

PUBLIC POLICY AND TAXATION

Professional 2 examination
11 June 2004

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.



SECTION A (Answer two 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. According to Vernon Bogdanor (*Constitutions in Democratic Politics*, 1988), the dominating characteristic of the British constitution is parliamentary sovereignty.

• Requirement for question 1

- (a) (i) Outline the three main criteria that are typically used to classify and distinguish different types of constitutions. 6
- (ii) Use the three criteria outlined in (a) (i) to explain the nature of the British constitution. 3
- (b) Explain what is meant by the term parliamentary sovereignty. Analyse the extent to which the limited regional devolution of government in the UK has impacted upon parliamentary sovereignty. 3
- (c) Since 1973, the UK has been a member of what is now the European Union. Evaluate the extent to which this membership has affected British parliamentary sovereignty. 4
- (d) (i) Describe the principal roles of the House of Commons. 5
- (ii) Outline the main constraints on the power of the House of Commons. 4
- (25)**

2

The exchange rate is one of many tools of economic management that governments have at their disposal to facilitate their objectives of optimising economic performance, maximising the welfare of citizens and gaining re-election to office.

- **Requirement for question 2**

- (a) Define what is meant by the term *exchange rate*. What are the key factors that influence the level of exchange rates? 6
- (b) The UK Chancellor of the Exchequer has devised five economic tests that must be met before the Government will formally recommend UK membership of the Single European Currency. What are these five tests? 5
- (c) Outline the main arguments for and against the adoption of any country's membership of the European Single Currency. 8
- (d) The two principal tools of UK economic management are fiscal policy and monetary policy. Briefly describe these tools and outline their present relative importance in the management of the UK economy. 6

(25)

3

It is frequently asserted that the majority of UK governmental decisions are made in “Whitehall” departments rather than in Cabinet. The process of decision making within Whitehall is therefore of vital significance in British government.

- **Requirement for question 3**

- (a) Identify and briefly describe the five models that seek to explain the alternative views of the relationship between civil servants and government ministers in the decision making process. 10
 - (b) Outline the three traditional features of the British civil service. Evaluate the extent to which recent civil service reforms and other changes have impacted on these three features. 9
 - (c) Non-governmental “policy actors” frequently have an important influence on government policy. Outline and comment on the relative influence of any three groups of non-governmental “policy actors” on central government economic policy. 6
- (25)**
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SECTION B (Answer two questions)**4**

Highvale Trading Ltd, a UK local authority trading company, has the following results for the two years to 31 March 2003:

	y/e 31/3/02	y/e 31/3/03	Notes
	£	£	
Trading profit/(loss)	1,230,300	(258,320)	1,2
Bank interest received	21,150	16,680	3
UK dividends received	nil	13,500	4
Gift Aid donation	1,000	1,000	

Notes:

- 1 The figures shown for the company's trading profit or loss have already been adjusted for tax purposes. Capital allowances on plant and machinery have also been accounted for. However, no adjustment has yet been made for industrial buildings allowances.
- 2 The company owned no industrial buildings until 1 October 2002, when £300,000 was spent on the purchase of a second-hand industrial building from Gamma plc. This price included £120,000 for the land on which the building stands.

The building was constructed on 1 October 1997 by Gamma plc (which prepares accounts to 31 December each year) at a cost of £160,000, excluding land. The building was used continually for industrial purposes until it was sold to Highvale Trading Ltd, apart from a period of non-industrial use which lasted from 1 September 1999 until 1 June 2000. Highvale Trading Ltd wishes to claim the maximum available capital allowances in relation to this building.

- 3 The figures shown for bank interest received are the amounts actually received in each accounting period. Accrued interest at the end of each year was as follows:

	£
31 March 2001	4,430
31 March 2002	3,980
31 March 2003	nil

- 4 The figures shown for UK dividends received are the amounts actually received in each accounting period, with no adjustment for tax credits.
- 5 On 28 November 2002, the company sold 10 hectares of land for £20,000. This was one-half of a 20-hectare plot bought in June 1996 for £17,500. The value of the remaining 10 hectares on 28 November 2002 was £30,000.
- 6 On 1 January 1996, the company had acquired a 10-year lease on a building at a cost of £25,000. On 1 January 2003 this lease was assigned to a third party for £15,000.

- 7 There were no trading losses brought forward on 1 April 2001 but there were capital losses brought forward of £12,758.
- 8 The company wishes to claim tax relief in relation to its trading loss at the earliest possible opportunity.
- 9 Chargeable profits for the year to 31 March 2004 are expected to be approximately £2 million. Corporation tax rates and limits for that year are expected to be the same as for the year to 31 March 2003.

• **Requirement for question 4**

- (a) Compute the industrial buildings allowances available for the year to 31 March 2003 and hence the company's adjusted Schedule D Case I loss for that year. 4
- (b) Compute the chargeable gains arising on the sale of the land and the lease. Assume Retail Price Indices as follows: 4
- | | |
|---------------|-------|
| January 1996 | 150.2 |
| June 1996 | 153.0 |
| November 2002 | 178.2 |
| January 2003 | 178.4 |
- Extracts from the short lease amortisation table given in Schedule 8 of the Taxation of Chargeable Gains Act 1992 are as follows:
- | | |
|----------|---------|
| 3 years | 16.959% |
| 10 years | 46.695% |
- (c) Calculate the company's corporation tax liabilities for the year to 31 March 2002 and the year to 31 March 2003, *before* relief is given for the trading loss incurred in the year to 31 March 2003. 8
- (d) Calculate the company's corporation tax liabilities for the year to 31 March 2002 and the year to 31 March 2003, *after* relief is given for the trading loss incurred in the year to 31 March 2003. 3
- (e) Comment on the company's decision to claim relief for its trading loss "at the earliest possible opportunity", contrasting this approach with the available alternative. 6

(25)

5 Howard was born in 1955 and is not married. He is employed by his local County Council as a senior systems analyst and his gross salary for tax year 2002/03 was £42,500. He is a member of an occupational pension scheme and contributes 6% of his gross salary into this scheme each month. The County Council contributes a further 14%. Howard also pays £20 per month into a payroll giving scheme operated by the Council. He is contracted out of the State Second Pension.

The Council does not provide Howard with a motor car but expects him to use his own car when travelling from Council headquarters (where he is based) to visit Council offices situated throughout the County. In 2002/03 he was paid 32p per mile for driving his own car for 2,500 miles on Council business. His motoring in 2002/03 can be analysed as follows:

	Miles
Travel between home and work	4,800
Travel on Council business	2,500
Private motoring	4,700
	<u>12,000</u>

The total cost of running Howard's car during 2002/03 (including depreciation) was £3,600.

The Council has a policy of offering low-interest loans to its employees and Howard has taken advantage of this policy by borrowing £10,000 at an annual interest rate of 2%. The amount outstanding on this loan at the start of 2002/03 was £8,000. The corresponding amount at the end of 2002/03 was £5,600. Further benefits received by Howard from the Council during the year were as follows:

- his own parking space at Council headquarters
- a mobile telephone costing £150 for making both business and private calls; the council paid line rental of £180 and call costs of £225 (60% of which related to private calls)
- a long service award comprising a cheque for £400 in recognition of 20 years of service with the Council
- the annual staff party (which cost the Council £40 per employee).

However, the Council does not pay Howard's annual subscription to the British Computer Society. In 2002/03, this cost him £114.

Other than his income from employment, Howard had other income during 2002/03 as follows:

- National Savings Bank interest of £75 from an ordinary account and £115 from an investment account
- interest on a cash mini-ISA of £375
- UK dividends of £4,860
- a £1,000 premium bond prize

- rent of £70 per week for 52 weeks from a lodger who lives in Howard's own home.

He made Gift Aid donations totalling £507 during the year.

Howard has no wish to leave the Council or to work for anyone else but he would like to change his status so that he is no longer regarded as an employee. He is thinking of asking the Council to treat him as a self-employed consultant as from the start of the next tax year. Alternatively, he might form a private limited company (of which he would be the only shareholder and director) and provide his services to the Council via this intermediary company. In either case, he would continue working exclusively for the Council in the same role as at present.

- **Requirement for question 5**

- | | |
|---|-------------|
| (a) Identify those elements of Howard's income (from employment or otherwise) which are <i>not</i> subject to income tax. If necessary, briefly explain why the income in question is not taxable. | 4 |
| (b) Explain why Howard's Gift Aid donations of £507 are worth more than £507 to the charities concerned, but (in effect) cost Howard less than £507. | 2 |
| (c) Calculate the amount of income tax borne by Howard in 2002/03. | 8 |
| (d) Calculate the National Insurance contributions payable in relation to Howard by himself and by his employer in 2002/03. | 3 |
| (e) Explain the tests which are used to distinguish between employment and self-employment and give your view as to whether Howard is likely to achieve his goal of being treated as a self-employed consultant for tax purposes. | 5 |
| (f) Explain why the formation of a private limited company would probably not provide any tax advantages in Howard's case. | 3 |
| | (25) |

- 6** (a) In general, a "person" who is VAT-registered makes quarterly returns to Customs and Excise, showing the output tax charged to customers during the quarter and the input tax charged by suppliers. The amount by which output tax exceeds input tax is payable to Customs and Excise within one month of the end of the quarter. If input tax exceeds output tax, the excess may be recovered from Customs and Excise. There are penalties for failing to submit a VAT return on time or failing to make a VAT payment on time.

However, there are several variations to this procedure. In particular:

- Some registered persons who make quarterly VAT returns are required to make payments on account of their VAT liability during the quarter.
- Subject to certain conditions, registered persons may join the annual accounting scheme and make only one VAT return per year.
- Again subject to certain conditions, registered persons may join the cash accounting scheme and account for VAT on a cash basis.

Furthermore, registered persons who make both taxable and exempt supplies may recover only part of their input tax, though special rules apply to certain public sector organisations.

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- **Requirement for question 6 (a)**
 - (i) State the circumstances in which a registered person making quarterly returns is required to make payments on account. Explain how these payments are calculated and when they are payable. 3
 - (ii) State the conditions which must be satisfied before a registered person may join the annual accounting scheme. Explain the main features of this scheme. 4
 - (iii) State the conditions which must be satisfied before a registered person may join the cash accounting scheme. Explain the main features of this scheme. 3
 - (iv) Explain the rules which determine the extent to which a person making both taxable and exempt supplies may recover input tax. 3
 - (v) Explain the special VAT regime which applies to a public sector organisation of your choice. (Your chosen organisation should be stated at the start of your answer.) 3
 - (vi) Explain the consequences which follow if a registered person submits a late VAT return and makes a late payment of VAT to Customs and Excise. 3
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- (b) The system of Self Assessment for individuals was introduced in tax year 1996/97 and is now well established. Before 1996/97, the assessment of an individual's tax liability was entirely the responsibility of the Inland Revenue and it was quite possible for taxpayers to delay the assessment and payment of tax by withholding information from the Inland Revenue for as long as they could. The introduction of Self Assessment shifted responsibility from the Inland Revenue to the taxpayer and made it much more likely that tax is assessed and paid on time.

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

Outline the main features of the system of Self Assessment for individuals.

6

(25)

SUMMARY OF TAX DATA**Corporation Tax**

	<i>Financial Year 2002</i>	<i>Financial Year 2001</i>	<i>Financial Year 2000</i>
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

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

<i>Emission rating</i>	<i>Taxable percentage of list price</i>
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

	<i>first 10,000 miles per year</i>	<i>miles in excess of 10,000</i>
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