

TAXATION

Diploma stage examination

9 June 2008

From 2.00pm to 4.00pm

Plus ten minutes reading time from 1.50pm to 2.00pm

Instructions to candidates

*There are **four** questions on this question paper*

*Answer **three** questions in total*

One** compulsory question from **Section A

Two** of the three questions from **Section B

*The question in Section A carries **40** marks*

*The questions in Section B carry each carry a total of **30** 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.

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 (Compulsory)**1**

Liver Trading Ltd is a UK local authority trading company. Its results for the two years to 31 December 2007 are as follows:

	Year ended 31/12/06	Year ended 31/12/07	Notes
	£	£	
Trading profit/(loss)	1,530,300	1,457,680	1,2
Gain on sale of asset	Nil	280,000	3,4,6
Bank interest received	21,150	16,680	
UK dividends received	Nil	9,000	5
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 the items listed below:
- 2 The company owned no industrial buildings until 1 February 2007, when £320,000 was spent on the purchase of a second-hand industrial building from Chester plc. This price included £120,000 for the land on which the building stands. The building was brought into use immediately following acquisition.

The building was constructed on 1 February 2002 by Chester 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 Liver Trading Ltd, apart from a period of non-industrial use which lasted from 1 September 2003 until 1 June 2004. Liver Trading Ltd wishes to claim the maximum available capital allowances in relation to this building.

- 3 In order to pay for the acquisition of the industrial building, the company sold an office on 5 February 2007 for £350,000. It was originally acquired on 1 September 1979 for £70,000, and its market value at 31 March 1982 was £120,000.
- 4 On 1 February 2000, the company acquired a 10-year lease on a building at a cost of £25,000. On 1 February 2007 this lease was assigned to a third party for £10,000.
- 5 The figures shown for UK dividends received are the amounts actually received in each accounting period, with no adjustment for tax credits.
- 6 There were no trading losses brought forward on 1 January 2006 but there were capital losses brought forward of £6,000.
- 7 Chargeable profits for the year to 31 December 2008 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 December 2007.
- 8 The company paid corporation tax at 30% on its profits for the year ended 31 December 2006.

• **Requirement for question 1**

- (a) Compute the industrial buildings allowances available for the year to 31 December 2007 and hence the company's adjusted Schedule D Case I profit for that year. 6
- (b) Compute the chargeable gains arising on the sale of the following:
- (i) the assignment of the lease; and
- (ii) the disposal of the office.

8

Assume Retail Price Indices as follows:

March 1982	79.44
February 2000	167.5
February 2007	203.1

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) State the conditions required for the company to defer the chargeable gain arising on the sale of the office. Comment on whether or not it is possible for Liver Trading Limited to take advantage of this relief. You should support your answer with calculations of any gains to be deferred. 8
- (d) Calculate the company's corporation tax liability for the year to 31 December 2007 on the assumption that the company takes advantage of any capital gains deferral reliefs.

Assume that the taxation rates (including marginal relief fractions) for Financial Year 2007 apply throughout the year. 9

- (e) (i) State when the corporation tax for the year to 31 December 2007 will be payable. 1
- (ii) When would corporation tax be payable for the years ended 31 December 2006 and 2007 if the company did not defer the gain arising on the sale of the office? If different, explain the changes and the reasons why. 8

(40)

SECTION B (Answer two from three questions)

2

Alan Bradley and Claire Dunn work for Healthsafe Ltd, which is preparing its year end tax information for 2007/08. The following information is available in relation to these two employees and for the company:

Claire Dunn

- 1 Claire was born in 1965 and has worked for the company since 1984. Her gross pay in 2007/08 was £43,000. Income Tax of £8,934 was deducted via the PAYE system.
- 2 Claire is not provided with a company car but she uses his own car for business journeys and is paid 30p per mile by the company. She drove 15,000 business miles during 2007/08. Claire understands that she may be able to obtain income tax relief in relation to the level of company mileage allowance.
- 3 During 2007/08, Claire received a long-service award in recognition of 20 years of loyal service to the company. The award consisted of a gold watch which cost the company £850.
- 4 Claire's only other income for 2007/08 consisted of UK dividends of £3,078 and ISA interest of £330. She made Gift Aid donations to the British Heart Foundation of £25 per month for the last four months of the year.

Alan Bradley

- 1 Alan was born in 1973 and joined the company on 6 May 2007. His gross pay for 2007/08 was £27,500 and Income Tax of £4,696 was deducted via PAYE.
- 2 Alan is provided with a company car for both business and private motoring. The cars provided during 2007/08 were as follows:

	List price £	Emissions g/km	Fuel used
6 May 2007 to 5 July 2007	15,400	172	Diesel
6 July 2007 to 5 April 2008	18,800	164	Petrol

The company paid for all of the running costs of these cars but Alan contributed £120 per month for private use of the cars. In addition, the company provided free fuel from 6 July 2007 onwards.

- 3 Before taking up his employment with the company, Alan lived 300 miles away in another town. In May 2007, the company reimbursed his relocation expenses of £5,800. All of this sum was spent on legal fees, estate agent's fees and other moving costs, and was paid on presentation of Alan's bills.
- 4 On 6 July 2007, the company lent Alan £50,000 at an interest rate of 2% per annum. Alan repaid £20,000 of the loan on 6 January 2008.
- 5 Alan is provided with a mobile telephone and is allowed to use this telephone to make both business and private calls. The company did not have to pay for the telephone itself but paid call charges of £546 during the year (of which £290 related to private calls).

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- 6 Alan's only other income for 2007/08 consisted of gross pay from his previous employer of £1,920 (PAYE paid £395) and net building society interest of £2,520.

Healthsafe Limited

- 1 Healthsafe Limited sold a painting which it had bought in April 1998 for use in its offices. The company paid £3,200 for the painting, and sold it for £7,020 (after deduction of 10% commission costs) in November 2006.
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• **Requirement for question 2**

- (a) Prepare an Income Tax computation for Claire for the tax year 2007/08. If any of her income is not taxable, explain why this is the case. 7
- (b) Calculate both Employers' and Employees' National Insurance Contributions (NICs) payable in relation to Claire for 2007/08. You should assume that Claire is not contracted out of the State Second Pension (formerly SERPS). 3
- (c) Prepare an income tax computation for Alan for tax year 2007/08. If any of his income is not taxable, explain why this is the case. 10
- (d) Briefly outline the main features of the PAYE system. 6
- (e) Calculate the chargeable gain on the sale of the painting by Healthsafe Limited in November 2006. 4

Assume Retail Price Indices as follows:

April 1998	162.6	
November 2006	201.1	
(30)		

3

Julie started her own business on 1 December 2007 providing translation services mostly to UK police forces. Prior to doing so, she had performed the same services as an employee with one of the larger Police forces.

Before commencing trading, Julie bought a computer for £1,500 excluding value added tax (VAT) on 1 November 2007. She also paid consultancy fees of £4,000 excluding VAT on 1 January 2008. She made sales of £3,000 in December 2007, and her sales increased by £1,000 every month to the current ongoing level of £8,000 per month. Julie believes that her monthly costs of £1,000 excluding VAT will remain constant. Her year end will be 31 August 2007, and the first accounts will be drawn up to 31 August 2008.

Julie has heard that she needs to consider VAT registration, and is unsure what her obligations are. She is also very busy and is also concerned that as a small business, she may not have the time to deal with VAT returns and calculations. Julie is unsure if there are any VAT schemes available to her that might simplify the work involved in accounting for VAT.

• **Requirement for question 3**

- (a) Using the information above, write a letter to Julie stating the date on which she must register for VAT, and advise her whether or not she can recover the pre-trading VAT suffered on the computer and consultancy fees. 7
- (b) State the options open to Julie in simplifying her VAT accounting, describing each in turn. You should state any conditions required for any such VAT schemes. You should ignore the option of using the cash accounting scheme. 7
- (c) List the information that Julie will be required to include on her VAT invoices to the police services. You should assume that all of her customers are VAT registered. 6
- (d) Explain the terms formal incidence and effective incidence in relation to a tax, and using an example in each case, illustrate the difference between a direct tax and an indirect tax. 3
- (e) Discuss and apply the criteria which may be used to determine whether or not an individual is employed or self-employed. 7

(30)

4

You have been asked to look at the corporation tax computation prepared by Stephen, an accountant at Tay Water Trading Limited. Its year end is 31 March 2008. Stephen has claimed everything as tax deductible, as he sees no reason why all expenditure should not be allowable for tax. In preparing the tax computation, he has not provided any analysis of expense categories in the Income Statement.

You are given the following analysis of Administrative Expenses. None of the expenditure has been disclosed or adjusted in the corporation tax computation.

	£
Bad Debts: increase in general provision	5,000
Donation to Green Party	1,250
Entertaining & gifts:	
Customer entertaining	3,255
Staff entertaining	1,453
Christmas Gifts of wine to customers	2,699
Interest: loan to buy investment asset	48,200
Legal and professional fees:	
Audit and accountancy fees	25,000
Fine for late submission of tax return	100
Motor expenses:	
Running costs of employees' cars	17,640
Running costs of non-employee's car: director's daughter	3,472
Office stationery	1,269
Pension contributions (paid 10 February 2008)	18,611
Sundry expenses (all allowable)	2,106
Travel & subsistence	<u>3,742</u>
	<u>133,797</u>

Stephen has also expensed some machinery through the Cost of Sales figure. According to Stephen, it is easier to expense all items apart from cars and large machinery.

- Requirement for question 4**

- (a) Analyse the information given under Administrative Expenses. Outline what items need to be adjusted for tax purposes, explaining why each item needs adjusting. 12
- (b) Discuss the definition and treatment of capital items from a tax perspective, giving examples of capital items usually found in accounting income statements. Your answer should make reference to four relevant cases on capital items. 8
- (c) Explain the difference between tax avoidance and tax evasion, and comment on the current stance of HM Revenue & Customs to aggressive tax avoidance. 3

When disclosing information in this personal tax return, Stephen takes a similar approach to the way in which he discloses information for Tay Water Trading Limited's corporation tax return. Stephen is unaware of the consequences of submitting an incorrect income tax return.

- (d) Advise Stephen when he should file his income tax return. State how HM Revenue & Customs could enquire into Stephen's return, and outline the options open to Stephen if he disputed any detail. Your answer should include time limits for all aspects. 7
(30)

SUMMARY OF TAX DATA**Corporation Tax**

	<i>Financial Year 2007</i>	<i>Financial Year 2006</i>	<i>Financial Year 2005</i>
Full rate	30%	30%	30%
Small company rate	20%	19%	19%
Lower limit	£300,000	£300,000	£300,000
Upper limit	£1,500,000	£1,500,000	£1,500,000
Marginal relief fraction	1/40	11/400	11/400
Starting rate			0%
Lower limit			£10,000
Upper limit			£50,000
Marginal relief fraction			19/400
Non-corporate distribution rate			19%

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 companies:

Acquired on or after 2 July 1998	40%
Acquired 1 April 2004 to 31 March 2005	50%
Acquired 1 April 2006 to 31 March 2007	50%

Income Tax

		<i>2007/08</i>	<i>2006/07</i>
Starting rate	10%	first	£2,230
Basic rate	22%	next	£32,370
Higher rate	40%	over	£34,600
Personal allowance:			
Age 0 to 64		£5,225	£5,035
Age 65 to 74		£7,550	£7,280
Age 75 or over		£7,690	£7,420
Married couple's allowance:			
Age under 75 and born before 6 April 1936		£6,265	£6,065
Age 75 or over		£6,365	£6,135
Minimum amount		£2,440	£2,350
Income limit for age-related allowances		£20,900	£20,100

Car benefit

<i>Emission rating</i>	<i>Taxable percentage of list price</i>
Up to 140 g/km	15%
Each additional 5g/km	+ 1%
Diesel engine	+ 3%
Maximum charge	35%

Car fuel benefit

Figure to which appropriate percentage is applied so as to calculate car fuel benefit £14,400

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

	<i>2007/08</i>	<i>2006/07</i>
Primary threshold (annual)	£5,225	£5,035
Secondary threshold (annual)	£5,225	£5,035
Upper earnings limit (annual)	£34,840	£33,540
Employee contribution rates:		
On earnings up to primary threshold	0%	0%
On remainder up to UEL (Not contracted out)	11%	11%
On remainder up to UEL (Contracted out)	9.4%	9.4%
On earnings above the UEL	1%	1%
Employer contribution rates:		
On earnings up to secondary threshold	0%	0%
On remainder up to UEL (Not contracted out)	12.8%	12.8%
On remainder up to UEL (Contracted out)	9.1%	9.3%
On earnings beyond UEL	12.8%	12.8%

Class 1A National Insurance Contributions

	<i>2007/08</i>	<i>2006/07</i>
Employer contribution rate	12.8%	12.8%

Value Added Tax

Standard rate (from 1 April 1991)	17.5%
Registration threshold (from 1 April 2007)	£64,000
Deregistration threshold (from 1 April 2007)	£62,000
Fuel quarterly scale charges (from 1 May 2007):	
VAT due per car:	
Petrol engines: up to 1,400cc	£40.66
up to 2,000cc	£51.53
2,001cc or more	£75.66
Diesel engines: up to 1,400cc	£38.72
up to 2,000cc	£38.72
2,001cc or more	£49.30