

**TAXATION  
REPUBLIC OF IRELAND**

**Diploma stage**

**11 December 2006**

**MARKING SCHEME**



**Question 1**

(a)

	Equipment	Jaguar	Audi	VW	Toyota	Total	
<b>COST</b>							
B/F at 1							
January 2005	180,000	50,000	30,000	25,000		285,000	
Additions	102,400				28,340	130,740	½
Disposals	(34,900)		(30,000)			(64,900)	1
C/F at							
31/12/05	247,500	50,000	0	25,000	28,340	350,840	
Specified Cost	247,500	22,000	0	22,000	22,000	313,500	1
<b>TWDV</b>							
B/F at 1							
January 2005	135,000	8,800	8,800	16,500		169,100	
Additions	102,400				22,000	124,400	½
Disposals	(26,175)		(8,800)			(34,975)	1
W&T	(30,938)	(4,400)	0	(2,750)	(2,750)	(40,838)	1
C/F at							
31/12/05	180,287	4,400	0	13,750	19,250	217,687	

**BALANCING ALLOWANCES/CHARGES**

**SALE OF EQUIPMENT**

Cost – 2003 = €14,900  
W&T – 12.5% for 2 years = (€3,725)  
TWDV at 1 January 2005 = €11,175

Sales Proceeds = €9,450

Balancing Allowance = (€1,725) 1

**SALE OF AUDI CAR**

Cost – 2002 = €30,000  
Restricted Cost = €22,000  
W&T – 20% for 3 years = (€13,200)  
TWDV at 1 January 2005 = €8,800

Sales Proceeds = €12,500

Restricted Proceeds = €9,167 (22,000/30,000 \* 12,500)

Balancing Charge = €367 1

**SALE OF EQUIPMENT**

Cost – 2003 = €20,000  
W&T – 12.5% for 2 years = (€5,000)  
TWDV at 1 January 2005 = €15,000

*Sales Proceeds* = €15,600

*Balancing Charge* = €600

1

Capital Allowances Summary

	€
Equipment	(30,938)
Jaguar	(4,400)
VW	(2,750)
Toyota	(2,750)
Balancing Allowance	(€1,725)
Balancing Charge (367 + 600)	967
Total Capital Allowances	<u>(41,596)</u>

(8)

(b)

	€	€	
Pre-tax profit per accounts		458,080	½
<i>Add:</i> Depreciation of delivery vans	26,110		½
Depreciation (€16,350 + €11,440 + €9,770)	37,560		½
Loss on disposal of motor car	3,510		½
Amortisation (€15,000 - (€140,400/12))	3,300		1
Expenses re rented property	39,130		½
Customer entertaining	5,960		½
Gifts of whisky	2,700		½
Fees relating to tax appeal	12,500		½
Interest on overdue corporation tax	<u>670</u>	131,440	½
<i>Less:</i> Profit on disposal of delivery van	2,400		½
Profit on disposal of admin. equipment	1,390		½
Decrease in general provision	1,950		½
Other operating income	133,660		½
Interest receivable	4,430		½
Capital allowances	<u>41,596</u>	<u>(185,426)</u>	1
Schedule D Case I profit		<u>404,094</u>	

If the accounting period was greater than 12 months than more than one corporation tax assessment would be required to be calculated. A period of account exceeding 12 months in length is subdivided into two or more accounting periods, each resulting in a separate corporation tax assessment. The first accounting period is the first 12 months of the period of account. The second accounting period is the next 12 months of the period of account (and so forth). Capital allowances are apportioned accordingly.

2

(11)

(c)

		€	
Schedule D Case I	404,094		
Less: s396(1) relief	<u>(133,900)</u>	270,194	1
Schedule D Case III		4,430	1
Schedule D Case V:			
Rental income	173,660		½
Premium received (€60,000 x 92%)	55,200		1 ½
Premium paid (€100,000 x 82% x 5/10)	(41,000)		1 ½
Expenses	<u>(39,130)</u>	148,730	½
Profits chargeable to corporation tax		<u>423,354</u>	

Capital losses c/f are €37,240. There are no trading losses to carry forward. 1  
(7)

(d)

		€	
Corporation tax due:			
<i>Taxable Profits:</i>			
Trading Profits @ 12.5%	270,194		
Passive Income @ 25%	<u>153,160</u>		
		<u>423,354</u>	
Taxed as follows:			
Trading – 270,194 @ 12.5%	33,774		
Passive – 153,160 @ 25%	<u>38,290</u>		
Total CT due		<u>72,064</u>	2

This corporation tax is due *in instalments* – 21 November 2005, 21 June 2006 and 21 September 2006. 2  
(4)

(e) There are transitional arrangements in place until 2006. These transitional arrangements are essential a lead in phase. For accounting periods ending in 2005, companies (which are not small companies) will have to pay the following amount of their final CT liability on the following dates;

- 21<sup>st</sup> day of the month before accounting period end – 72%
- 21<sup>st</sup> day of the sixth month after accounting period end – 18%
- 21<sup>st</sup> day of the ninth month after accounting period end -10%

For accounting periods ending in the year ended 31 December 2006 and going forward, all companies will be required to pay 90% of the final corporation tax liability for a period one month before period end. 4

(4)

- (f) The CT1 tax return for the year to 31 December 2005 must be submitted by 21 September 2006. A late return will attract a surcharge and restrictions on the use the company may make of certain reliefs and allowances as follows: 2
- (i) If the return is less than two months late, there will be a surcharge of 5% of the tax payable subject to a maximum of €12,695. 1
- (ii) If the return is more than two months late, there will be a surcharge of 10% of the tax payable subject to a maximum of €63,485. 1
- (iii) In addition to the above surcharges, there will be a restriction on certain allowances and reliefs, as follows:
- If the return is less than two months late, reliefs and allowances are restricted by 25% subject to a maximum in each case of €31,740.
  - If the return is made more than two months late, the reliefs and allowances are restricted by 50% subject to a maximum in each case of €158,715. 2
- (6)
- (40)**

**Question 2**

- (a) Terry's annual salary of €48,000 absorbs the whole of the income tax basic rate bands. Therefore any further taxable income will be taxed at the higher rate of 42%. Similarly, his salary exceeds the PRSI upper earnings limit and therefore any further income which is subject the 2% health levy. 2

If Terry accepts the car, there will be additional tax of €1,518 ( $((15,500 * 30\%) - (50 * 12) - (50 * 12)) * 44\%$ ). 4

If Terry retains his own car, he will receive a mileage allowance of €2,500 which will be subject to tax at 44% i.e. €1,100. He will also have to pay his car's running costs of €6,000. The total cost to him is €7,100. 2

Therefore the more efficient option for him is to accept the company car.

(8)

(b)

	€	€	
Salary		48,000	½
Car and fuel benefits	4,650		½
Lunches in staff dining room (available to all staff)	-		½
Relocation expenses (not taxable)	-		½
Personal Incidental Expenses (up to €5 per night)	-		½
Mobile phone (statutorily exempt)	-		½
Beneficial loan:			
(€50,000 x 3/12) * 11%	1,375		½
(€30,000 * 9/12) * 11%	2,475		½
Employer's pension contributions (exempt)	-		½
Reimbursed travel and subsistence expenses	7,150		½
Professional Subs	164	15,814	½
		<u>63,814</u>	
Less: Pension contributions €48,000 x 7%	3,360		½
Necessary travel and subsistence	7,150		½
Professional subscription	164		½
Charitable donation (PAYE therefore no deduction for individual)	-	(10,674)	½
Employment income		<u>53,140</u>	
Rental of room in own home (under €7,620)		-	½
Dividends (€27,000 /80%)		<u>33,750</u>	½
<i>Taxable Income</i>		<u><u>86,890</u></u>	
Income tax payable:			
€38,400 @ 20%		7,680	½
€48,490 @ 42%		<u>20,366</u>	½
		28,046	
Less: Tax Credits:			
PAYE credit		(1,270)	½
Married persons allowance		(3,160)	½
Dividend Tax Credit		<u>(6,750)</u>	½
		16,866	2
Less: PAYE		<u>(15,000)</u>	1
Remaining income tax liability		<u><u>1,866</u></u>	

The 2005 return and balance of tax payable would be due by 31 October 2006.

1

(15)

(c) Taxation is a compulsory levy made by public authorities for which nothing is received directly in return. In theory, therefore, PRSI and Healthy Levy contributions should not be seen as a form of taxation, since they are made in return for specific benefits (such as old age pension, the state retirement pension, disability benefit, unemployment benefit). However, once a threshold number of contributions has been made, the benefits received are not directly related to the contributions made. Also, the PRSI fund is supplemented by government expenditure financed from other sources. For these reasons, most commentators regard PRSI as a tax and this view is borne out by their inclusion in the OECD classification of taxes.

(4)

(d) Transferring the preference shares to Terry's wife would save no tax as the couple are jointly assessed and therefore the dividend income would be treated the same whether it was earned by Terry or his wife.

(3)

(30)

**Question 3**

**(a) Disposal of Bentley**

Motor cars are chargeable assets. Usually the expenditure has wasted so no chargeable gain arises. But in this case the car is worth more than what was paid for it so a chargeable gain does arise. There is an exemption from CGT for wasting assets but the exemption does not apply to wasting chattels that have been used for the trade or business. So the gain is calculated in the normal way and if a loss had arisen capital allowances would have then been deducted to restrict the loss:

**Disposal of Bentley**

	€	€	
Disposal proceeds		50,000	
Less: Original cost – November 1997	30,000		
<i>Indexation Factor (1997/98)</i>	<u>1.232</u>	<u>(36,960)</u>	
Chargeable gain		<u>13,040</u>	3

**Disposal of office building**

	€	€	
Disposal proceeds		1,300,000	½
Less: Original Cost - 31 March 1982	135,000		1
<i>Indexation Factor (1982/83)</i>	<u>7.528</u>	<u>(1,016,280)</u>	½
Less: Enhancement expenditure – September 1988	40,000		½
<i>Indexation Factor (1988/89)</i>	1.553	<u>(62,120)</u>	½
Chargeable gain		<u>221,600</u>	1

**Disposal of land**

	€	€	
Disposal proceeds		120,000	
Less: Original cost – November 1997	42,000		
<i>Indexation Factor (1997/98)</i>	<u>1.232</u>	<u>(51,744)</u>	
Chargeable gain		<u>68,256</u>	3

**Disposal of plant and machinery**

The plant and machinery disposed of in December 2005 was sold at a loss. This is not an allowable loss since it is relieved by means of the capital allowances system. The company's capital allowances computation for the year to 31 December 2005 will show a balancing charge of €9,000 which is the proceeds less the TWDV of nil (acquired in 1996 therefore fully written down for tax purposes).

The plant and machinery sold in May 2005 was sold at a profit. The company's capital allowances computation for the year to 31 December 2005 will show a disposal of €19,500 and there will be a chargeable gain as follows:

	€	€	
Disposal proceeds		22,500	
Less: Cost – May 2004	19,500		
<i>Indexation factor – nil as &lt; 12 months</i>	<u>-</u>	<u>(19,500)</u>	
Chargeable gain		<u>3,000</u>	4



**Disposal of Government Securities**

The disposal of government securities by a company falls within those assets which are exempt from capital gains. There is no chargeable gain or allowable loss. 2

**Disposal of shares in Theta plc**

	<i>No. of shares</i>	<i>Cost</i>	<i>Cost per Share</i>
		€	€
Bought June 1995	2,500	12,500	5
Bought January 2002	3,000	18,000	3

FIFO rules apply:

	€	€	
Disposal proceeds – 3,000 * €10		30,000	½
Less: Original Cost – June 1995 – 2,500 * €5	12,500		1
<i>Indexation Factor (1995/96)</i>	1.277	(15,963)	½
Less: Additional Shares – January 2002 – 500 * 6	3,000		½
<i>Indexation Factor (2002)</i>	1.049	(3,147)	½
Chargeable gain		<u>10,089</u>	1

(20)

(b) Total gains are €215,985 (€13,040 + €121,600 + €68,256 + €3,000 + €10,089). There are no current-period allowable losses but there are capital losses brought forward of €156,200, reducing the chargeable gains figure to €59,785. (4)

(c) Indexation relief has the effect of eliminating the part of the gain attributable to inflation. It is available to all taxpayers and applies to expenditure incurred up to 2002. It is based on a multiplier applied to deductible expenditure in computing a gain/loss. The multiplier is based on the year in which the asset was incurred if that asset was acquired after 5 April 1974. For all assets acquired prior to 5 April 1974, indexation relief is based on the Market Value of the asset at 6 April 1974 and the rate for 1974/75 is used. Indexation relief also applies to subsequent enhancement expenditure and the rate is the rate applicable to the year in which the enhancement expenditure was incurred. 2

There are exceptions to the general rule on the application of indexation:

- Indexation relief is not available if it has the effect of increasing the loss. In that situation, the actual loss (proceeds less actual cost) is the loss available as a chargeable loss for set off against chargeable gains.
- Indexation relief is not available if the effect is to turn an actual gain on disposal into a loss. In that situation, the disposal is treated as giving "NO GAIN/NO LOSS"

4

(6)

(30)

**Question 4**

- (a) Once the threshold is exceeded, Toucan must register for VAT within 30 days. 1

One consequence of failing to register is that the company would be held liable for the output tax that should have been charged to customers since the date on which registration should have occurred. 1

A further consequence of failing to register is that the company would become liable to a penalty of €1,520. 2

If Toucan register on 10<sup>th</sup> September, registration is effective from the 1<sup>st</sup> day of the bi-monthly period in which the company registered i.e. 1 September 2005. An input credit is not available on the VAT incurred from the date of trading to the date of registration therefore it is advisable for businesses to voluntarily register for VAT as soon as they begin trading. 2

(6)

- (b)

	€	€	
<i>Output tax:</i>			
Standard-rated supplies €28,800 x 97.5% x 21%		5,897	1
Supply invoiced 15/10/05 €4,800 x 21%		1,008	1
		6,905	
<i>Input tax:</i>			
Standard-rated goods €9,280 x 21%	1,949		1
Standard-rated services €5,200 x 21%	1,092		1
VAT on van (not wholly for business use)	1,960		1
Fixed asset €14,100 x 13.5/113.5	2,447	(7,448)	1
VAT refund due from Revenue		(543)	

If the company had been liable to make a payment of VAT to the Revenue, this payment would have been due on 19 November 2005. A VAT invoice must be issued to VAT registered customers by the 10<sup>th</sup> day of the month following the sale. 3

(9)

- (c) **Discount:** Where the consideration actually received in relation to a supply of goods is less than the amount on which tax is chargeable, relief shall be given by repayment. The condition of claiming the relief is that a credit note must be issued in respect of the reduction or discount. 2

**Bad Debt:** As indicated above, the company is accountable for output VAT relating to the sale of €1,600, even though the customer never paid and the debt was then written off. However, a claim may be made for a refund of the VAT lost in relation to a bad debt so long as:

- goods or services have been supplied for a consideration in money and the related output tax has been accounted for to the Revenue and
- the debt has been written off in the books of account 2

Toucan may claim a refund of the VAT lost (€1,600 x 21% = €336).

(4)

(d) Items that must be shown on a VAT invoice (other than those mentioned in the question) include:

- invoice number
- invoice date
- tax point
- VAT registration number of the supplier
- for each invoice item, the amount payable (excluding VAT) and the VAT rate applicable
- the total amount due (excluding VAT)
- the rate of any cash discount available
- the total amount of VAT chargeable.

*1/2 mark for each valid point up to a maximum of (3)*

(e) In applying for membership of a VAT group, the persons concerned must be:

- (i) established in Ireland; and
- (ii) closely bound by financial, economical and organisation skills 2

It should be expedient for Revenue to grant VAT group registration to persons who qualify for reasons of the efficient administration of the tax. 2

*(4)*

(f) A person who joins the cash accounting scheme accounts for output tax in the tax period in which payment is received from the customer and reclaims input tax in the tax period in which payment is made to the supplier. This allows the person to delay the payment of output tax to the Revenue Commissioners until the tax has actually been received from customers, which is beneficial if customers are given extended credit. The scheme also provides automatic relief for bad debts. On the other hand, input tax cannot be reclaimed until that tax has actually been paid to suppliers. 2

A registered person may not join the cash accounting scheme unless at least 90% of their turnover is derived from supplies to non-taxable persons, or the value of their turnover is less than €635,000. 1

A person wishing to account for VAT on a cash receipts from the sale of goods must notify the Revenue of the following;

- The nature of his business
- The percentage turnover derived from supplies to unregistered persons in the previous 12 months (or since trading commenced) and the estimated percentage for the next 12 months
- The amount of his debtors prior to election

The cash receipt basis is not allowed in respect of sales of goods and services between connected persons. 1

*(4)*

**(30)**