

PUBLIC POLICY AND TAXATION

Professional 2 examination **7 December 2001**

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.

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 The public debate about the UK's possible full participation in European Economic and Monetary Union (EMU) has, to date, focused mainly on issues concerning the loss of national political identity and sovereignty. Against this backdrop:

- **Requirement for question 1**

- (a) Outline the main arguments for and against the UK's possible future participation in the European Single Currency. 6
 - (b) Briefly describe the structure and key functions of the following institutions of the European Union:
 - (i) The European Commission 4
 - (ii) The Council of the European Union 4
 - (iii) The European Parliament 4
 - (c) Analyse the extent to which Britain's *parliamentary sovereignty* has already been impaired by the UK's membership of the European Union. 7
- (25)

2

The UK constitution is often typified as a parliamentary democracy where the role of parliament is central to public governance and where government is exercised by elected representatives.

- **Requirement for question 2**

(a) Outline the key functions of:

(i) The House of Commons 5

(ii) The House of Lords 5

(b) Pressures for the reform of parliament have, since the early-1990s, significantly increased. Describe **two** key reforms or proposed reforms over the past decade, for each of:

(i) The House of Commons 4

(ii) The House of Lords 4

(c)

(i) What do you understand by the term *representative government*? 2

(ii) To what extent is the composition of the House of Commons, following the 2001 UK general election (see table below), consistent with your understanding of the term *representative government*? 5

Summary of the UK General Elections Results, 2001				
	Labour	Conservative	Liberal Democrat	Other Parties
Votes in millions	10.7	8.4	4.8	2.4
House of Commons seats	413	166	52	28
% Share of vote	40.7	31.9	18.3	9.1
(59.2% of the electorate voted at the 2001 election)				

(25)

3 During and since the 1980s, successive UK governments have given considerable policy emphasis to the *marketisation* and *privatisation* of public services.

- **Requirement for question 3**

- (a) Explain the aims of *marketisation* and *privatisation*, highlighting any differences in policy approach between the Conservative and New Labour governments. 6
 - (b) Outline the variety of policies and programmes used by UK governments to implement *marketisation* and *privatisation*. 11
 - (c) Evaluate, with examples, the extent to which you believe the policies of *marketisation* and *privatisation* have been successful. 8
- (25)

SECTION B (Answer 2 questions)**4**

Castle Manufacturing Ltd is a UK resident trading company with no associated companies. It is medium-sized for financial reporting purposes. Results for the 15 months to 31 March 2001 are as follows:

	£	Notes
Trading profits	969,600	1,6
Debenture interest received	40,000	2
Dividends received from UK companies	90,000	3
Patent royalties payable	38,400	4
Charitable covenant payable	22,500	5

Notes:

- The company's trading profits have been adjusted for tax purposes but capital allowances have not yet been calculated or deducted. Information relating to capital allowances is given in Note 6 below. Maximum capital allowances are claimed by the company.
- The company acquired £500,000 of 8% debentures on 1 April 2000. Interest is received half-yearly on 31 March and 30 September and income tax is deducted at source from this interest.
- UK dividends received during the 15-month period (excluding tax credits) were as follows:

	£
Received 31 December 2000	49,500
Received 1 January 2001	9,000
Received 27 February 2001	31,500
	<u>90,000</u>

- The company pays patent royalties on 31 January each year, deducting income tax at source. Royalties payable for the 15-month period (gross amounts) were as follows:

	£
Accrued to 31 December 1999	(68,400)
Paid 31 January 2000	75,300
Paid 31 January 2001	26,700
Accrued to 31 March 2001	4,800
	<u>38,400</u>

The gross amount accrued on 31 December 2000 was £24,200.

- 5 The company makes a covenanted payment to a charity on 30 April each year. Before 1 April 2000, income tax was deducted at source when making these payments but they are now paid gross. The gross amount payable for the 15-month period was as follows:

	£
Accrued to 31 December 1999	(12,000)
Paid 30 April 2000	18,000
Accrued to 31 March 2001	16,500
	<u>22,500</u>

- 6 On 1 January 2000, the tax written down values of the company's plant and machinery were as follows:

	£
General pool	117,300
Mercedes car (used by Chief Executive)	32,420
BMW car (used by Marketing Director)	18,760

The company bought and sold the following plant and machinery during the 15 months to 31 March 2001:

		£
15 February 2000	Bought factory machinery	72,500
16 June 2000	Sold BMW car	21,500
16 June 2000	Bought replacement BMW car	29,300
27 November 2000	Bought car	10,420
16 December 2000	Sold plant (original cost £31,600 in 1997)	15,000
11 January 2001	Bought plant	42,000
26 March 2001	Sold plant (original cost £2,920 in 1999)	3,100

None of the company's plant and machinery ranks as a short-life or long-life asset. It has been agreed with the Inland Revenue that there is 50% private use of the Mercedes motor car by the Chief Executive and that there is 25% private use of the BMW motor cars by the Marketing Director.

- 7 On 19 February 2001 (RPI 171.7), the company sold 1,000 shares in ABC Holdings plc for £6,000. Shares in this company had been acquired as follows:

		£	RPI
1 October 1975	Bought 1,000 shares	1,000	
27 January 1981	Bought 1,000 shares	1,500	
15 May 1989	Bought 1,000 shares	2,000	115.0
4 March 1996	Bought 1,000 shares	2,400	151.5

The Retail Prices Index for March 1982 was 79.44.

- 8 On 1 January 2000, the company had trading losses brought forward of £630,000 and capital losses brought forward of £10,000.

- **Requirement for question 4**

- (a) Identify the accounting periods into which the company's 15-month period of account will be divided for corporation tax purposes. 1
 - (b) Perform a capital allowances computation for each accounting period. 7
 - (c) Compute the chargeable gain arising on the sale of the shares in ABC Holdings plc. 5
 - (d) Calculate the company's chargeable profits for each accounting period. 6
 - (e) Calculate the corporation tax payable for each accounting period and state the date on which this corporation tax is due for payment. 6
- (25)

5

Colin is the Finance Director of a company. He was born on 17 March 1938 and is married to Catherine who was born on 3 April 1935. Catherine had no income for tax purposes in 2000/01.

Colin earned a basic gross salary of £80,000 in tax year 2000/01, paying tax of £33,400 via the PAYE system. He also received an expenses allowance of £5,000. He used £3,000 of this to pay for business entertaining and spent the remaining £2,000 on necessary subsistence expenses incurred whilst travelling on business. The following further information relates to his employment:

- 1 Throughout 2000/01, Colin lived in a house provided by the company for which he works. This house cost the company £140,000 in 1998 and has an annual rateable value of £8,400. The company furnished the house in 1999 (when Colin moved in) at a cost of £15,000 and paid the following ancillary expenses during 2000/01:

	£
Cleaning services	480
Gas and electricity bills	690
Repairs	310

Colin paid his employer rent of £200 per month during 2000/01. The house does not qualify as job-related accommodation.

- 2 He was also provided with a company car throughout 2000/01, which he used for both business and private travel. He drove a total of 14,000 miles during the year, of which 20% was business mileage. The car had a list price of £32,000 when it was first registered on 1 January 2000 and has a 2,500cc petrol-driven engine. The company paid for all of the car's running expenses but Colin contributed £100 per month during 2000/01 for private use of the car and a further £50 per month towards fuel costs. Total fuel costs for the year were £1,880.
- 3 On 1 April 2000, the company made Colin an interest-free loan of £4,500. The full amount of this loan was outstanding during the whole of tax year 2000/01.
- 4 The company provides each of its directors with a mobile telephone which may be used for both business and private calls.
- 5 Colin contributes 6% of his basic salary into his employer's occupational pension scheme. He paid a professional accountancy subscription of £230 on 1 January 2001 and made a qualifying Gift Aid donation of £1,170 on 18 March 2001.

In addition to his income from employment, Colin also receives income from investments.

Colin's investment income for 2000/01 is listed below. In each case, the amount shown is the amount actually received during the tax year, net of any income tax deducted at source.

	£
National Savings Bank ordinary account interest	120
National Savings Bank investment account interest	140
Building society interest	1,320
Interest from Individual Savings Account	180
Dividends from UK companies	2,790

• **Requirement for question 5**

- (a) Calculate Colin's Schedule E income for tax year 2000/01. 8
- (b) Calculate Colin's income tax liability for tax year 2000/01. 8
- (c) Assuming that Colin is contracted out of the State Earnings Related Pension Scheme (SERPS), calculate the National Insurance contributions payable by him for tax year 2000/01. 1
- (d) Explain why Colin is likely to receive a tax return for 2000/01 and state the date upon which this return must be submitted to the Inland Revenue. Also explain the consequences of making a late return. 4
- (e) Colin is thinking of transferring his investments into his wife's name so as to reduce his family's overall income tax liability. If he does so, would this be a case of tax avoidance or tax evasion? Explain the difference between these terms and comment briefly on the view currently held by the courts with regard to complex tax avoidance schemes. 4

(25)

6

- (a) For the purposes of value added tax (VAT) a supply of goods or services made by a business may be exempt or may be taxable at the standard rate, the lower rate or the zero rate.

• **Requirement for question 6(a)**

State the VAT consequences of making:

- (i) Only zero-rated supplies
- (ii) Only exempt supplies

and give at least one example of each of these types of supply. Also state the consequences of making a mixture of taxable supplies (at any rate) and exempt supplies.

4

- (b) Cordelia started a business on 1 February 2000. She chose not to register voluntarily for VAT. Her sales of taxable goods during the initial months of trading were as follows:

	£
2000	
February	900
March	1,400
April	1,700
May	3,300
June	4,400
July	5,600
August	5,700
September	6,200
October	5,400
November	7,300
December	10,400
2001	
January	3,000
February	3,700
March	5,500

Her sales in December 2000 included £4,500 in connection with the sale of a fixed asset used in her business.

• **Requirement for question 6(b)**

- (i) State the date by which Cordelia would probably be required to register for VAT and the date from which her registration would normally take effect, explaining the consequences which would ensue if she made a late registration. Also indicate any circumstances in which she would not be required to register.

5

- (ii) Explain why Cordelia might have chosen not to register voluntarily and why some business persons might make the opposite decision. 2
- (c) A registered person who is unable (or unwilling) to join the cash accounting scheme might account to Customs and Excise for the output tax relating to a supply and then find that the customer in question fails to pay for the goods or services which have been supplied.
- **Requirement for question 6(c)**
List the conditions which must be satisfied in order that a registered person may claim a refund of the VAT lost if a bad debt occurs. 3
- (d) In certain circumstances, a registered person may join the annual accounting scheme and submit only one VAT return per year.
- **Requirement for question 6(d)**
State the circumstances in which the annual accounting scheme may be used and describe the way in which the scheme operates. 3
- (e) A wide variety of penalties may be exacted by Customs and Excise for non-compliance with VAT regulations.
- **Requirement for question 6(e)**
State when a default surcharge may be levied and explain how the surcharge is calculated. 2
- (f) Taxes can be classified into direct taxes and indirect taxes and can be described as progressive, regressive or proportional.
- **Requirement for question 6(f)**
 - (i) Explain the terms “direct” and “indirect” and give at least one example of each classification of tax. 2
 - (ii) Explain the terms “progressive”, “regressive” and “proportional” and indicate which of these terms should be applied to VAT. 4
- (25)

SUMMARY OF TAX DATA**Corporation Tax**

	<i>Financial Year 2000</i>	<i>Financial Year 1999</i>	<i>Financial Year 1998</i>
Full rate	30%	30%	31%
Small company rate	20%	20%	21%
Starting rate	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	-	-
Upper limit	£50,000	-	-
Marginal relief fraction	1/40	1/40	1/40

Marginal relief formula: $\text{fraction} \times (M-P) \times \frac{1}{P}$

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>2000/01</i>	<i>1999/00</i>
Starting rate	10%	first	£1,520	£1,500
Basic rate	22% (23% in 1999/00)	next	£26,880	£26,500
Higher rate	40%	over	£28,400	£28,000
Personal allowance:				
Age 0 to 64			£4,385	£4,335
Age 65 to 74			£5,790	£5,720
Age 75 or over			£6,050	£5,980
Married couple's allowance:				
Age 0 to 64			-	£1,970
Age 65 to 74			£5,185	£5,125
Age 75 or over			£5,255	£5,195
Minimum amount			£2,000	-
Income limit for age-related allowances			£17,000	£16,800

Fuel Benefit Tables

	<i>2000/01</i>	<i>1999/00</i>
Petrol: up to 1,400cc	£1,700	£1,210
1,401cc to 2,000cc	£2,170	£1,540
2,001cc and above	£3,200	£2,270
Diesel: up to 2,000cc	£2,170	£1,540
2,001cc and above	£3,200	£2,270

Official Rate of Interest

6%

Class 1 National Insurance Contributions

	<i>2000/01</i>	<i>1999/00</i>
Primary threshold (annual)	£3,952	£3,432
Secondary threshold (annual)	£4,385	£4,335
Upper earnings limit (annual)	£27,820	£26,000
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)	12.2%	12.2%
On remainder up to UEL (Contracted out)	9.2%	9.2%
On earnings beyond UEL	12.2%	12.2%

Value Added Tax

Standard rate (from 1 April 1991)	17.5%
Registration threshold (from 1 April 2000)	£52,000
Deregistration threshold (from 1 April 2000)	£50,000