

PUBLIC POLICY AND TAXATION

Professional 2 examination 6 June 2003

From 10.00 am to 1.00 pm,
plus 10 minutes reading time from 9.50 am to 10.00 am

Instructions to candidates

Answer **four** questions in total. **Two** questions from section **A** and **two** questions from section **B**. The marks available for each question are shown in italics in the right hand margin.

Please ensure that you submit your section A and section B answers in separate cover sheets. Two cover sheets will be provided for this purpose.

All workings should be shown. Where calculations are required using formulae, calculators may be used but steps in the workings must be shown. Calculations with no evidence of this (for example using the scientific functions of calculators) will receive no credit. Programmable calculators are not permitted in the examination room.

Where a question asks for a specific format or style, such as a letter, report or layout of accounts, marks will be awarded for presentation and written communication.

Calculations may be performed to the nearest £ and any necessary apportionments may be made to the nearest month. There is a summary of useful tax data at the end of the examination paper.



SECTION A (Answer 2 questions)**1**

Constitutions define the formal governance systems of states. They allocate political authority and legal power within states; they define the composition and powers of the main offices and institutions of state; and they regulate the relationships of institutions of state with each other and with the citizens.

• Requirement for question 1

- (a) Outline the three major criteria by which constitutions are distinguished from each other. Evaluate the UK constitution against each of these criteria. 9
- (b) Briefly explain, with examples where appropriate, the six principal sources of the UK constitution. 12
- (c) Define the term “parliamentary sovereignty” and briefly outline the impact of EU membership upon UK parliamentary sovereignty. 4

(25)

2 The debate about the UK becoming a full participant in Economic and Monetary Union (EMU) within the European Union (EU) is one of the most important policy issues faced by successive UK governments.

• **Requirement for question 2**

- (a) Twelve of the fifteen members of the European Union (EU) have committed themselves to monetary union. Explain what is meant by the term “monetary union”. 2
- (b) Outline the main arguments for and against the UK’s possible future full participation in the European Single Currency. 6
- (c) Outline the main powers and responsibilities of
- (i) The European Council of Ministers 3
 - (ii) The European Parliament 3
 - (iii) The European Commission 3
 - (iv) The European Court of Justice. 4
- (d) Briefly discuss the proposition that a “democratic deficit” exists within the EU policy-making process. 4
- (25)**
-

3

Over the past 20 years, both the Conservative and Labour Parties have changed their ideological stances quite dramatically.

- **Requirement for question 3**

- (a) Outline the main features of the ideologies of
 - (i) Traditional Conservatism. 5
 - (ii) The New Right. 5
 - (iii) Conservatism under Hague and Duncan Smith. 4
 - (b) The Labour Party, prior to election to government in 1997 following 18 years in opposition, had repositioned itself ideologically. Explain the main features of the party's new ideological positioning. 6
 - (c) Define what is meant by marketisation and privatisation and discuss how far they are consistent with the ideology of New Labour. 5
- (25)**
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SECTION B (Answer 2 questions)**4**

Frampton Trading Ltd is a UK local authority trading company. It has no associated companies and is medium-sized for financial reporting purposes. The company's summarised profit and loss account for the year to 31 March 2002 is as follows:

	£	£	Note
Gross profit		724,260	
Operating expenses:			
Depreciation	76,560		
Loss on sale of machinery	2,700		1
Gifts and entertaining	18,370		2
Bad and doubtful debts	21,910		3
Legal and professional fees	7,500		4
Repairs	12,590		5
Other expenses	<u>214,430</u>	<u>354,060</u>	6
		370,200	
Other operating income:			
Income from property		<u>24,000</u>	7
Operating profit		<u>394,200</u>	
Investment income:			
UK dividends	45,000		8
Profit on sale of shares	<u>27,000</u>	<u>72,000</u>	9
		466,200	
Interest payable		35,000	10
Profit before taxation		<u>431,200</u>	

Notes:

- 1 In October 2001, machinery which had cost £28,000 in 1998 and which had accumulated depreciation of £13,800 was sold for £11,500. In March 2002, second-hand machinery was acquired for £14,700.

After deducting capital allowances for the year ended 31 March 2001, the tax written down values of the company's plant and machinery were:

	£
General pool	123,460
Jaguar motor car used by Managing Director	28,420

There is 40% private use of the Jaguar motor car by the company's Managing Director.

- 2 Gifts and entertaining expenses comprise:

	£
Customer entertaining	11,630
Gift Aid donation	2,500
Christmas gifts to customers (bottles of champagne at £20 each)	1,000
Christmas party for employees	<u>3,240</u>
	<u>18,370</u>

- 3 The bad and doubtful debts account in the company's nominal ledger for the year to 31 March 2002 is as follows:

Bad and doubtful debts					
		£			£
Trade debts written off	17,910		General provision b/d	7,400	
Employee loan written off	500		Profit and loss a/c	21,910	
General provision c/d	10,900				
	<u>29,310</u>				<u>29,310</u>

- 4 Legal and professional fees consist of the annual audit fee of £5,000 plus professional fees of £2,500 relating to a successful tax appeal.
- 5 Repairs include £2,200 in relation to the second-hand machinery which was acquired during the year. Of this sum, £1,300 was spent on repairing a machine which could not be used until the repair had been completed. The remaining £900 was spent on repairing a machine that was usable before being repaired.
- 6 The other expenses of £214,430 are all allowable under the rules of Schedule D Case I.
- 7 On 1 October 2001, the company let property to a tenant at a rent of £8,000 per annum payable annually in advance. On the same date, the company received a premium from the tenant of £20,000. The property is let on a 6-year lease and no expenses were incurred in relation to this property during the year to 31 March 2002.
- 8 The amount shown for UK dividends is the actual amount received during the year, with no adjustment for tax credits.
- 9 In November 2001 (RPI 174.6) the company sold 2,000 shares in Continental Holdings plc for £15 per share. Shares in Continental Holdings plc had been acquired as follows:

		£	RPI
17 January 1982	Bought 2,000 shares	3,000	
10 August 1989	Bought 2,000 shares	7,000	115.8
4 March 1998	Bought 1,000 shares	8,000	160.8

The RPI for March 1982 was 79.44. For accounting purposes, the company has assumed that the shares sold in November 2001 are those which were bought in January 1982.

- 10 Interest of £30,000 was paid during the year for trade purposes and a further £5,000 was accrued at the end of the year. Income tax was not deducted from the interest paid.

- **Requirement for question 4**

- (a) Compute the company's Schedule D Case I trading profit for the year to 31 March 2002, before deduction of capital allowances. (Your computation should begin with the pre -tax profit of £431,200). 6
 - (b) Perform a capital allowances computation for the year. 5
 - (c) Compute the company's Schedule A income from property for the year. 3
 - (d) Compute the chargeable gain arising on the sale of shares in Continental Holdings plc. 6
 - (e) Calculate the amount of corporation tax payable for the year. 5
- (25)**
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5 Fiona (who was born in March 1945) is a company director. Her salary in tax year 2001/02 was £60,000 of which she contributed 7% to the company's occupational pension scheme. The company contributed a further 9%. In addition to her salary, Fiona received a general expenses allowance of £5,000 during the year, of which £4,000 was spent on necessary train travel and hotel costs. The remaining £1,000 was spent on business entertaining.

Fiona does not have a company car but often uses her own 1,850cc motor car for business travel. The company pays her a mileage allowance of 30p per mile. She drove 5,000 business miles during 2001/02.

In 2001/02, the company paid Fiona's private medical insurance premium of £630 and provided her with free use of the company's workplace sports facilities. It is estimated that it would cost Fiona £520 per annum to obtain similar facilities from a commercial leisure centre. She also has a £10,000 interest-free personal loan from the company. The loan was made in March 2001 and no repayments were made during 2001/02.

Fiona pays her own £250 annual subscription to the Institute of Directors.

Fiona's husband Frank (who was born in May 1934) is retired. During 2001/02 he received a state retirement pension of £3,900 (gross) and an occupation pension of £10,520 (gross). The couple's investment income is as follows:

	Fiona	Frank
	£	£
Dividends from UK companies	918	603
Building society interest	3,072	4,144

For the whole of 2001/02, Fiona and Frank's grandson (aged 14) lived with them at their expense. Fiona made Gift Aid donations totalling £663 during the year.

• **Requirement for question 5**

- | | |
|---|----|
| (a) Calculate Fiona's Schedule E income for tax year 2001/02. | 5 |
| (b) Advise whether Fiona or Frank can benefit from Children's Tax Credit for the year 2001/02. | 3 |
| (c) Calculate Fiona's income tax liability for 2001/02 and Frank's income tax liability for 2001/02, before deduction of tax paid via the PAYE system. No elections have been made in relation to the married couple's allowance. | 10 |
| (d) Calculate the National Insurance contributions payable by Fiona for 2001/02 (she is contracted-out of SERPS). | 1 |
| (e) Explain the purpose of the PAYE system (which was introduced in 1944) and outline the main features of this system. | 6 |

(25)

6

- (a) The sale of an asset by a limited company may give rise to a trading profit or a chargeable gain. In either case, the resulting profit or gain is included in the company's chargeable profits for the accounting period in which the sale takes place and is charged to corporation tax. A set of tests known as the "badges of trade" is used to distinguish between trading and non-trading activities.

- **Requirement for question 6(a)**

- (i) List and explain the "badges of trade". 6
- (ii) Explain why it is important to distinguish between trading profits and chargeable gains, even though both of these are charged to corporation tax. 2
-

- (b) Under certain circumstances, a VAT-registered person may join the cash accounting scheme.

- **Requirement for question 6(b)**

- Explain the circumstances in which a registered person may join the cash accounting scheme and outline the consequences of joining the scheme. 5
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- (c) Some goods and services are exempt from VAT whilst some others carry VAT at the zero rate. In effect, no VAT is charged when a supply of exempt or zero-rated goods or services is made.

- **Requirement for question 6(c)**

- (i) Give two examples of an exempt supply and two examples of a zero-rated supply. 2
- (ii) Explain why it is important to distinguish between an exempt supply and a zero-rated supply, even though no VAT is charged in either case. 2
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- (d) Formally, VAT is chargeable when a taxable supply of goods or services is made in the UK by a taxable person in the course of business. A taxable person is a person who is (or who should be) registered for VAT.

- **Requirement for question 6(d)**

- (i) State the circumstances in which VAT registration is compulsory. 2
- (ii) Explain why a person who is not required to register compulsorily may nonetheless do so voluntarily. 2
-

(e) A person who wishes to reduce his or her tax liability may attempt to do so by means of either "tax evasion" or "tax avoidance".

- **Requirement for question 6(e)**

Distinguish between tax evasion and tax avoidance and briefly outline the view currently held by the courts with regard to each of these means of reducing tax liabilities.

4

(25)

SUMMARY OF TAX DATA**Corporation Tax**

	<i>Financial Year 2001</i>	<i>Financial Year 2000</i>	<i>Financial Year 1999</i>
Full rate	30%	30%	30%
Small company rate	20%	20%	20%
Starting rate	10%	10%	-
Small company rate limits:			
Lower limit	£300,000	£300,000	£300,000
Upper limit	£1,500,000	£1,500,000	£1,500,000
Starting rate limits:			
Lower limit	£10,000	£10,000	-
Upper limit	£50,000	£50,000	-
Marginal relief fraction	1/40	1/40	1/40

Marginal relief formula: fraction $n \times (M-P) \times I/P$

Capital Allowances

Writing down allowance (per annum):

Plant and machinery	25%
Industrial buildings	4%

First year allowance on acquisitions of qualifying plant and machinery by qualifying businesses:

Acquired 2 July 1997 to 1 July 1998	50%
Acquired on or after 2 July 1998	40%
ICT acquired 1 April 2000 to 31 March 2003	100%

Income Tax

			<i>2001/02</i>	<i>2000/01</i>
Starting rate	10%	first	£1,880	£1,520
Basic rate	22%	next	£27,520	£26,880
Higher rate	40%	over	£29,400	£28,400
Personal allowance:				
Age 0 to 64			£4,535	£4,385
Age 65 to 74			£5,990	£5,790
Age 75 or over			£6,260	£6,050
Married couple's allowance:				
Age under 75 and born before 6 April 1935			£5,365	£5,185
Age 75 or over			£5,435	£5,255
Minimum amount			£2,070	£2,000
Children's tax credit			£5,200	-
Income limit for age-related allowances			£17,600	£17,000

Fuel Benefit Tables

	2001/02	2000/01
Petrol: up to 1,400cc	£1,930	£1,700
1,401cc to 2,000cc	£2,460	£2,170
2,001cc and above	£3,620	£3,200
Diesel: up to 2,000cc	£2,460	£2,170
2,001cc and above	£3,620	£3,200

Official Rate of Interest

6.25%

Authorised mileage rates

	<i>first 4,000 miles per year</i>	<i>miles in excess of 4,000</i>
up to 1,500cc	40p	25p
1,501cc to 2,000cc	45p	25p
2,001cc and above	63p	36p

Class 1 National Insurance Contributions

	2001/02	2000/01
Primary threshold (annual)	£4,535	£3,952
Secondary threshold (annual)	£4,535	£4,385
Upper earnings limit (annual)	£29,900	£27,820
Employee contribution rates:		
On earnings up to primary threshold	0%	0%
On remainder up to UEL (Not contracted out)	10%	10%
On remainder up to UEL (Contracted out)	8.4%	8.4%
Employer contribution rates:		
On earnings up to secondary threshold	0%	0%
On remainder up to UEL (Not contracted out)	11.9%	12.2%
On remainder up to UEL (Contracted out)	8.9%	9.2%
On earnings beyond UEL	11.9%	12.2%

Value Added Tax

Standard rate (from 1 April 1991)	17.5%
Registration threshold (from 1 April 2001)	£54,000
Deregistration threshold (from 1 April 2001)	£52,000