

TAXATION

Diploma stage examination

10 December 2007

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 in total **40** marks

The questions in Section B 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)

Hartington Ltd is a UK resident company. Its profit and loss account for the year to 31 December 2006 is as follows (all amounts are gross):

| | | |
|---|----------------|----------------|
| | £ | £ |
| Gross Trading Profit | | 1,964,500 |
| Receivable from other UK companies: | | |
| Dividends | | 18,000 |
| Debenture interest (note 1) | | 15,000 |
| Bank interest receivable (note 2) | | 14,000 |
| Income from property (note 3) | | 26,000 |
| Profit on sale of investments (note 4) | | <u>17,500</u> |
| | | 2,055,000 |
| Less: | | |
| Distribution costs (all allowable) | 52,000 | |
| Administrative expenses (all allowable) | 106,000 | |
| Other operating expenses (note 5) | <u>407,000</u> | <u>565,000</u> |
| Net profit for the year | | 1,490,000 |
| | | 0 |

Notes:

- The debentures were acquired (for non-trade purposes) in 2005. Interest is receivable on 30 June and 31 December.
- Bank interest receivable includes interest of £1,250 which had accrued at 31 December 2006 but which was not paid until 1 February 2007. There was no accrued interest at 31 December 2005.
- The property was let on 1 May 2006 on a 10-year lease for a rental of £2,000 per month, payable in advance on 1 May, 1 August, 1 November, 1 February each year. The figure in the profit and loss account includes a premium of £10,000 which was received on 1 May 2006. There are no allowable expenses in the year to 31 December 2006, but an allowable loss of £6,000 has been brought forward to 1 January 2006.
- The figure for the profit on sale of investments was arrived at as follows:
 - The company sold a chargeable asset in May 2006 (RPI 195.8) for £10,500. It had cost £4,250 in July 2000 (RPI 170.5).
 - A two-thirds interest in a second chargeable asset was sold for £21,250 in October 2006 (RPI 197.8). The asset was originally purchased in September 1998 (RPI 164.4) for £25,000. The value in the remaining one-third interest is £10,000.
- Other operating expenses include the following:

| | |
|-----------------|---------|
| | £ |
| Directors' Fees | 105,000 |

| | |
|--|--------|
| Debenture interest payable (note 6) | 25,000 |
| Patent royalties payable (note 6) | 12,750 |
| Depreciation of tangible fixed assets (note 7) | 74,000 |

6. The debentures were issued and patent royalties payable for trade purposes.
 7. Capital allowances of £37,250 are claimed for the year.
 8. In the year to 31 December 2005, Hartington Ltd paid corporation tax at the marginal rate.
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• **Requirement for question 1**

- | | |
|--|----|
| (a) Compute the company's Schedule D Case I income for the year, briefly explaining your treatment of items in the profit and loss account. | 13 |
| (b) Compute the company's chargeable profits for the year, showing and briefly explaining calculations where necessary. | 16 |
| (c) Compute the company's corporation tax liability. | 4 |
| (d) State the date by which the company's tax must be paid, and comment on the implications if it is paid on 31 December 2007, calculating and explaining any interest due. Use the official rate of interest where appropriate. | 7 |

(40)

SECTION B (Answer two from four questions)**2**

Tom is a 45 year-old company director with a property management company. He receives a salary of £65,000 a year, and a petrol-engine company car with an emission rating of 195g/km, which cost £27,000 when new, and for which all costs are paid by the company.

Tom also receives the following benefits from his employer:

- 1) An interest free season ticket loan of £2,500, and a personal loan of £4,000 on which he pays interest at 4% annually.
- 2) Use of a company flat (non job-related) in London, in which he and his wife live. The flat was purchased by the employer in 2005 for £250,000 and has an annual value of £8,300. The employer immediately paid £17,000 for improvements to be made to the flat, which is now worth £350,000. Furniture which cost the employer £8,500 in 2005 is also provided for their use. During 2006/07, the employer paid £1,400 for weekly cleaners to come to the flat, the heating and lighting bills of £975, insurance of £625, and the council tax of £1,080. All other costs were met by Tom.

In 2006/07, Tom received the following income from his investments (all amounts are net unless otherwise indicated):

| | |
|--|--------|
| Dividends from UK companies | £7,200 |
| Bank interest | £6,800 |
| Premium Bonds winnings | £150 |
| National Savings Bank ordinary account interest (received gross) | £3,400 |
| Building Society interest | £2,100 |

In addition, Tom owns a furnished flat by the sea, which he and his wife use for six weeks a year, and which is rented out for the rest of the year, at a rate of £650 a week. The expenses Tom incurred in 2006/07 in relation to this house were:

| | |
|---|--------|
| Advertising | £2,399 |
| Gardener/handyman's wages @ £100 per week | £5,200 |
| Insurance | £8,000 |
| Council tax | £2,300 |
| Repairs to guttering | £890 |

Tom's wife, Miranda, is 39 years old and was in full-time employment in 2006/07. She is paid a salary of £34,600 per annum (paid at a monthly rate of £2,883.33). She is a member of her employer's contracted-out salary-related (COSR) occupational pension scheme. She does not receive a company car, using her own. Her employer reimburses her at a rate of 48 pence per mile. In 2006/2007 she drove 12,300 business miles. She also had her private medical insurance premium of £550 paid by her employer. In addition, she received £560 (gross) in interest on her National Savings Bank investment account during 2006/07.

Both Tom and Miranda are entitled to the personal allowance.

• **Requirement for question 2**

- | | |
|---|-------------|
| (a) Calculate Tom's income tax payable for 2006/07. | 18 |
| (b) Calculate Miranda's income tax payable for 2006/07. | 7 |
| (c) Calculate the NICs payable by Miranda and her employer for 2006/07. | 5 |
| | (30) |
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- **Requirements for question 4**

- (a) Differentiate between direct and indirect taxes, identifying and briefly explaining the main UK direct taxes. 10
- (b) Discuss the terms 'tax avoidance' and 'tax evasion', giving an example of each. Explain the steps taken by the government and the courts to reduce tax avoidance. 10
- (c) Discuss the viability and equity of charging for private goods and services provided by UK public sector organizations as an alternative to taxation. 10

(30)

SUMMARY OF TAX DATA

Corporation Tax

| | <i>Financial Year 2006</i> | <i>Financial Year 2005</i> | <i>Financial Year 2004</i> |
|---------------------------------|--------------------------------|--------------------------------|--------------------------------|
| Full rate | 30% | 30% | 30% |
| Small company rate | 19% | 19% | 19% |
| Lower limit | £300,000 | £300,000 | £300,000 |
| Upper limit | £1,500,000 | £1,500,000 | £1,500,000 |
| Marginal relief fraction | 11/400 | 11/400 | 11/400 |
| Starting rate | - | 0% | 0% |
| Lower limit | - | £10,000 | £10,000 |
| Upper limit | - | £50,000 | £50,000 |
| Marginal relief fraction | - | 19/400 | 19/400 |
| Non-corporate distribution rate | - | 19% | 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 (medium-sized companies) | 40% |
| Acquired 1 April 2004 to 31 March 2005 | 50% |
| Acquired 1 April 2006 to 31 March 2007 | 50% |

Income Tax

| | | | <i>2006/07</i> | <i>2005/06</i> |
|---|-----|-------|----------------|----------------|
| Starting rate | 10% | First | £2,150 | £2,090 |
| Basic rate | 22% | Next | £31,150 | £30,310 |
| Higher rate | 40% | Over | £33,300 | £32,400 |
| Personal allowance: | | | | |
| Age 0 to 64 | | | £5,035 | £4,895 |
| Age 65 to 74 | | | £7,280 | £7,090 |
| Age 75 or over | | | £7,420 | £7,220 |
| Married couple's allowance: | | | | |
| Age under 75 and born before 6 April 1935 | | | £6,065 | £5,905 |
| Age 75 or over | | | £6,135 | £5,975 |
| Minimum amount | | | £2,350 | £2,280 |
| Income limit for age-related allowances | | | £20,100 | £19,500 |

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>2006/07</i> | <i>2005/06</i> |
|---|----------------|----------------|
| Primary threshold (annual) | £5,035 | £4,895 |
| Secondary threshold (annual) | £5,035 | £4,895 |
| Upper earnings limit (annual) | £33,540 | £32,760 |
| 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) | 9.3% | 9.3% |
| On earnings beyond UEL | 12.8% | 12.8% |

Class 1A National Insurance Contributions

| | <i>2006/07</i> | <i>2005/06</i> |
|----------------------------|----------------|----------------|
| Employer contribution rate | 12.8% | 12.8% |

Value Added Tax

| | |
|---|---------|
| Standard rate (from 1 April 1991) | 17.5% |
| Registration threshold (from 1 April 2006) | £61,000 |
| Deregistration threshold (from 1 April 2006) | £59,000 |
| Fuel quarterly scale charges (from 1 May 2006): | |
| 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 |