TREASURY AND TAX MANAGEMENT

Professional 2
June 2001

MARKING SCHEME

Question 1

(a) Both models depend upon the same relationship between variables but differ in the particular content recognising the conflict between two factors. *1*

EOQ-cost per order, storage cost per unit and annual demand for the item. *2*

Baumol – transaction cost on each occasion, interest payable on deposit and cash payments in a year. *2*

(5)

(b) Just in Time (JIT) implies efficient inventory management in which customer demands are met through good communication/integration with suppliers, who provide materials/components/goods/services at the time and place they are needed. *3*

This avoids the need for substantial inventory although short term needs must be considered. *2*

Perishability of inventory must be considered, especially in a health context, where many supplies have limited "lives".

2 marks for relevant example
(Up to a maximum of 2)

(7)

(c) Organisations do not pay at a steady rate. Cash flows fluctuate even to positive and negative net figures. *1*

Miller-Orr – recognises that cash flows are not completely predictable. It allows for the specification of an upper and lower limit to cash balances. At the upper limit, the organisation will deposit cash. At the lower limit, the organisation will withdraw cash from deposit. *2*

The determination of the upper and lower limits to which cash balances will be allowed to fluctuate depends upon daily variability, the transaction costs associated with placing and withdrawing cash from deposit and the prevailing interest rate. *2*

Problems associated with using cash management models:

- Training of staff/knowledge of models
- Assumptions within models
- Time and cost to collect data *2*

(7)

(d) The Baumol model must be used given the data supplied. *1*

Optimal amount of cash injection = $\sqrt{\dfrac{2 \times 10 \times 2{,}650{,}000}{.05}}$ = £32,558 *1*

This will be required $\dfrac{£2{,}650{,}000}{£32{,}558}$ = 81 times per annum or every 4.5 days *1*

(3)

(e) The EOQ model must be used.

The cost of storing one lock must be established = $\dfrac{£50{,}000}{15{,}000}$ = £3.33 and $\dfrac{£3.33}{50}$ = 6p *1*

EOQ = $\sqrt{\dfrac{2 \times \text{cost of one order} \times \text{Annual Demand for the locks}}{\text{Cost of storing one lock}}} = \sqrt{\dfrac{2 \times 20 \times 10{,}000}{.06}}$

EOQ = 2,581 units *1*

Frequency of ordering = $\dfrac{10{,}000}{2{,}581}$ = 3.87 timers per year. $\dfrac{365}{3.87}$ = every 94 days *1*

(3)

(25)

Question 2

(a)

Principles of PFI

- It is a mechanism for the public sector to secure improved value for money in partnership with the private sector.
- Attracts funding from the private sector.
- Attracts expertise from the private sector.
- Allows greater opportunity for public sector organisations to undertake capital projects as historically there has been an environment of tight public expenditure controls.
- It is a partnership between the public and private sectors.
- VFM is the overriding principle. *6*

Projects funded by PFI

- Schools, hospitals, IT projects, housing repairs, MOD garrisons, central government department offices, street lighting.

½ mark per example given up to max of 2
(8)

(b)

Advantages

- Transfer of risk to the private sector where they are perceived to be more capable of managing them – but ultimately all risks are included in the overall cost of the project.
- Private sector has no restrictions other than market capacity when raising finance from the markets – but public sector market opportunities are available and arguably cheaper.
- Efficiency gains can be achieved from private sector management experience but there is increased training and awareness in the public sector.
- Recognition that neither central/local government will in isolation be able to finance all the investment needed – agreed due to Government policy – Governments may change.

Disadvantages

- Costly from a public sector pocket to procure/manage – but gradually this issue is reducing due to standardisation of processes etc.
- Accounting treatment has been seen to take precedence over VFM – although this is now reversing.
- Lack of experience in public sector organisations therefore reliance on consultants – but increased expertise in public sector is reducing this trend – improved role of 4P'S and PUK.
- Ultra vires issue – judgements have cleared this issue significantly.
- Often seen as the only partnership option and certainly seen to be favoured by government departments.

8 marks for points raised – extra 2 marks if student has discussed rather than listed the issues

(10)

(c)

- Bates review was designed to reinvigorate PFI.
- It was requested by the Treasury. *1*

Recommendations

- Standardisation of contracts.
- Standardisation of documentation of the key stages of the procurement process.
- Government should make a firm commitment to PFI.
- Clear division of responsibilities within Central Government.
- Training of staff - key skills/secondments etc.
- Accreditation of consultants.
- Encourage the grouping of schemes to increase bankability.
- Accounting treatment must be clarified.
- Minimise bidding costs for private sector by better scoping of project definition and clearer specifications.

1mark per issue discussed up to a maximum of 6 marks
(7)

(25)

Question 3

(a)

Public Sector	Private Sector	
Risk Averse	Risk Taking	*2*
Primary objective to avoid risk	Treasury management may be a profit centre required to contribute to profit, eg by management of foreign currency	
Stewardship of public finances		
Legislation governing activities will effect attitude to risk		*4*
		(6)

(b) Types of risk

Liquidity: Risk that insufficient funds are available to place the investment and that once the investment is made, insufficient monies will be available to meet other commitments.

Credit: Risk that the institution with which the investment is placed will not be able to repay the loan on maturity.

Legal: The organisation placing the loan does not have the legal authority to do so.

Interest Rate: The risk that movements in interest rate during the period of the loan result in the amount of interest received or paid is less/more that potentially available.

Inflation rate: the risk that movements in inflation rate during the period of the loan effect the value of capital invested at a given interest rate.

Procedures of systems: Risk that the organisation has inadequate procedures in place to ensure loan is placed, accounted for and dealt with correctly on maturity.

2 marks for correct identification and description of each risk
Up to a maximum of 8

(c) **Liquidity:** provision of full and timely information relating to treasury management and compiling frequent and accurate cashflow forecasts will ensure only surplus sums are invested for an appropriate period.

Credit: Decisions on where surplus funds can be invested should be properly authorised and documented and according to a laid down policy eg investments can only be made with Institutions with a given credit rating. Use should be made of credit rating agencies if appropriate.

Legal: The Treasury Manager should be made aware of all legislation relating to investment decision in the particular type of organisation. The information should remain up to date and legal advice sought on areas where uncertainty exists.

Interest Rate and Inflation Rate: The Treasury Manager should ensure they have relevant and up to date information on interest rate trends and inflation rate targets and indices when making investment decisions. The Treasury manager should receive adequate training to allow him/her to understand specialist financial information and should keep up to date with information by reading daily newspapers and periodicals relevant to investments.

Up to 2 points per risk, with a maximum of 4

(d) The purpose of the Codes of Practice is to provide CIPFA members working in the Treasury Management functions in a variety of organisations with **statements of best practice**. The aim of the codes is to support the **quality and status** of treasury management and provide **guidance on proper practices**. The guidance recommends adopting several clauses as part of **standing orders or financial regs**. For example the adoption of a treasury policy statement that requires the Chief Financial Officer to assume responsibility for the treasury management function.

Statements of Professional Practice serve to define **individual members' professional obligations** and may be enforced through the Institute's disciplinary **procedures**. The SOPP requires members with responsibility for treasury management to take reasonable steps to ensure that:

- They and their staff have the appropriate **skills and competencies** required and are familiar with best practice and guidance.
- Ensure that **financial control systems and procedures** are in place to define, measure and control treasury risks.
- **Performance is monitored**
- Activities are **accounted for in accordance with accounting practice** and adequate records maintained.
- **Responsibilities** within the treasury management function are **properly defined and allocated.** *7*

(25)

Question 4

4(a) **Pyrogem Ltd**

Corporation tax computation: 6 months ended 30 June 2000

	£	
Schedule D Case 1 trading profit (W1)	24,340	*1*
Chargeable gain	1,550	½
Profits chargeable to corporation tax	25,890	½

		3 months to 31.3.00 FY99	3 months to 30.6.00 FY00	
PCTCT		12,945	12,945	*1*
FY99	20%	2,589		
FY00	20%			
			2,589	
Corporation tax payable			5,178	*1*

Workings

W1 Schedule D Case 1 profit

		£	£	
Net profit per accounts			22,940	½
Add:	Depreciation – not w & e		4,960	½
	Lease premium – special rules (see W3)		1,000	½
	General entertaining – never allowable		4,180	
	Legal fees (only allow for renewal of short lease)		350	½
			33,430	*1*
Less:	Capital Allowances (W2)	6,620		½
	Lease amortisation (W3)	920		½
	Chargeable gain	1,550		½
			9,090	
			24,340	

W2 Capital Allowance calculation

		General Pool	Expensive Car	Total	
		£	£		1
Additions not qualifying for FYA WDA			32,000		2
25% X 6/12			1,500 max	1,500	1
Additions qualifying for FYA					
Computer system	7,000				
Office equipment	5,800				
FYA 40%	12,800				
	5,120	7,680		5,120	1 ½
Balance at 30 June 2000		7,680	30,500		
Total allowances				6,620	½

W3 Lease premium calculation

10,000 – [£10,000 x [2% (5-1)]]	£10,000 - 800	£9,200/5 x ½	£920	2

Items W & E for the purpose of the trade:

Redecoration – assume after use of the building OR relates to pre-purchase wear and tear (alternative assumption okay if reason given) *1*

Travel expenses – okay provided the trip is for business *1*

Trade magazines – key is trade related *1*

Gentleman's club – allow for D1 but will be taxed under E in hands of director *1*

Other legal fees – all relate to functions of the business *1*

(19)

(b)

(i) A CT600, company's tax return must include a self assessment of any tax payable. A return may also be required to include other information, accounts and reports. *½*

A company that does not receive a notice requiring a return must, if it is chargeable to tax, notify the Revenue within 12 months of the end of the accounting period. *½*

Failure to notify the revenue results in a maximum penalty equal to the tax unpaid 12 months after the end of the accounting period; *1*

(ii) There is £100 penalty for failure to submit a return on time, increasing to £200 if the delay exceeds 3 months; *1*

An additional tax geared penalty is applied if a return is more than 6 months late. The penalty is 10% of the tax unpaid 6 months after the return was due and 20% of that tax if the return is over 12 months late; *1*

(iii) Large companies must make quarterly payments on account of their corporation tax liability. The system is being phased in over a four-year period. For the first accounting period ending after 30.6.99, a large company paid 60% of its corporation tax by 4 equal instalments, each of 15%, with the remaining 40% as a balancing payment 9 months after the accounting end. Then:
72% in instalments (4 x 18%), 28% as a balance in year 2
88% in instalments (4 x 22%), 12% as a balance in year 3
100% in instalments (4 x 25%) *2*

(6)
(25)

Question 5

(a)

Registration

Compulsory registration

A person making taxable supplies becomes liable to register for VAT if, in any period of up to 12 consecutive calendar months, the value of his taxable supplies (excluding VAT) exceeds £52,000 (from 1 April 2000 onwards). *1*

The person is required to notify HM Customs & Excise within 30 days of the end of the 12-month period. HM Customs & Excise will then register the person with effect from the end of the month following the 12 month period, or from an earlier date if they and the trader agree. *2*

Registration under this rule is not required if HM Customs & Excise are satisfied that the value of the trader's taxable supplies (excluding VAT) in the year starting at the end of the 12 month period will not exceed £50,000 (from 1 April 2000 onwards). *1*

A person is also liable to register at any time if there are reasonable grounds for believing that his taxable supplies (excluding VAT) in the following 30 days will exceed £52,000. HM Customs & Excise must be notified by the end of the 30-day period and registration will be with effect from the beginning of that period. Supplies at £8,000p.a – at end of 7th month, statutory limit is breached and a registration application must be made. *3*

When determining the value of a person's taxable supplies for the purposes of registration, supplies of goods and services that are *capital assets* of the business are to be disregarded, except for non-zero rated supplies of interests in land. *1*

Notification of liability to register must be made on form VAT 1. Simply writing to, or telephoning, a local VAT office is not enough. On registration the VAT office will send the trader a certificate of registration. *1*

Penalties

Late notification

A trader who makes taxable supplies is obliged to notify HM Customs & Excise if supplies exceed the registration limit. A penalty can be levied for failure to notify a liability to register by the proper date. In addition, the VAT which would have been accounted for had the trader registered on time must be paid. *2*

The penalty for late notification is based on the net VAT due from the date when the trader should have been registered to the date when notification is made or, if earlier, the date on which HM Customs & Excise become aware of the liability to be registered. The rate varies as follows.

Number of months registration late by	*% of VAT*
Up to 9	5%
Over 9, up to 18	10%
Over 18	15%

1

A minimum penalty of £50 applies.

Criminal fraud

Where a person knowingly takes steps to evade VAT this amounts to criminal fraud. The penalty for criminal fraud depends on whether the conviction is summary (by magistrates) or on indictment (by a jury). On summary conviction the maximum term of imprisonment is six months, and the maximum fine is the greater of £2,000 and three times the VAT involved. On conviction on indictment the maximum term of imprisonment is seven years and the level of fine is unlimited. *1*

Conduct involving dishonesty (civil fraud)

This arises where a person dishonestly takes steps, or omits to take steps, in order to evade VAT. Failing to provide any information, failing to register, and therefore failing to make any VAT statement, and providing false information can count. The penalty for civil fraud is 100% of the tax involved. This may be mitigated by up to 100% in recognition of co-operation given by the trader during the investigation into the true VAT position. HM Customs & Excise need only show on the balance of probabilities that the conduct took place, whereas criminal fraud must be proved beyond reasonable doubt. *2*

Marks will be awarded for other penalties if correctly included.

(15)

(b) Functional test:
Qualifying – plant actively used in the business
Non qualifying – setting in which the business is carried on. *2*

To define plant students may quote from:

(i) Movable partitions have been held to be plant and machinery, not being part of the setting in which the business is carried on, because they are movable.

(ii) Canopy over petrol stations – not allowable, because part of the setting rather than actively employed.

(iii) Barrister's library of books – held to be plant in Munby v Foolong.

(iv) Fire safety expenditure – statutorily allowed for capital allowances as if plant and machinery.

(v) Drawing offices – quality for industrial buildings allowance if associated with an industrial operation, otherwise not qualifying.

(vi) Office accommodation – allowed for industrial buildings allowance up to maximum of 25% of cost. Above that limit, no allowance.

(vii) Computer software – statutorily allowed for capital allowances as if plant and machinery.

(viii) Swimming pools – held to be plant and machinery (proided, of course, that the trade involves customers using the pool).

1 mark per item, plus 2 extra for fullness of answers.

(ix) Bradley v London Electricity Plc1996
Electricity sub station *not plant*

(x) Leeds Permanent Building Society v Proctor 1982
Free standing decorative screens *Plant*

(xi) Brown v Burnley Football and Athletic Co. Ltd. 1980
Football club spectator stand *not plant*

(xii) Cooke v Beach station Caravans Ltd 1974
Swimming pool *plant*

(xiii) Hampton v Fortes Autogrill Ltd 1979
False ceilings *not plant*

(xiv) CIR v Scottish and Newcastle Breweries Ltd 1982
Light fittings, decor and murals *plant*

(xv) Cole Brothers Ltd v Phillips 1982
General lighting *not plant*

(Other relevant cases will be recognised)
½ mark for case and ½ mark for demonstrating a distinction with other cases

Up to a maximum of 8

(10)
(25)

Question 6

(a)

(i) Loss options available therefore Y to use Loss
393 (1) – carry forward against first available Trading Profit of the sale trade
393 A1a – total profits of loss making CAP
393 A1b – carry back 12 month – total profit less trade charge *3*

Group Loss – only for co-termines CAP's
On to X
Transfer all/part of loss to X
(not Z as not in 75% group) *3*

If any part of loss relates to capital loss then also pass to X *2*

Use loss effectively:

X is marginal 'Company' therefore use first £80k of loss to bring X to SCR *2*

(ii)

- Transfer asset between CGT groups
  No gain – no loss = auto offset of gains and losses - also not VAT *3*
- Relief for replacement of business asset between group companies *2*
- Relief only available for prescribed categories of asset –
  - 4 year window
  - Gain rolled over *3*
- Select 'asset owning company' to optimise benefit of capital allowances *2*

Note: Give up to 5 marks if general chargeable gains points are raised in 6 (a)(i)

(20)

(b) General discussion of the major charge role:

- Each case is different
- Wholesaler to retailer
- Change in size of operation
- Significant change in move of business operation
- Stops carry forward and carry back of losses
- Can create unreliable losses
- Care needed in tax planning

Up to 1 ½ mark per valid point up to a maximum 5

(25)