TAXATION
REPUBLIC OF IRELAND

Diploma stage examination

12 June 2006

From 2.00pm to 4.00pm
plus ten minutes reading time from 1.50pm to 2.00pm

Instructions to candidates

*Answer **three** questions in total: **One** question 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.

Where a question asks for a specific format or style, such as a letter or report, 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.

AT THE HEART OF
YOUR CAREER

SECTION A (Compulsory)

1 Rushcliffe plc is a large company as defined by the Companies Acts and is Irish resident. Until recently, the company prepared annual accounts to 31 August but the accounting date has now been changed to 31 December. The following information relates to the 16-month period from 1 September 2004 to 31 December 2005:

	€	*Notes*
Trading profit	864,800	1, 2, 3
Property income received	49,000	4
Loan interest received	nil	5
UK dividends received	54,000	6
Gift Aid donations	10,000	7

Notes:

1 The trading profit is stated *after* deducting depreciation of €194,000 but *before* deducting capital allowances. All of the expenses taken into account when computing the trading profit before depreciation are allowable under the rules of Schedule D Case I. Maximum capital allowances are always claimed.

2 On 1 September 2005, the company bought a brand-new factory building and immediately began using this building for industrial purposes. The building's cost of €750,000 was made up as follows:

	€
Land	250,000
Factory	360,000
General offices	140,000
	750,000

This building is not the subject of any special capital allowances regime.

3 On 1 December 2002 the company purchased the following assets

	€
General plant and machinery	308,167
Lexus motor car	46,000
MG motor car	23,000
Computer Equipment	71,167

There were no further purchases or disposals until the following which occurred in the the 16-month period to 31 December 2005 as follows:

Bought:		€
September 2004	Citroën motor car	10,700
October 2004	Mercedes motor car	56,100
January 2005	Peugeot motor car	13,600
May 2005	Motor lorry	45,000
August 2005	Machinery	63,800
November 2005	Assembly Equipment	15,000

Sold:		€
October 2004	Lexus car	30,000
February 2005	Computer Equipment (cost €42,700)	29,500
July 2005	General Machinery (cost €1,000 in 2002)	1,200
August 2005	Machinery (cost €10,000 in 2002)	3,400

All the assets sold were purchased during the period ended 31 August 2003

The Peugeot motor car bought in January 2005 was a low-emission car (with an emission rating of less than 120 g/km).

4 On 1 April 2005, the company began leasing spare office space to a tenant at a rent of €2,000 per month. The lease was for five years and the first year's rent was received in advance on 1 April 2005. On the same day, the company also received a premium of €25,000. No expenses were incurred in relation to this lease during the period to 31 December 2005.

5 On 1 August 2005, the company lent the sum of €1 million to another Irish company at an annual interest rate of 6%. Interest is receivable on 1 February and 1 August each year. No interest was received in the period to 31 December 2005. The borrowing company took a tax deduction for interest of €25,000 paid in the five month period 1 August 2005 to 31 December 2005.

6 The company receives preference dividends of €27,000 on 1 October each year. This is the amount actually received, without adjustment for tax credits.

7 A donation of €10,000 is made on 1 June every year to an approved charity.

8 The company's only chargeable disposals during the period to 31 December 2005 were as follows:

(i) On 31 July 2005, the company sold one hectare of freehold land (with planning permission for residential development) for €1.5 million. This was part of a plot of five hectares which the company had bought in December 1975 for €120,000. The value of the remaining four hectares on 31 July 2005 was €750,000.

(ii) On 10 November 2005, the company sold an antique desk (which had been used in the Chairman's office) for €8,400. The desk was originally bought for €2500 in June 1985.

9 Capital losses brought forward at 1 September 2004 were €74,400. There were no trading losses brought forward.

10 Chargeable profits for the year to 31 August 2004 exceeded €2 million.

- **Requirement for question 1**

(a) Distinguish between a period of account and an accounting period for corporation tax purposes and explain when an accounting period is usually deemed to end. Hence, explain why the 16 months to 31 December 2005 must be split into two accounting periods and identify these two accounting periods. *4*

(b) For each of the two accounting periods which make up the 16 months to 31 December 2005:

(i) Compute the industrial buildings allowance which may be claimed by the company.

(ii) Compute the plant and machinery capital allowances which may be claimed by the company. *13*

(c) Compute the chargeable gains or allowable losses arising on the disposal of the freehold land and the disposal of the antique desk and explain whether it would be possible for Rushcliffe Plc to claim rollover relief on its chargeable gains. *6*

(d) Compute the company's corporation tax liability for each of the two accounting periods which make up the 16 months to 31 December 2005. In each case, state the date (or dates) on which this corporation tax is due for payment. *17*

(40)

SECTION B (Answer two questions from this section)

2 Steven was born on 1 February 1942 and is a director of Southern Trading Ltd. His basic salary in the 2005 tax year was €52,000. He was entitled to receive a bonus of €10,000 on 30 November 2005 but payment of this bonus was delayed (because of an administrative error) until 15 January 2006.

The following information relates to the benefits received by Steven from Southern Trading Ltd (in addition to his salary and bonus) during 2005:

(i) Since 1 July 2001, he has lived rent-free in a house which is provided by the company. This house cost the company €100,000 in 1992 and was valued at €225,000 on 1 July 2001. This valuation increased to €600,000 in January 2005.

According to a local auctioneer the annual market rent of this house is €14,400.

The company refurnished the house at a cost of €18,500 in 2004 and pays all ancillary costs such as heating, lighting, cleaning etc. These ancillary costs amounted to €4,355 in 2005. Steven's occupation of the house is not job-related.

(ii) He receives free meals in the directors' dining room. In 2005, these meals cost the company €5 per day for a total of 240 working days. Employees who are not directors are not entitled to free meals.

(iii) He does not have a company car but receives a mileage allowance of 60c per mile when he uses his 1400 c.c. VW Golf car on business trips. During 2005, his business mileage amounted to 15,000 miles.

(iv) He has a reserved parking space in the company's car park. It is estimated that it would cost €50 per week to rent a similar space in a commercial car park.

(v) He has a company loan on which interest is charged at 2.4% per annum. The amount owing at 1 January 2005 was €24,000. Steven repaid €6,000 of this loan on 1 June 2005 and a further €12,000 on 1 December 2005. The remainder of the loan was repaid in January 2006.

(vi) He received an award of €1,000 from the company's staff suggestion scheme in November 2005.

Steven's only income in 2005 was his employment income. He paid 10% of his basic salary into the company's occupational pension scheme during the year but otherwise incurred no expenses in relation to his employment.

Steven's wife Suzanne was born on 8 March 1935. Her income for the 2005 tax year was as follows:

	€
NIB investment account interest	95
Net building society interest	4,960
Irish dividends received	61,200

Steven and Suzanne have jointly elected that the married couple's tax credit for 2005 should (insofar as the law allows) be allocated to Suzanne. All other allowances and credits should be allocated equally between Steven and Suzanne.

An Income Tax return form in Stevens name was received by him at his home received in mid-Feb 2006. Neither Suzanne nor Steven has had time to complete the form and therefore the Return form has not been submitted to the Revenue Commissioners.

Neither Steven nor Suzanne has ever made any donations to an Approved Charity or Sports Body in the past but they are thinking of doing so in the near future.

- **Requirement for question 2**

(a) Calculate the amount of income tax borne by Steven in the 2005 tax year. If any of his employment income is not taxable, explain why this is the case. *11*

(b) List the types of expenses which are deductible from employment income for tax purposes. *5*

(c) Calculate the amount of income tax payable by Suzanne for 2005. *8*

(d) In relation to Suzanne's tax return for 2005, state the date or dates:

(i) by which the return must be submitted to the Revenue Commissioners

(ii) by which tax payable in relation to 2005 must be paid over to the Revenue Commissioners

(iii) until which the Irish Revenue Commissioners may initiate an enquiry into the return. *2*

(e) Briefly explain the tax relief available to a PAYE individual who makes a donation to an approved body. Provide an example of the total monetary benefit of the donation to the Approved Charity. *4*

(30)

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3 A "taxable person" for VAT purposes is required to register for VAT with the Revenue Commissioners and then make periodic VAT returns. A VAT return generally shows the input tax and output tax charged during the period to which it relates. Generally, VAT is accounted for on an invoice basis but some taxable persons may account for VAT on a cash basis instead.

Sanjay began trading on 1 February 2005, selling goods and services at the 21% VAT rate (90% of his turnover is derived from the sale of goods). He decided not to register for VAT voluntarily. His turnover (excluding VAT) for the first 16 months was as follows:

2005	**€**	**2006**	**€**
February	1,450	January	6,680
March	2,560	February	6,920
April	2,780	March	5,780
May	3,140	April	5,100
June	3,660	May	4,890
July	4,190		
August	4,330		
September	5,220		
October	6,310		
November	6,950		
December	7,170		

In January 2006, he sold a machine (which had been used as a fixed asset) for €800. This is *not* included in the above turnover figures.

Sanjay's sales are mostly made on credit terms and he is worried about the possibility of incurring bad debts. He is also worried that his monthly turnover has started to fall and he is considering offering customer discounts in an attempt to reverse this trend.

- **Requirement for question 3**

(a) Explain the term "taxable person" for VAT purposes. *3*

(b) State the circumstances in which VAT registration is compulsory and explain why some persons may choose to register voluntarily. *5*

(c) Outline the main features of the cash accounting scheme. *4*

(d) In what circumstances, if any, may a person's authorisation to account for VAT on a cash basis be cancelled? *2*

(e) State the date by which Sanjay would be required to register for VAT. If his monthly turnover for the remainder of 2006 seemed likely to continue on a downward trend? *8*

(f) In what circumstances can a person deregister? *3*

(g) Explain how the VAT system deals with bad debts. *3*

(h) Explain the VAT consequences which would ensue if Sanjay began offering trade discounts or cash discounts to his customers. *2*

(30)

4

(i) The sale of an asset by a limited company may be treated as a trading transaction giving rise to a trading profit or loss. Alternatively, the sale may be treated as a chargeable disposal giving rise to a chargeable gain or allowable loss. In either case, any resulting profit or gain is charged to corporation tax. A set of tests known as the "badges of trade" is used to distinguish between trading and non-trading activities.

(ii) The main purpose of taxation is generally seen to be that of raising revenue to fund public expenditure. However, economists would suggest that taxation has a role to play in connection with the following matters:

- the correction of market failure
- the redistribution of wealth
- the stabilisation of the economy

(iii) Governments seeking an alternative to taxation as a means of raising revenue might consider charging for some of the goods and services provided by the public sector. So-called "user charges" have certain advantages and disadvantages when compared with taxation.

- **Requirement for question 4**

(a) Explain why it is important to distinguish between trading transactions and chargeable disposals. List and explain the badges of trade which are used to make this distinction. *13*

(b) Explain (with appropriate examples) the way in which taxation might play a role in the correction of market failure, the redistribution of wealth and the stabilisation of the economy. *10*

(c) Explain the concept of "user charges" and discuss the advantages and disadvantages of such charges as an alternative to taxation. *7*

(30)

SUMMARY OF TAX DATA

Corporation Tax

	Financial Year 2005	*Financial Year 2004*	*Financial Year 2003*
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%	0%
Lower limit	€10,000	€10,000	€10,000
Upper limit	€50,000	€50,000	€50,000
Marginal relief fraction	19/400	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	40%
Acquired 1 April 2004 to 31 March 2005	50%

Income Tax

			2005/06	*2004/05*
Starting rate	10%	first	2,090	€2,020
Basic rate	22%	next	30,310	€29,380
Higher rate	40%	over	32,400	€31,400

	2005/06	2004/05
Personal allowance:		
Age 0 to 64	4,895	€4,745
Age 65 to 74	7,090	€6,830
Age 75 or over	7,220	€6,950
Married couple's allowance:		
Age under 75 and born before 6 April 1935	5,905	€5,725
Age 75 or over	5,975	€5,795
Minimum amount	2,280	€2,210
Income limit for age-related allowances	19,500	€18,900

Car benefit

Emission rating	*Taxable percentage of list price*
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	*first 10,000 miles per year*	*miles in excess of 10,000*
Motor cars and vans	40p	25p
Motor cycles	24p	24p
Bicycles	20p	20p

Class 1 National Insurance Contributions

	2005/06	*2004/05*
Primary threshold (annual)	€4,895	€4,745
Secondary threshold (annual)	€4,895	€4,745
Upper earnings limit (annual)	€32,760	€31,720
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

	2005/06	*2004/05*
Employer contribution rate	12.8%	12.8%

Value Added Tax

Standard rate (from 1 April 1991)		17.5%
Registration threshold (from 1 April 2005)		€60,000
Deregistration threshold (from 1 April 2005)		€58,000
Fuel quarterly scale charges (from 1 May 2005):		
VAT due per car:		
Petrol engines:	up to 1,400cc	€36.64
	up to 2,000cc	€46.32
	2,001cc or more	€68.06
Diesel engines:	up to 1,400cc	€35.15
	up to 2,000cc	€35.15
	2,001cc or more	€44.68