PUBLIC POLICY AND TAXATION

Professional 2 examination
5 December 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.*

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.

CIPFA

SECTION A (Answer 2 questions)

1

Some commentators argue that the British system of government has, over the past 50 years, evolved towards prime ministerial government.

- **Requirement for question 1**

(a)	Define what is meant by prime ministerial government.	*2*
(b)	Identify the main sources of prime ministerial power.	*5*
(c)	Evaluate the extent to which these sources of power have, in practice, led to the exercise of prime ministerial power.	*11*
(d)	State the doctrine of collective responsibility of Cabinet Ministers and identify the practical implications that this doctrine has for the behaviour of the Cabinet.	*7*
		(25)

2

In a competitive global economy, where the UK government is anxious to maximise the welfare of its citizens, optimal national economic performance is a policy priority.

- **Requirement for question 2**

(a) Outline and comment on the relative impact of the principal “actors” and groups of “actors” that can potentially influence the formation of central government economic policy. *9*

(b) Describe the nature and objectives of the major tools that central government has used to manage the UK economy since the 1970s. *12*

(c) Outline any changes, since the 1970s, in the relative importance of central government’s tools of economic management. *4*

(25)

3

The introduction, since the 1980s, of a more business-like style of public management has prompted closer UK government attention to issues of ethical behaviour and ministerial responsibility.

- **Requirement for question 3**

(a) The Nolan Report (1995) addressed public concern about the declining ethical behaviour amongst politicians and other public figures by setting out *seven principles of public life*. Outline the *seven principles of public life* laid down by the Nolan Report. *7*

(b) The Nolan Report (1995) also addressed public concern about the declining ethical behaviour amongst politicians and other public figures by providing recommendations for ethical conduct within central government. Outline Nolan's main recommendations for ethical conduct within central government. *6*

(c) The doctrine of ministerial responsibility is a convention that governs relationships between ministers, civil servants and Parliament.

(i) State the convention of ministerial responsibility and explain the implications it has for relationships between ministers, civil servants and Parliament. *4*

(ii) Evaluate the extent to which the convention of ministerial responsibility is reflected in the realities of modern political life. *8*

(25)

SECTION B (Answer 2 questions)

4 GNC Trading Ltd is a UK local authority trading company. It has no associated companies and is medium-sized for financial reporting purposes. An extract from the company's profit and loss account for the year to 31 March 2003 is shown below:

	£	£	Note
Turnover		8,350,420	
Cost of sales		3,996,770	1
Gross profit		4,353,650	
Distribution costs	898,230		2
Administrative expenses	1,594,020	2,492,250	3
		1,861,400	
Other operating income		120,000	4
Operating profit		1,981,400	
Interest receivable		15,000	5
Income from fixed asset investments		81,000	6
Profit before taxation		2,077,400	

Notes:

1 All of the cost of sales figure is allowable under the rules of Schedule D Case I.

2 Distribution costs are as follows:

	£
Depreciation of distribution vehicles	85,980
Loss on disposal of distribution vehicle	4,170
Profit on disposal of distribution vehicle	(1,230)
General distribution costs (all allowable)	809,310
	898,230

3 Administrative expenses are as follows:

	£
Depreciation of office equipment	51,490
Depreciation of motor cars	37,510
Loss on disposal of motor car	2,390
Profit on disposal of oil painting	(7,300)
Bad and doubtful debts:	
Trade debt recovered	(5,000)
Increase in specific provision for doubtful debts	2,040
Entertaining and gifts:	
Customer entertaining	7,690
Cost of annual staff dinner dance	5,880
Gift Aid donation	2,400
Legal and professional fees:	
Re tax appeal	2,500
Debt collection	650
Expenses incurred re property let to tenants	59,600
General administrative expenses (all allowable)	1,434,170
	1,594,020

4 Other operating income consists of rents receivable. GNC Trading Ltd rents part of its premises (unfurnished) to tenants at a rent of £10,000 per month, payable in advance on the first day of each month. During the year to 31 March 2003, all rents were received on the due date apart from the rent due on 1 March 2003 which was not received until 2 April 2003.

5 On 1 January 2003, the company lent £1,000,000 to another UK company at an interest rate of 6% per annum. Interest is due half-yearly on 30 June and 31 December. No interest was received during the year to 31 March 2003.

6 Income from fixed asset investments consists of dividends received from UK companies. The profit and loss account shows the amount actually received during the accounting period, with no adjustment for tax credits.

7 After deducting capital allowances for the year to 31 March 2002, the tax written down values of the company's plant and machinery were:

	£
General pool	379,440
Daimler motor car	27,550
BMW motor car	31,910

During the year to 31 March 2003, two vans used for distribution purposes were sold for a total of £15,400 (which was less than original cost) and a new van was acquired at a cost of £17,600. Also, the Daimler motor car was sold for £25,000 and replaced by a new Audi costing £42,500. There was no private use of the Daimler or the Audi but there was 25% private use of the BMW car (which was used by a director of the company).

8 On 15 July 2002, the company sold an oil painting which had been hanging in the directors' boardroom since it was bought for £260 in September 1989. The painting was sold for £8,400, less auctioneer's fee of £840.

9 Capital losses brought forward at 1 April 2002 amounted to £28,110.

10 In the year to 31 March 2002, the company's profits chargeable to corporation tax were £2,137,600.

- **Requirement for question 4**

(a) Compute the company's Schedule D Case I assessment for the year to 31 March 2003, before deduction of capital allowances. *7*

(b) Compute the capital allowances available for the year. *5*

(c) Compute the chargeable gain arising on the sale of the oil painting. Assume Retail Price Indices as follows:

September 1989	116.6
July 2002	176.0

4

(d) Assuming that maximum capital allowances are claimed, compute the profits chargeable to corporation tax for the year. *6*

(e) Calculate the amount of corporation tax payable for the year and prepare a schedule showing the dates on which this tax is payable and the amount due on each date. *3*

(25)

5 Graham was born in February 1942 and his only income in tax year 2002/03 was derived from employment. Throughout the year he worked as a sales manager at a basic salary of £32,000 per annum. His employer started a bonus scheme during the accounting year to 31 March 2003 and during that year Graham earned a £3,500 bonus. This was paid to him in May 2003.

Until 6 August 2002, Graham did not have a company car but as from that date he was provided with a 1,999cc diesel-engined motor car with a list price of £11,600 and an emission rating of 212g/km. Graham was permitted to use the car for both business and private motoring. His employer paid for all of the running expenses of the car (including fuel) but Graham made a contribution of £40 per month towards fuel costs and £25 per month towards other running expenses. His fuel contribution did not cover the whole cost of the fuel used for private motoring in 2002/03.

On 1 April 2002, Graham's employer granted him an interest-free loan of £5,400. The loan was repayable by monthly instalments of £200 payable on the first day of each month, starting on 1 May 2002. Graham's employer has a policy of encouraging IT literacy amongst its staff and, in pursuit of this policy, allowed Graham to borrow a £3,000 laptop computer for the whole of 2002/03. Graham kept this computer at home and used it entirely for private purposes.

Since May 2001 Graham has lived in accommodation provided by his employer. The accommodation cost Graham's employer £125,000 in April 2001 and has an annual value of £7,500. Graham pays rent of £500 per month and also pays all of the household bills apart from council tax, which cost his employer £1,500 in 2002/03. The accommodation is not job-related.

Graham is married to Georgina who was born in July 1947. Her income is mainly derived from a portfolio of properties which she lets to tenants. All of these properties are let furnished. Rental income for 2002/03 amounted to £61,280 and Georgina also received a premium of £10,000 on the grant of a 20-year lease to a tenant. Her property expenses for the year were as follows:

	£
Council tax	7,420
Water rates	5,860
Insurances	2,800
Administrative expenses	1,450
Painting and decorating	3,670
Cost of building a garage block	15,000
Sundry minor repairs	1,180
	37,380

Georgina's only other income for 2002/03 consisted of dividends received of £30,600 and interest from a cash mini-ISA of £780. She had Schedule A losses brought forward from 2001/02 of £2,300 and she made Gift Aid donations of £1,755 during 2002/03.

Graham is hoping to retire soon. When he does so, his income will be zero until he reaches the age of 65. He will then receive a state retirement pension estimated at £10,000 per annum.

- **Requirement for question 5**

(a) Calculate Graham's Schedule E income for tax year 2002/03. *8*

(b) Suggest TWO ways in which his remuneration package could have been restructured so as to reduce his income tax liability. *3*

(c) State the rules which govern the deductibility of expenses under Schedule E. *3*

(d) Calculate the income tax payable by Graham for 2002/03 *before* deducting tax paid under the PAYE system. *3*

(e) Calculate the income tax payable by Georgina for 2002/03. *6*

(f) Suggest a way in which the couple's total income tax liability could legally be reduced after Graham's retirement. Explain why your suggestion is an example of tax avoidance rather than tax evasion. *2*

(25)

6

(a) Gordon started trading on 1 January 2002, making wholly standard-rated supplies. He wished to delay VAT registration for as long as he could and, if possible, avoid registration altogether. His sales during the first 15 months of trading were as follows:

2002	**£**	**2003**	**£**
January	1,900	January	8,300
February	2,000	February	9,100
March	2,700	March	10,500
April	2,700		
May	2,600		
June	3,000		
July	3,300		
August	3,800		
September	4,500		
October	5,200		
November	7,300		
December	6,900		

His sales in November 2002 included £1,000 relating to a capital asset used in Gordon's business.

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

(i) State the date by which Gordon would be required to register for VAT and the date on which registration would normally take effect. *2*

(ii) Explain why Gordon might wish to avoid VAT registration and why some other self-employed people might in fact be keen to register. *3*

(iii) If Gordon were to split his business into two separate businesses, each in his own name and each with approximately 50% of the turnover of his existing business, would he then be able to avoid registration? Would the situation be any different if one of the two separate businesses was in his wife's name rather than his? *2*

(b) In certain circumstances, Customs and Excise may require a VAT-registered person to pay a default surcharge.

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

Explain the circumstances in which a default surcharge is payable and the way in which the surcharge is calculated. *2*

(c) During the quarter to 31 March 2003, Gillian made supplies as follows:

	£
Standard-rated supplies (including VAT)	129,250
Zero-rated supplies	60,000
Exempt supplies	30,000

She suffered the following input tax for the quarter:

	£
Attributed to taxable supplies	12,250
Attributed to exempt supplies	3,270
Unattributed	7,850

The unattributed input tax includes £1,450 in relation to the purchase of a motor car which is used partly for business purposes and partly for private purposes.

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

(i) Compute the VAT provisionally payable to Customs and Excise for the quarter. *5*

(ii) Explain why this calculation can only be provisional. *1*

(d) In general terms, the principal function of taxation is to provide Government with the revenue required in order to fund public expenditure. But economists might suggest that this is a simplistic view and that taxation does in fact serve a number of distinct functions.

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

Explain the main functions of taxation as viewed from the perspective of economic theory. *4*

(e) Taxes may be classified in a number of ways. In particular, taxes may be classified as *direct* or *indirect*. They may also be classified as *progressive*, *regressive* or *proportional*. Furthermore, some taxes might be described as *hypothecated*.

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

Explain each of the italicised terms used above, using examples to illustrate your explanations. *6*

---

(25)

SUMMARY OF TAX DATA

Corporation Tax

	Financial Year 2002	*Financial Year 2001*	*Financial Year 2000*
Full rate	30%	30%	30%
Small company rate	19%	20%	20%
Lower limit	£300,000	£300,000	£300,000
Upper limit	£1,500,000	£1,500,000	£1,500,000
Marginal relief fraction	11/400	1/40	1/40
Starting rate	0%	10%	10%
Lower limit	£10,000	£10,000	£10,000
Upper limit	£50,000	£50,000	£50,000
Marginal relief fraction	19/400	1/40	1/40

Marginal relief formula: fraction x (M-P) x 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 on or after 2 July 1998	40%
ICT acquired 1 April 2000 to 31 March 2003	100%

Income Tax

			2002/03	*2001/02*
Starting rate	10%	first	£1,920	£1,880
Basic rate	22%	next	£27,980	£27,520
Higher rate	40%	over	£29,900	£29,400

	2002/03	*2001/02*
Personal allowance:		
Age 0 to 64	£4,615	£4,535
Age 65 to 74	£6,100	£5,990
Age 75 or over	£6,370	£6,260
Married couple's allowance:		
Age under 75 and born before 6 April 1935	£5,465	£5,365
Age 75 or over	£5,535	£5,435
Minimum amount	£2,110	£2,070
Children's tax credit	£5,290	£5,200
Income limit for age-related allowances	£17,900	£17,600

Car benefit

Emission rating	*Taxable percentage of list price*
Up to 165 g/km	15%
Each additional 5g/km	1% increase
Diesel engine	3% increase
Maximum charge	35%

Fuel Benefit Tables

		2002/03	*2001/02*
Petrol:	up to 1,400cc	£2,240	£1,930
	1,401cc to 2,000cc	£2,850	£2,460
	2,001cc and above	£4,200	£3,620
Diesel:	up to 2,000cc	£2,850	£2,460
	2,001cc and above	£4,200	£3,620

Official Rate of Interest
5%

Authorised mileage rates	*first 10,000 miles per year*	*miles in excess of 10,000*
Motor cars and vans	40p	25p
Motor cycles	24p	24p
Bicycles	20p	20p

Class 1 National Insurance Contributions

	2002/03	*2001/02*
Primary threshold (annual)	£4,615	£4,535
Secondary threshold (annual)	£4,615	£4,535
Upper earnings limit (annual)	£30,420	£29,900
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)	11.8%	11.9%
On remainder up to UEL (Contracted out)	8.3%	8.9%
On earnings beyond UEL	11.8%	11.9%

Value Added Tax

Standard rate (from 1 April 1991)	17.5%
Registration threshold (from 25 April 2002)	£55,000
Deregistration threshold (from 25 April 2002)	£53,000