the input tax of £12,250 which is attributed to taxable supplies. She may also deduct 85% of the unattributed input tax (less the input tax relating to the car, which is non-deductible). Total deductions are £12,250 + 85% of £6,400, giving £17,690. The amount payable to C & E is £19,250 - £17,690 = £1,560. *2*

She cannot deduct the remaining input tax of £4,230 (£3,270 + 15% of £6,400) since this exceeds the de minimis limit of £625 per month. *1*

(5)

(ii) The calculation is provisional since the situation will be reviewed at the end of the year. If the input tax attributed to exempt supplies (including the relevant percentage of unattributed input tax) does not exceed £7,500 and is no more than 50% of the total input tax for the year, this input tax may then reclaimed from Customs and Excise. *(1)*

(d) *Correction of market imperfections*

- explanation of these imperfections *½*
- public goods *½*
- merit/demerit goods *½*
- external benefits/costs *½*
- government intervention to correct market imperfections. *½*

Redistribution of wealth

- the need for redistribution *½*
- the roles of charity and taxation *½*

Fiscal policy

- the use of taxation as a tool for managing the economy. *½*

(4)

(e) *Direct* taxes are those where the formal incidence of the tax and the effective incidence of the tax are the same. In other words, the person or organisation who is formally required to pay the tax is also the person or organisation who bears the tax. Corporation tax is an example of a direct tax. *1*

Indirect taxes are those where the formal incidence of the tax is different from the effective incidence of the tax. VAT is an indirect tax because formally it is a turnover tax payable by businesses but effectively (since the tax is passed on to customers) it is borne by those who buy goods or services from businesses. *1*

A *progressive* tax is one where the proportion of income or wealth paid in tax increases as the amount of income or wealth increases. Corporation tax is an example of a progressive tax, since (in FY2002) the rate of tax applicable to a company's chargeable profits increases from 0% to 30% as profits rise. *1*

A *regressive* tax is one where the proportion of income or wealth paid in tax decreases as the amount of income or wealth increases. A poll tax of (say) £500 per annum on each member of the UK population would be regressive, since £500 represents a higher percentage of a poorer person's income or wealth than it does of a richer person's income or wealth. *1*

A *proportional* tax is one where the proportion of income or wealth paid in tax stays the same as the amount of income or wealth increases. *1*

A tax is *hypothecated* if the revenue from that tax is specifically devoted to certain expenditure. For example, the road fund licence was hypothecated at one time to the building and maintenance of roads (though this is no longer the case). *1*

(6)

(25)