

PUBLIC POLICY AND TAXATION

Professional 2 examination 14 June 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.



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

- **Requirement for question 1**

- (a) The two principal tools of economic management are fiscal policy and monetary policy. Distinguish between these, commenting upon the way in which their roles in UK macroeconomic policy have developed over time and the organisations responsible for decisions concerning them. 8
- (b) The overwhelming proportion of the UK government's revenue is raised through direct and indirect taxation. Define, using appropriate examples, each type of taxation, commenting upon the UK administrative responsibility for each. 6
- (c) Define the concepts of progressive and regressive taxation. Explain why UK Income Tax is a progressive tax and why UK Value Added Tax is a regressive tax. 6
- (d) It is frequently argued that should the UK decide to participate fully in the European Union's Economic and Monetary Union, the Government will no longer have the freedom to manage the UK economy. Explain what is meant by this argument, indicating the extent to which you feel it is valid. 5
- (25)

2

Pressure groups are important institutions in modern democratic societies that, in combination, enjoy a larger membership than political parties.

- **Requirement for question 2**

- (a) Define the term "pressure group" and explain how a pressure group differs from a political party. 7
- (b) Distinguish, with examples, the main types of pressure groups in terms of:
- (i) What the groups represent. 5
 - (ii) The groups' strategies and relations with government. 5
- (c) To what extent do you agree with the argument that pressure groups distort rather than enhance democracy. 8
- (25)

3 The introduction, since the 1980s, of a more business-like style of public management has prompted closer UK government attention to issues of ethical behaviour and regulation.

- **Requirement for question 3**

- (a) The Nolan Report (1995) addressed public concern about the declining ethical behaviour amongst politicians and other public figures by setting out the “seven principles for public life” and by providing recommendations for ethical conduct within central government. Outline the “seven principles of public life” laid down by the Nolan Report. 7
 - (b) The privatisation and marketisation of public services have been accompanied by increasing regulation.
 - (i) The main objectives of privatisation and marketisation have been to increase the efficiency and effectiveness of public services. Evaluate, with the aid of examples, the extent to which these objectives have been achieved. 9
 - (ii) Summarise the economic case for regulation. 2
 - (iii) Outline, with the aid of examples, the criticisms that are typically made of the UK regulatory framework. 7
- (25)

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

Dawson Ltd is a UK resident company with no associated companies. It is medium-sized for financial reporting purposes and has always prepared accounts to 31 March annually. The company's profit and loss account for the year to 31 March 2001 shows a net profit of £442,600 *after* the following items of income and expenditure have been accounted for:

	£	Notes
<i>Income:</i>		
Debenture interest (gross)	11,250	1
Dividends received from UK companies	30,150	2
Profit on sale of building	50,000	3
<i>Expenditure:</i>		
Loss on sale of computer	1,600	4
Depreciation	42,700	-
Debenture interest (gross)	9,000	5
Bad debts	23,000	6
Patent royalties (gross)	8,600	7
Legal costs	16,000	8

Notes:

- Dawson Ltd owns £200,000 of 7.5% debentures issued by a UK company. The debentures were acquired (not for trade purposes) on 1 July 2000 and interest is received half-yearly on 30 June and 31 December net of income tax. The figure given in the profit and loss account (gross) is derived as follows:

	£
Received 31 December 2000	7,500
Accrued to 31 March 2001	3,750
	<u>11,250</u>

- The amount shown for dividends received from UK companies is the amount actually received during the year to 31 March 2001, without any adjustment for tax credits.
- Dawson Ltd operates mainly from rented premises but has owned a single factory building since 1994. This factory was sold (and not replaced) on 1 January 2001 for £250,000 (including land £130,000).

The factory was originally built for the company at a cost of £200,000 (including land £90,000) and was first used on 1 July 1994. It was not in an enterprise zone and no initial allowance was claimed. The factory was used continually for industrial purposes until it was sold, apart from a period of non-industrial use between 1 January 1997 and 31 December 1997. The company has always claimed the maximum available industrial buildings allowances.

4. On 1 April 2000, the tax written down values of the company's plant and machinery were as follows:

	£
Main pool	123,200
Short-life asset (computer)	4,130

The computer was sold on 15 December 2000 for £2,300 and replaced on the same date by a new computer (also to be treated as a short-life asset) costing £12,000. Apart from this, there were no disposals of plant and machinery in the year. The only acquisitions made in the year were a delivery van costing £18,000 on 17 April 2000 and a car costing £20,000 on 2 March 2001. The car is used by the company's managing director and private motoring accounts for 50% of the miles driven.

5. The company issued £100,000 of 9% debentures for trade purposes some years ago. Income tax is deducted at source when the debenture interest is paid.

6. Bad debts for the year are as follows:

	£
Trade debts written off	24,000
Staff loan written off	500
Increase in general provision	3,200
Decrease in special provision	(1,000)
Trade debts recovered	(3,700)
	<u>23,000</u>

7. As from 1 October 2000, the company began paying patent royalties, deducting income tax at source from the payments made. The royalties figure shown (gross) in the profit and loss account is derived as follows:

	£
Royalties paid during the year	5,000
Royalties accrued to 31 March 2001	3,600
	<u>8,600</u>

8. Legal costs are as follows:

	£
Debt collection costs	12,500
Fine for breach of health and safety laws	3,500
	<u>16,000</u>

9. The company anticipates that there will be a substantial trading loss in the year to 31 March 2002.

- **Requirement for question 4**

- (a) Calculate the company's corporation tax liability for the year to 31 March 2001 (ignoring the loss which is expected to occur in the following year) and state the date upon which payment is due. Assume RPIs as follows:

July 1994	144.0	
April 1998	162.6	
January 2001	171.1	16

- (b) List the main ways in which the trading loss expected in the year to 31 March 2002 might be relieved and discuss the factors which should be considered when planning how to utilise this loss. 6
- (c) Outline the system of payment of corporation tax by instalments and indicate the types of company to which this system applies. 3

(25)

5

Dorothy is the marketing director of a limited company. She is a full-time working director and she owns no shares in the company for which she works. Her remuneration package is as follows:

1. An annual salary of £50,000.
2. An annual bonus based on the company's profits for the previous accounting year. Dorothy's recent bonuses have been:

	£
y/e 31/12/1999 (received 1 May 2000)	4,570
y/e 31/12/2000 (received 1 May 2001)	5,130

3. A company car available for both business and private use, with all running costs paid for by the company. During tax year 2000/01, the cars supplied for Dorothy's use were as follows:

Dates available	List price	Engine size	Fuel	Business miles driven
	£			
6/4/2000 – 31/8/2000	19,720	1998cc	Petrol	8,000
1/9/2000 – 5/4/2001	20,680	2300cc	Diesel	10,000

Dorothy paid £1,000 towards the list price of each of these cars.

4. A reserved parking space in the company car park.
5. A non-contributory pension scheme. Dorothy's employer makes contributions into the scheme each year equal to 7% of her annual salary.
6. Free lunches in the director's restaurant at a cost to the company of £5 per day for 230 working days in the year. Employees who are not directors are not supplied with free meals.
7. The loan throughout 2000/01 of a computer system for private use (costing £1,500) and camera equipment also for private use (costing £900).
8. Membership of BUPA (providing private medical treatment) at a cost to the company of £540 in 2000/01.
9. Free use of gymnasium facilities provided by the company on its own premises.
10. A personal loan of £2,800 at an interest rate of 2% pa and a mortgage of £70,000 at an interest rate of 3% pa. Dorothy's employer is not a money-lender by trade and the full amount of both loans was outstanding during 2000/01.

During 2000/01, Dorothy also received an award of £2,000 under the company's staff suggestion scheme and the company paid her annual subscription of £300 to the Chartered Institute of Marketing. Dorothy herself spent £560 during the year on clothing to be worn only at work.

- **Requirement for question 5**

- (a) Explain the taxation implications of each element of Dorothy's remuneration package and calculate her Schedule E income for tax year 2000/01. 10
- (b) Compute the National Insurance contributions payable by Dorothy and by her employer for tax year 2000/01. (Dorothy is contracted out of the State Earnings Related Pension Scheme) 2

Dorothy and the company for which she works are now planning to change their working relationship. One suggestion is that Dorothy should become a self-employed marketing consultant providing consultancy services to the company. Another option is that Dorothy should form a company of her own (Dorothy Ltd) of which she would be the sole shareholder and director. Her consultancy services would then be invoiced to her ex-employer in the name of Dorothy Ltd.

- (c) Explain the tests which are used to distinguish between employed and self-employed people for tax purposes and outline the main taxation advantages from which Dorothy would benefit if she were treated as self-employed. 6
- (d) Consider the potential pitfalls and benefits of the idea that Dorothy should form her own personal service company. 7

(25)

6

- (a) From the perspective of economic theory, taxation can be said to have a number of important functions.

- **Requirement for question 6(a)**

List and explain the main functions of taxation, using examples to illustrate each function.

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- (b) The current tax regime is not necessarily the best that could be devised and several alternative systems have been suggested. One proposal is that increased use should be made of “user charges”.

- **Requirement for question 6(b)**

Explain the concept of a “user charge” and discuss the advantages and disadvantages of a taxation system based wholly or partly on user charges.

7

- (c) Danuta is a practising accountant. She is VAT-registered. Her inputs and outputs for the quarter to 31 March 2001 (all excluding VAT) are as follows:

	£
Fees charged to clients	39,000
Rent received from letting spare office space	2,600
General overhead expenses incurred (all standard rated)	7,680

Danuta has a diesel-engined 1,800cc motor car which she uses for both business and private motoring. All fuel is paid for out of the business bank account.

- **Requirement for question 6(c)**

Calculate the amount of VAT payable to Customs and Excise for the quarter.

4

- (d) If a mixture of goods and/or services is supplied together at a single inclusive price, it may be difficult to determine the rate of VAT which should be applied to this supply.

- **Requirement for question 6(d)**

Explain how the amount of VAT which should be charged in relation to such a supply is determined.

3

(25)

SUMMARY OF TAX DATA**Corporation Tax**

	<i>Financial Year</i> 2000	<i>Financial Year</i> 1999	<i>Financial Year</i> 1998
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: $\text{fraction} \times (M-P) \times \frac{I}{P}$

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

			<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

6.25%

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
Fuel quarterly scale charges (from 6 April 2000):	
Petrol engines:	
up to 1,400cc	£38.12
up to 2,000cc	£48.40
2,001cc or more	£71.19
Diesel engines:	
up to 2,000cc	£34.55
2,001cc or more	£43.93