

PUBLIC POLICY AND TAXATION

Professional 2 examination 6 December 2002

From 10.00 am to 1.00 pm
plus ten 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 questions are worth equal marks.*

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 examinations room.

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.

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.



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

Many policy analysts argue that the majority of UK governmental decisions are made in “Whitehall” Departments rather than in Cabinet. The process of decision making within “Whitehall” Departments is therefore of vital significance in British government.

- **Requirement for question 1**

- (a) Identify and briefly describe the five models that seek to explain alternative views of the relationship between civil servants and their Ministers in the decision making process. 10
 - (b) Evaluate the ability of the above models to accurately capture the relationships between UK civil servants and ministers since the mid 1970s. 15
- (25)

2

In a democratic society such as the UK, it is appropriate to take a wide view of the number of “actors” involved in economic policy formation and management.

- **Requirement for question 2**

- (a) Outline the main institutions and organisations that can potentially influence the formation and management of central government economic policy, commenting briefly on their relative impact. 9
 - (b) The two principal tools of 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
 - (c) In recent decades, there have been a number of major structural changes to the UK economy. Briefly outline any two of these changes, commenting upon their significance. 6
 - (d) For much of 2001 and 2002, the consumer sector of the UK economy experienced boom conditions whilst the manufacturing sector was in recession. Explain the nature of the dilemma posed for UK monetary policy managers by this “twinspeed” economy. 4
- (25)

3 The relationship between local and central government is complex, but there has been a general trend in which central government has assumed increasing control over local government.

- **Requirement for question 3**

- (a) Outline the main roles of local government. 8
- (b) Define what is meant by a “democratic deficit” and give examples of why some commentators believe it exists in the context of UK local government. 3
- (c) Identify and briefly explain the principal models that attempt to explain the relationship between local and central government. 8
- (d) Political scientists recognise differing relationships between local authorities and the communities that they serve. Identify and explain these relationships, and assess their relative impact upon the “democratic deficit”. 6

(25)

SECTION B (Answer two questions)**4**

East Midlothian Ltd is a UK resident local authority trading company. The following items appear in the company's profit and loss account for the year to 31 March 2002:

Income:

- (i) Loan interest receivable from another UK company £10,000.
- (ii) Rents receivable £27,500.
- (iii) Premium received of £12,000 on the grant of a 5-year lease on premises owned by the company.
- (iv) Profit on disposal of plant and machinery £880.

Expenditure:

- (i) Debenture interest payable (gross amount) £30,000. Income tax has been deducted at source from the interest paid in the year.

- (ii) Entertaining and gifts:

	£
Entertaining customers	2,450
Staff function (for 50 employees)	4,500
10,000 "East Midlothian" calendars	10,000
200 bottles of wine	1,000
	17,950

- (iii) Bad and doubtful debts:

	£
Trade debts written off	12,430
Trade debts recovered	(110)
Staff loan written off	600
Increase in general provision	300
	13,220

- (iv) Expenses relating to property rented to tenants £6,190.

- (v) Gift Aid donation £1,000.

- (vi) Legal fees:

	£
On issue of debentures	18,000
On disposal of office building in January 2002	3,000
	21,000

- (vii) Hire of car for use by marketing director £5,200. The car in question had a list price of £20,000.

The following information is also available:

- 1 On 12 January 2002, the company sold an office building for £250,000. The building had been acquired in 1980 for £50,000 and legal costs of £600 were incurred on the acquisition. The building was extended in 1981 at a cost of £13,000 and again in May 1986 at a cost of £18,000. The market value of the building at 31 March 1982 was £73,000.
- 2 The company plans to buy another office building during 2006 at an expected cost of approximately £300,000. Fixed plant and machinery was acquired on 10 April 2001 for £225,000.
- 3 No election has been made (or will be made) to re-base the cost of assets held on 31 March 1982 to their market value on that date.
- 4 East Midlothian Ltd is a close company.

• **Requirement for question 4**

- (a) Explain how each of the items of income and expenditure listed above will be dealt with when computing the company's Schedule D Case I assessment for the year to 31 March 2002. Also explain any other tax consequences of each of these items. 13
- (b) Compute the chargeable gain arising on the disposal of the office building in January 2002 and explain how this gain might be deferred. Assume the following Retail Price Indices:

March 1982	79.44	
May 1986	97.85	
January 2002	175.2	8
- (c) Explain the meaning of the term "close company". Also outline the main tax consequences of close company status and indicate why special tax rules for close companies are thought necessary. 4

(25)

5 Edward is 33 years old. His wife is 34 years old and they have two children aged 10 and 7. Edward is a junior director of Elgin Ltd and in tax year 2001/02 he received a basic salary of £30,000. He also receives an annual performance-related bonus. His recent bonuses have been as follows:

	£
y/e 31/3/2001 (received 31 May 2001)	3,900
y/e 31/3/2002 (received 31 May 2002)	4,150

Edward does not receive any benefits-in-kind and he incurs no allowable expenses in relation to his employment. He is not contracted-out of the State Earnings Related Pension Scheme. Income tax deducted under PAYE in 2001/02 was £5,735.

Apart from his employment income, Edward's other income in 2001/02 was as follows:

	£
Building society interest (net)	188
Interest from Individual Savings Account	120
Dividends received	297

On 20 December 2001, Edward gave £100 to a registered charity. A Gift Aid declaration was made in relation to this donation.

• **Requirement for question 5**

- (a) Calculate Edward's income tax liability for 2001/02 (after tax already paid has been deducted) and explain how this tax is likely to be collected. 10
- (b) Calculate the National Insurance contributions payable in relation to Edward for tax year 2001/02. 2
- (c) Elgin Ltd currently offers its directors only a basic salary plus an annual bonus. Write a short report to the company's Chief Executive suggesting four significant taxable benefits-in-kind which could be made available to directors, outlining the way in which each benefit is taxed. 13

(25)

6

Elliott Ltd is VAT registered and makes only standard-rated supplies. The company's taxable turnover greatly exceeds the registration threshold. At present, no discounts of any kind are offered to the company's customers.

- **Requirement for question 6**

- (a) Explain the VAT consequences which would ensue if the company began to make some exempt supplies as well as standard-rated supplies. 4
- (b) Explain the VAT consequences of offering trade discounts or cash discounts to the company's customers. 2
- (c) The tax invoices issued by Elliott Ltd are required to state the tax point of each supply. Explain what is meant by the term "tax point" and show how the tax point of a supply is determined. Why is the tax point significant? 4
- (d) In general, the company can recover the VAT payable in relation to its inputs. Give two examples of input tax which is *not* recoverable. 2
- (e) VAT is an indirect tax and is sometimes criticised as regressive. Explain what is meant by the terms "indirect" and "regressive". Is it correct to regard VAT as a regressive tax? Would the situation be improved if the UK government (with EU approval) were to replace VAT with a poll tax? 3
- (f) Explain and compare the way in which VAT is assessed and collected with the way in which corporation tax is assessed and collected. 7
- (g) Explain, with reference to a public sector organisation of your choice, how the VAT treatment of public sector organisations differs from that of commercial organisations. 3

(25)

SUMMARY OF TAX DATA**Corporation Tax**

	<i>Financial Year</i> 2001	<i>Financial Year</i> 2000	<i>Financial Year</i> 1999
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: $\text{fraction} \times (M-P) \times \frac{I}{P}$

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

			2001/02	2000/01
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 0 to 64			-	-
Age 65 to 74			£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

	<i>2001/02</i>	<i>2000/01</i>
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%

Class 1 National Insurance Contributions

	<i>2001/02</i>	<i>2000/01</i>
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
Fuel quarterly scale charges (from 6 April 2001):	
Petrol engines:	
up to 1,400cc	£36.04
up to 2,000cc	£45.72
2,001cc or more	£67.46
Diesel engines:	
up to 2,000cc	£33.51
2,001cc or more	£42.59