TREASURY AND TAX MANAGEMENT

Professional 2 examination
9 June 2000

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 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.

Formula sheets, statistical tables, graph paper and cash analysis paper are available from the invigilator, where applicable.

SECTION A (Answer two questions)

1 Lowtown Transport purchases glass panels for bus shelter maintenance. It uses 4,000 panels per annum. It is considering purchasing larger quantities to obtain quantity discounts. This will have the effect of reducing the frequency of placing orders but will increase administrative costs. The present and proposed systems are compared below:

	Present	**Proposed**
Cost of ordering (£)	50	100
Purchase price per panel (£)	5	4
Annual stockholding cost as % of purchase price (%)	10	10

The warehouse will need to be reorganised at a cost of £20,000.

- **Requirement for question 1**

(a) Identify the impact on the Economic Order Quantity (EOQ) of the proposed change. *6*

(b) Consider whether the change of ordering policy can be justified. *12*

(c) Critically evaluate the use of the EOQ model in the context of cash management in a public sector application with which you are familiar. *7*

(25)

2

- **Requirement for question 2**

(a) Describe the term 'money markets', differentiating between short-term and long-term money markets. *5*

(b) Explain the role of discount houses within the money markets and the role of the Bank of England. *4*

(c) Explain why there is more volatility in the overnight interest rates offered within the money markets than the long-term interest rates. *3*

(d) Describe what gilt-edged securities are and explain how returns are identified, including reference to the gilt repo market. *10*

(e) Explain what the 'London Code of Conduct' is and what it requires. *3*

(25)

3

(a)

You work in the Treasury Management section of a local authority. One of your duties is to compile a report to the finance committee reporting on the performance of the external investment managers employed to invest the authority's pension fund.

You receive a message that a newly elected member of the committee would like an explanation of the some of the terms in your report. The councillor has asked to see you before the committee meeting this evening.

- **Requirement for question 3a**

Prepare a set of notes that will help you explain the following terms to the councillor:

- Asset allocation;
- Pooled vehicles;
- Active management;
- Passive management;
- Balanced portfolio; and
- Performance measurement and benchmarking. *12*

(b)

The Chief Executive of your authority is particularly interested in governance issues and is attempting to develop an ethical code for the authority as a whole.

- **Requirement for question 3b**

Prepare a briefing note explaining why CIPFA's Code of Practice for Treasury Managers has been adopted by your section and how this could fit into an authority-wide code. *13*

(25)

SECTION B (Answer two questions)

4

Jones Ltd is a UK resident manufacturing company. It commenced trading on 1 June 1998 and has no associated companies.

The profit and loss account for the period to 31 March 1999 showed a profit before taxation of £360,000. The following items were included in the accounts:

Income

	£	
Rental income	26,600	
Patent royalties (received on 23 December 1998)	9,000	(gross amount)
Bank interest (received on 28 February 1999)	6,500	

Expenditure

Loan interest paid (non-trading purpose)	7,900	(gross amount)
Loan interest paid (trading purpose)	2,000	" "
General expenses	4,837	
Depreciation	14,200	
Directors' remuneration	63,600	

The general expenses comprised the following:

Entertaining customers	969	
Charitable deed of covenant for four years (The deed was paid on 1 September 1998)	1,000	(gross amount)
Hire purchase interest on two new fork lift trucks	783	
Christmas gifts to customers: 200 executive desk diaries bearing the company's name	2,085	
	4,837	

The company has traded in a purpose built unit since it commenced on 1 June 1998. The total cost of the unit was made up as follows:

	£
Manufacturing area	240,000
Design office	90,000
General office	70,000
Canteen	30,000
Freehold land	50,000
	480,000

The unit was not situated in an enterprise zone.

On 1 June 1998, the following capital purchases were made:

- New machinery, with an expected useful life of 30 years, costing £140,000.
- Four cars for the salesmen, at a total cost of £40,000 (each car cost £10,000).
- A new car costing £18,000 for the managing director.
- Plant costing £65,000 which was expected to last approximately eight years.
- A new precision engineering machine for £90,000; it was expected that the machine would be obsolete within three years and the appropriate election was made for de-pooling.

On 1 March 1999 the following acquisitions and disposals were made:

- one of the salesmen's cars was sold for £10,500;
- plant (expected to last for seven years) was purchased at a cost of £14,000.

Notes

1 The company qualifies as being "small/medium" for the purposes of the first year allowance.
2 The loan interest paid on both the non-trading loan and the trading loan was paid on 1 March 1999.

- **Requirement for question 4**

(a) Calculate the mainstream corporation tax payable for the year ended 31 March 1999, stating the date that the tax will be due for payment. *17*

(b) Show the entries to be made in the quarterly returns for income tax, stating the date(s) that the tax is due. *5*

(c) Explain the ways in which a company can set off a non-trading loan deficit on its loan relationships. From the information given for Jones Ltd above, how would you advise the company to use a non-trading loan deficit? *3*

(25)

5

(a)

Since 1975, Ceptor Ltd has owned 75% of the issued ordinary share capital of Drag Ltd and 75% of that of Pull Ltd, with Pull Ltd owning 75% of Brush Ltd. All the companies have an accounting year end of 31 March.

On 1 October 1999, Brush Ltd acquired a building at a cost of £650,000.

On 1 January 1997, Ceptor Ltd disposed of a building for £700,000 which had cost £180,000 in 1980. The market value at 31 March 1982 was £250,000. No election had been made to base all asset disposals on their value at 31 March 1982.

- **Requirement for question 5a**

Calculate Ceptor Ltd's potential corporation tax liability and discuss the options it can consider within the group with regard to the above transactions. *8*

(b)

Choice Ltd has owned 60% of the issued ordinary share capital of Cooper Ltd since its incorporation, the remaining 40% being held by Miss Cooper. Both companies have always prepared accounts to 30 June, their most recent accounts showing the following:

	Choice Ltd		**Cooper Ltd**	
Year ended	**30 June 1998**	**30 June 1999**	**30 June 1998**	**30 June 1999**
	£	**£**	**£**	**£**
Adjusted trading profit	4,000		60,000	200,000
Adjusted trading loss		(96,000)		
Charges paid (gross)			12,000	12,000

On 1 January 1998, Choice Ltd acquired 80% of the issued ordinary share capital of Classic Ltd, a company which had always prepared its accounts to 31 December.

Classic Ltd's accounts for the eighteen month period from 1 January 1998 to 30 June 1999 showed the following:

	£
Adjusted trading profit, before capital allowances	120,000
Chargeable gain, after indexation allowance, on land bought in 1984 and sold in February 1999	40,000

Classic Ltd had a written down value on plant and machinery at 1 January 1998 of £10,000. There were no acquisitions or disposals for the period to 30 June 1999.

- **Requirement for question 5b**

Compute the mainstream corporation tax payable by Choice Ltd, Cooper Ltd and Classic Ltd for the above periods of account, assuming all available claims and surrenders are made to minimise the mainstream corporation tax payable by the group. *17*

(25)

6

(a)

Carol and Ann are employed by Bodrin City Council at a weekly wage of £400 and £500 respectively. Carol is supplied with a 3 litre company car which is available for her private use. The benefit in kind for 1998/99 has been calculated as being £2,500. The council also pay for all her private petrol and she is not required to make any reimbursements.

Jock is self-employed and works for the council on an ad-hoc basis. His self-employment status is not in question. Jock always makes up accounts to 5 April and he estimates his tax-adjusted profits for the year to 5 April 1999 to be £20,000.

- **Requirement for question 6a**

(i) Explain the National Insurance Contributions (NIC) implications for each of the above three individuals and also the implications for Bodrin City Council.

(ii) Jock may have underestimated his profits for the year to 5 April 1999, a more realistic profit figure being £27,000. Explain the NIC implications, if any, for both Jock and the Council of this increased profit figure.

(10)

(b)

Greg Weir supplies and fits building materials and is in the process of completing his VAT return for the quarter to 31 May 1999. During the quarter, his only contract was a barn conversion. This commenced on 15 February 1999 and payments on account of £15,000 and £20,000 were received on 20 March 1999 and 10 April 1999 respectively. Work was completed on 25 May 1999 and an invoice issued on 3 June 1999 for the total contract price of £50,000 plus VAT. The balance of the contract price was received on 30 June 1999. Materials costing £18,000 (net of VAT) were bought during the quarter. These were all used on the contract apart from items costing £1,500 which Greg used on his private house. He also informs you of two errors in respect of a previous return which are:

- input tax was claimed on a motor car for which the total cost including VAT and car tax was £7,000; and
- output tax was overstated by £250.

Greg does not operate the cash accounting scheme for small businesses, and he pays in cash for all his purchases.

- **Requirement for question 6b**

(i)	Advise Greg of the VAT rules relating to the time of supply of goods and services.	*4*
(ii)	Show the entries to be made on Greg's VAT return for the quarter to 31 May 1999 in respect of the contract. (Assume today's date is 21 June 1999).	*3*
(iii)	Show how Greg should treat the errors from his previous return.	*3*
(iv)	State the conditions that Greg needs to satisfy before he will be permitted to use the cash accounting scheme and advise him of whether it will be beneficial to use either scheme.	*5*
		(15)
		(25)

TAXATION RATES

Corporation Tax	Financial Year (FY) 1994	FY 1995	FY 1996	FY 1997	FY 1998	FY 1999	FY 2000
Full rate	33%	33%	33%	31%	31%	30%	30%
Small companies	25%	25%	24%	21%	21%	20%	20%
Small companies profit levels:							
Lower relevant amount	£300,000	£300,000	£300,000	£300,000	£300,000	£300,000	£300,000
Higher relevant amount	£1,500,000	£1,500,000	£1,500,000	£1,500,000	£1,500,000	£1,500,000	£1,500,000
Small companies							
Marginal relief fraction	1/50	1/50	9/400	1/40	1/40	1/40	1/40

Small companies marginal relief formula: (UL-P) x (B/P) x MRF

where UL = Higher relevant amount
P = Profits chargeable to corporation tax plus FII
B = Basic profits
MRF = Marginal relief fraction.

Fuel benefit tables

	1998/99	
	Petrol	**Diesel**
	£	**£**
0 - 1400 cc	1280	1010
1401 - 2000 cc	1280	1280
2001 cc and above	1890	1890
No cylinder capacity	1890	1890

Retail Price Index

March 1982	79.4
January 1997	154.4
October 1999	169.0

Capital Allowances

Plant and machinery	%
Writing down allowance*	25
First year allowance (acquisitions 2.7.97 – 1.7.98)**	50
First year allowance (acquisitions 2. 7.98 – 1.7.00)	40

* 6% reducing balance for certain long life assets
** 12% for certain long life assets

Industrial buildings allowance	%
Writing down allowance	4

National insurance contributions (not contracted out rates) 1998/99

Class 1 Contributions	
Employee	
Earnings up to £64 per week	2%
Balance of earnings up to £485 per week	10%
Employer (% payable on all earnings)	
Earnings up to £64 per week	-
Earnings £64 to£109.99 per week	3%
Earnings £110 to £154.99 per week	5%
Earnings £155 to £209.99 per week	7%
Earnings £210 per week and above	10%

Class 1A	10%

Class 2 £6.35 per week

Class 4

Rate	6%
Lower earnings limit	£7310
Upper earnings limit	£25,220

VAT

Registration limit	£50,000
Deregistration limit	£48,000
Standard rate	17½ %

Income Tax rates 1998/1999

Lower rate	0-£4,300	20%
Basic rate	£4,301 to £27,100	23%
Higher rate	£27,101 and above	40%