PUBLIC POLICY AND TAXATION

Professional 2
December 2004

MARKING SCHEME

CIPFA

Question 1

(a) **Service Provision.**
This includes the planning and provision, directly or indirectly, of a wide range of individual local services such as education, environmental health. *1½*

Regulation
Local authorities regulate the economic behavior of individuals or other agencies in the public interest by insisting on their compliance with standards, rules and procedures of various kinds for exchange or provision of goods or services. This is where the licensing, inspection, monitoring, registration and certification come in. *1½*

Strategic Planning
Local authorities provide a long term planning framework to influence the activities of internal departments and external organisations in relation to individual service areas or authority-wide issues. *1½*

Promotion and Advocacy
Local authorities try to persuade one or more other organisations (eg private industry, voluntary bodies) to carry out activities that are likely to benefit the local community (eg through loans to small businesses, or by grants to voluntary organisations). *1½*

(b) There are four models that attempt to explain the relationship between central and local government. They are:

Local government as agency for central government, whereby local authorities simply implement/administer policies for central government. *1½*

The central-local relationship is seen as a **partnership** with both sides working to common ends. Central government is invariably the more powerful partner, but local government is not totally subordinate as in the agency relationship. *1½*

The **stewardship** model whereby central government, in the role of "master", delegates considerable authority and discretion to local government. *1½*

The **power-dependence model**. Here, each side has sources of power that it can exert against the other. The relationship is one of bargaining, exchange and negotiation. *1½*

(c) The democratic deficit is concerned with a low level of democratic accountability in local government. Examples/sources include the shift of some local government responsibilities to unelected and unaccountable bodies and the reduction in numbers of councillors. For example, France has one elected member for about every 120 citizens whereas the UK has one for about every 2,600. 3

Many alternative/additional examples of the democratic deficit may be cited. Credit should be awarded for those, subject to an overall maximum mark of 3 for 1 (c).

(d) *This part should be marked flexibly with 1 mark awarded per substantive point made, subject to an overall maximum of 6 marks for 1 (d). If candidates fail to demonstrate an awareness of each of the three models, the maximum of 6 must not be awarded, regardless of the number of substantive points made.*

The three models that attempt to explain the relationship between local authorities and the communities they serve are as follows.

Participative relationship

Members of the electorate share in local government decision-making and service provision. Individuals may be co-opted on to the Council decision making bodies, tenants may participate in the running of their estates, etc.

This model makes the greatest contribution towards addressing and overcoming the democratic deficit.

Consultative relationship

Here a significant consultation of local people occurs as input into council decision-making, even though no direct part is taken by local citizens in decision-making. There are a variety of ways of consulting local citizens and the extent to which this consultation impacts on decision making also varies widely.

The contribution of this model towards addressing and overcoming the democratic deficit lies approximately mid-way between the contributions of the two alternative models.

Informative relationship

The relationship between local authorities and citizens is restricted to one of information provision through, for example, "one-stop shops" or information lines.

This relationship makes the least contribution to addressing and overcoming the democratic deficit. However, this relationship is no longer sustainable, given local authorities' obligation, under Best Value, to consult their local communities.

(e) Research by Gerry Stoker suggests that:

Urban left wing authorities are responsive to voluntary sector, single cause and community groups. *1*

Soft/New Labour councils are less likely to support radical cause groups and more willing to work with business interests. *1*

Centre-right/Liberal Democrat councils encourage pressure group activity but appear to prefer voluntary/professional groups over some community groups. *1*

Right-wing conservative councils are keen to work with residents' associations and business interests, but not groups considered to be left wing. *1*

(25)

Question 2

(a) *Mark flexibly. 1 mark for each substantive point made, up to an overall maximum of 6 marks for part 2 (a).*

Definition: A pressure group is any organisation (normally working through lobbying rather than standing for office) that seeks to influence public policy and decisions at local, national, EU or international levels, usually within a particular, quite limited sphere.

Pressure groups, unlike political parties, do not normally contest elections.

On those occasions when pressure groups do contest elections, it is not usually with the aim of forming a government. Instead, the aim is normally to make a political point by indicating the level of public concern on an issue (eg the environment) or by drawing support away from the government on a key issue (eg Sir James Goldsmith's Referendum Party).

Pressure groups typically have narrower concerns than political parties. They generally contribute selectively to the political debate from a particular standpoint or in a specific field of concern. They do not adopt a comprehensive programme which seeks to cover the entire field of politics, as political parties do.

(b) **(i)** Distinction in terms of what the groups represent.

Sectional groups
Exist to further/protect the interests of people engaged in certain professions, trades and occupations. Membership is limited to those with a shared interest. *1*

One example needed (eg TUC, CBI, BMA, NUT, etc). *1*

Cause groups
Exist to further some belief, attitude or principle that generally promotes public welfare as perceived by the membership. Membership is open to all sharing the same attitude, ideology or principle. *1*

One example needed (eg Greenpeace, Child Poverty Action group, Amnesty International). *1*

(ii) Distinction in terms of the groups' strategies and relations with government.

Insider Groups
Are consulted regularly by government. *1*

One example needed (eg MENCAP, Howard League for Penal reform) *1*

Outsider groups
Either do not wish to become closely involved with government or are unable to gain government recognition. *1*

One example needed (eg Animal Rights Groups). *1*

(c) *Mark flexibly. 1 mark for each substantive point made, up to a maximum of 11 marks for 2 (c). The maximum of 11 must not be awarded if the candidate fails to show an awareness of all 3 models.*

Pluralism
Decision-making is a continuous process of interaction between a wide range of pressure groups and governing institutions.

Groups have unequal resources but no group becomes completely dominant because:
Groups counterbalance each other (eg CBI/TUC).
No group attempts to influence in more than a limited area.
Membership of groups overlaps.

Large scale expansion of cause groups since the 1960s supports pluralist theory but model is somewhat naïve about the issue of the real exercise of power.

Corporatism
Refers to a situation where consultation is limited to that between government and major sectional groups over economic policy.

These pressure groups then implement/enforce agreements on economic policy and conduct.

Limited as a general theory because applies only to producer groups and to a fairly brief era that ended when Mrs Thatcher came to office in 1979.

Policy Networks
Policy making is compartmentalised in a series of separate areas based on government departments, each of which has a distinct relationship with pressure groups. This is the most accurate description of the current relationship between government and pressure groups in the UK.

The concept of policy networks is a generic form denoting a continuum of relationships from policy communities to issue networks.

Government and institutions with interests in particular areas constitute stable “policy communities” that co-operate on the development of policy. Issue networks at the other end of the continuum are characterised by a larger number of groups, relatively open access to groups and greater conflict over policy.

(25)

Question 3

(a) Marketisation – the introduction of the market mechanism into the delivery of public sector goods and services. *1*

Privatisation – the transfer of public sector assets to the private sector. *1*

(b) *Note: Flexibility is also needed when marking (b) – plausible schemes/policies/programmes should all be given credit. It is equally acceptable if some students choose to address several schemes briefly or just a few in more detail. It is suggested that no more than 3 marks be allocated to the discussion of any one scheme, implying that students are expected to discuss at least two schemes. Overall, marks are available on the basis of 1 mark per relevant point well made, up to a maximum of 7 marks.* *7*

Schemes that candidates may discuss include:

Deregulation/liberalisation of markets to enhance competition (eg bus industry, banking industry).

Contracting out of public services. Associated with market testing and best value (eg school inspection, refuse collection by many local authorities).

Introduction of market forces into public sector "merit good" areas such as health and education. Involves "realistic" charges and/or "competing for customers" and being run akin to commercial businesses.

Civil Service reforms aimed at reducing waste, bureaucracy, and over-government eg reduction in size; curtailment of privileges (replacement of "pay by comparison" by performance-related pay); efficiency reforms (Rayner Scrutinies, FMI, Next Steps, Market Testing, Citizens Charter).

The Private Finance Initiative – aims to get the public and private sectors working more closely together in providing services to the public. Private sector funds the design, construction, maintenance and management of public-sector projects (eg hospitals, motorways) which are leased back to the public sector. Advantage for public sector is investment without public sector borrowing (leasing is cheaper than borrowing).

(c) *Part (c) requires candidates to evaluate the impact of policies. The subjective nature of (c) means that there is no simple right or wrong answer, and that there are likely to be significant differences in candidates' answers. Examiners are therefore required to use their discretion and to award credit for all well argued answers, up to a maximum of 8 marks.* *8*

As a broad guide, better candidates are likely to discuss some of the following points in their answers.

The results of privatisation and marketisation have been mixed.

Media emphasis tends to focus on problem areas (eg the railways). But some of the difficulties of problem areas have little to do with privatisation (eg the former Railtrack's problems were largely due to its inheritance of a railway infrastructure that had been seriously neglected whilst in public ownership).

Media tends to give relatively little attention to successful areas (eg public utilities have made huge gains in efficiency, though this has been at the expense of shedding 180,000 jobs).

Some sectors that have improved their efficiency have failed to also improve their effectiveness (eg bus deregulation has significantly improved efficiency, achieved largely via withdrawal of conductors from buses – but this often slows buses' progress along routes, makes other traffic slower, and increases passenger perception of their exposure to threats of theft/violence etc from other passengers).

Since privatisation, consumers have paid less for gas, electricity and telephones in real terms (but was this to do with privatisation or more to do with falling oil prices and technological advances?). Since privatisation, water bills have risen by one-third in real terms (was this because of privatisation or because of the ageing/inefficient system prior to privatisation?).

Perceived problem of "snouts in the trough"/"fat cats" (CEO's of privatised organisations). Connected with this is the huge shareholder gains when on-selling privatised companies (eg Eversholt Leasing sold two years after privatisation for twice its original price).

Fears that old public sector monopolies (especially utilities) are being replaced, through the process of Merger & Acquisition (M&A), by new private sector monopolies (eg TOCs on the railways). In such instances, the regulatory system (in particular, the Competition Commission and/or the Secretary of State) often seems reluctant to interfere with these moves (through M&A) towards private sector monopolies and their associated potential efficiency gains.

(d) **(i)** Basic argument is that regulation is a necessary evil. It is needed to correct market dysfunctions. For example, some companies may be natural monopolies while others might fall prey to unscrupulous use of information advantages (information asymmetries). *2*

(ii) *There are a wide variety of potential answers to (d) (ii). Examiners must be flexible and give credit for relevant issues, even if they are not included amongst the examples below (eg regulatory capture, problems of self regulation, and weakness (in terms of sheer size) of regulators relative to the* *organisations they regulate. Overall, there is a maximum of 2 marks per well-argued issue – overall maximum of 6 marks.* *6*

Regulation has a poor record in preventing fraud and scandal.
Bank of England failed to prevent depositor losses with BCCI.
IMRO failed to prevent Maxwell from plundering Mirror Group pension fund.

Utility regulators have been ineffectual.
Unable to enforce compliance or effectively punish.

Utility regulators have "tunnel vision" when deciding what is in the public interest. Insistence on promotion of competition has resulted in short-term advantage ("dash for gas") over long-term benefits (coal resources).

(25)

Question 4

(a) For corporation tax purposes, an "accounting period" is a period of time for which a corporation tax assessment is raised. This should be distinguished from a "period of account" which is a period of time for which a company makes up a set of accounts. *1*

In general, an accounting period is deemed to end on the earlier of:

- the expiration of 12 months from the beginning of the accounting period.
- the end of a period of account. *1*

The effects of this rule are as follows:

(i) A period of account of up to 12 months in length comprises a single accounting period and results in a single corporation tax assessment.

(ii) A period of account exceeding 12 months in length is subdivided into two or more accounting periods, each resulting in a separate corporation tax assessment. The first accounting period is the first 12 months of the period of account. The second accounting period is the next 12 months of the period of account (and so forth). If the length of the period of account is not an exact multiple of 12 months, the final accounting period will be of less than 12 months' duration. *1*

Therefore the period of account consisting of the 18 months to 31 March 2004 is divided into two accounting periods, which are the 12 months to 30 September 2003 and the 6 months to 31 March 2004.

(3)

(b)

		Pool	**Jaguar 1**	**Jaguar 2**	**Total**	
y/e 30/9/03						
WDV b/f		113,330	27,200			
Additions		9,270		36,800		
Disposals		(1,200)	(22,500)			
Balancing allowance			4,700		4,700	*1*
		121,400				
WDA 25%		30,350			30,350	*1*
WDA restricted				3,000	3,000	*½*
		91,050				
Additions	23,500					
FYA 40%	9,400	14,100			9,400	*1*
WDV c/f		105,150		33,800		
Total allowances					47,450	

		Pool	Jaguar 1	Jaguar 2	Total	
6 months to 31/3/04						
WDV b/f		105,150		33,800		
Disposals		(750)				
		104,400				
WDA 25% x 6/12		13,050			13,050	*1*
WDA restricted				1,500	1,500	½
		91,350				
Additions	20,400					
FYA 40%	8,160	12,240			8,160	*1*
WDV c/f		103,590		32,300		
Total allowances					22,710	

(Capital allowances are not restricted because of private use by an employee). *(6)*

(c)

	Original cost £	*Rebasing* £	
Disposal proceeds	300,000	300,000	½
Less: Acquisition cost	50,000		½
Market value 31/3/82		40,000	½
	250,000	260,000	
Less: IA			
(183.1-79.44)/79.44 = 1.305			
1.305 x £50,000	65,250	65,250	*1*
	184,750	194,750	

The lower gain is £184,750. ½

All except £75,000 of the disposal proceeds were invested in a replacement asset and rollover relief is claimed so the chargeable gain is £75,000. The rolled-over gain is £109,750 (£184,750 - £75,000) so the base cost of the replacement land is reduced to £115,250 (£225,000 - £109,750). *1*

(4)

(d)

	y/e 30/9/03	**6 months to 31/3/04**	
	£	**£**	
Schedule D Case I	576,000	288,000	*½*
Less: Capital allowances	47,450	22,710	*½*
	528,550	265,290	
Less: s393(1) relief	438,550		*1*
	90,000	265,290	
Schedule D Case III	20,000	20,000	*1*
Chargeable gains (£75,000 - £40,290)		34,710	*1*
	110,000	320,000	
Less: Charges	10,000		*1*
PCTCT	100,000	320,000	

(5)

(e)

	y/e 30/9/03	**6 months to 31/3/04**	
	£	**£**	
PCTCT	100,000	320,000	
FII £54,900 x 100/90	61,000		*½*
£72,000 x 100/90		80,000	*½*
Profits	161,000	400,000	
Corporation tax due:			
£100,000 @ 19%	19,000		*½*
£320,000 @ 30%		96,000	*½*
11/400 x (£750,000 - £400,000) x £320,000/£400,000		7,700	*1*
	19,000	88,300	
Due date	1 July 2004	1 January 2005	*1*

(4)

(f) The trading losses have reduced the company's profit for the year ended 30 September 2003. This profit would have been between the small companies rate lower and upper limits but is now beneath the lower limit. Tax has been saved partly at the marginal rate of 32.75% and partly at 19%.

The alternative would have been to make a s393A(1) claim to set the losses against chargeable profits of the loss-making period and the previous 12 months. This would have been more effective only if these profits were high enough to ensure that more of the loss would have been relieved at the marginal rate or at the full rate of 30%. *3*

(25)

Question 5

(a)

	£	£	
Salary		50,000	
Car 1 benefit:			
15% + 9% = 24% x £18,500 = £4,440 x 7/12		2,590	*1*
Car 1 fuel benefit:			
24% x £14,400 = £3,456 x 7/12		2,016	*1*
Car 2 benefit:			
15% + 5% + 3% = 23% x £20,400 = £4,692 x 5/12		1,955	*1*
Car 2 fuel benefit:			
All private fuel paid by employee		0	*½*
Living accommodation:			
Annual rateable value	6,800		*½*
5% x (£120,000 - £75,000)	2,250		*½*
Furniture 20% x £14,350	2,870		*½*
Running costs all paid by employee	0	11,920	*½*
Beneficial loan:			
Average method:			
(£24,000 + £18,000)/2 x (5% - 2%) x 10/12	525		*1*
Precise method:			
(£24,000 x 3% x 3/12) + (£18,000 x 3% x 7/12)	495	495	*1*
Loan of entertainment system:			
£2,700 x 20% x 9/12		405	*½*
plus the greater of:			
£2,700 - £1,485 - £750	465		
£1,000 - £750	250	465	*1*
Employment income		69,846	
			(9)

(b)

	£	£	
Rents		9,670	*½*
Less: Expenses			
Advertising for tenants		(280)	*½*
Cleaning		(1,200)	*½*
Council tax	860		
Water rates	310		
Insurances	450		
Painting and decorating	330		
48/52 x	1,950	(1,800)	*1*
		6,390	
Less: Wear and tear allowance:			
10% x (£9,670 - 48/52 x (£860 + £310))		859	*1*
		5,531	
Less: Losses b/f		1,150	*½*
Property income		4,381	
			(4)

(c)

Jonathan

	£	
Employment income	69,846	
Property income	4,381	
	74,227	
Less: Personal allowance	4,615	½
Taxable income	69,612	
Income tax borne:		
£1,960 @ 10%	196.00	
£28,540 @ 22%	6,278.80	
£39,112 @ 40%	15,644.80	
	22,119.60	½

Jennifer

	£	
Employment income (£80 x 52)	4,160	½
Building society interest £7,664 x 100/80	9,580	½
Dividends £4,590 + £510	5,100	½
	18,840	
Less: Personal allowance:		
£6,610 - 1/2 x (£18,840 - (£390 x 100/78) - £18,300)	6,590	*2*
Taxable income	12,250	
Income tax borne:		
£1,960 @ 10%	196.00	
(£9,580 - (£6,590 - £4,160) - £1,960) @ 20%	1,038.00	
£5,100 @ 10%	510.00	
	1,744.00	*1*

MCA cannot be claimed because neither partner to the marriage was born before 6 April 1935. ½

(6)

(d)

Jonathan

	£	
Primary Class 1 NIC's:		
(£30,940 - £4,615) = £26,325 @ 11%	2,895.75	
(£50,000 - £30,940) @ 1%	190.60	
	3,086.35	½
Secondary Class 1 NIC's:		
(£50,000 - £4,615) = £45,385 @ 12.8%	5,809.28	½
Class 1A NIC's:		
£19,846 @ 12.8%	2,540.29	½

No NIC's are payable in respect of Jennifer since her earnings are less than the primary and secondary threshold of £4,615. Even if her earnings exceeded this figure, there would still be no liability to primary contributions, since she is over state pensionable age. ½

(2)

(e) **(i)** Transferring cottage to wife:

- saving in higher-rate tax
- but property would be legally Jennifer's for her to do with as she wished. *1*

(ii) Reducing amount of loan:

- no tax at all if loan reduced to £5,000 or less
- small saving in higher-rate tax otherwise *1*

(iii) Own car instead of company car

- saving in higher-rate tax
- but costs of acquiring/running own car
- mileage allowances may be received tax-free (within limits) from employer. *2*

(4)

(25)

Question 6

(a) **(i)** A close company is one which is controlled by five or fewer participators or by any number of participator-directors. The term "participator" normally applies only to a company's shareholders, so a close company is generally one which is controlled by five or fewer shareholders or by its shareholder-directors. For this purpose, the rights of a participator's associates are aggregated with the participator's own rights. Broadly, the term "associate" covers family members and business partners. *2*

If special tax rules did not apply to close companies, it would be possible for the small number of participators involved to manipulate the company's financial affairs in such a way as to avoid tax. In particular, participators might be able to withdraw profits from the company without incurring a personal tax liability. This would be beneficial since rates of corporation tax are generally lower than those which apply to individuals. Two special tax rules which apply only to close companies are: *1*

- Any benefits in kind provided to participators (or to their associates) are treated as distributions. The effect of this rule is that the cost of such a benefit is disallowed in the company's tax computation and that the person receiving the benefit is taxed as if he or she had received a dividend equal to the amount of the benefit. However, this treatment does not apply in some cases, notably if the benefit is taxable as employment income. *1*

- Any loans made to participators (or to their associates) are generally assessed to tax. The company must pay an amount of tax equal to 25% of the loan. This tax is repayable when the loan is repaid or written-off. If the loan is written-off, the participator (or associate) is deemed for tax purposes to have received net income equal to the amount written-off. This amount is grossed-up at the Schedule F ordinary rate. Further tax will be due if the participator (or associate) is a higher-rate taxpayer. Loans made in the normal course of the company's business and certain other loans are excluded from this treatment. *2*

(6)

(ii) For corporation tax purposes, a large company is one which pays tax at the full rate (currently 30%) without deduction of marginal relief. Such companies are generally required to pay their corporation tax by instalments. However, a large company is not required to pay tax by instalments for an accounting period if: *1*

- it has chargeable profits of £10 million or less for the accounting period and was not a large company in the 12 months preceding that period, or *½*

- it has a tax liability of less than £10,000 for the period but pays tax at the full rate, either because it has substantial amounts of dividend income or because it has a number of associated companies. *½*

Instalment payments are based on the company's own estimate of its corporation tax liability for the accounting period. When the tax liability for the year is finalised, the company is charged interest on any underpaid instalments and is paid interest on any overpaid instalments. In general, there are four equal instalments. The first instalment is due 6 months and 14 days from the start of the accounting period. The remaining three instalments then fall due at quarterly intervals. *2*

(4)

(iii) A company which makes quarterly returns and has an annual VAT liability exceeding £2,000,000 is obliged to make monthly payments on account (POA's) to HM Customs and Excise. The first payment is due one month before the end of the quarter, the second payment is due at the end of the quarter and a balancing payment is due one month after the end of the quarter. All of these payments must be made electronically. *1*

Each of the two payments on account is usually calculated as 1/24 of the company's total VAT liability for the previous year. However, the company may choose to pay the actual VAT liability for each month rather than the set POA's. *1*

(2)

(b) (i) The main accounting records which must be kept for VAT purposes are:

- the usual business and accounting records (eg cashbooks, till rolls, paying-in slips, bank statements, purchases and sales books, orders and delivery notes, business correspondence, annual accounts etc).
- a VAT account
- a copy of each tax invoice issued
- all tax invoices received, but tax invoices are not required for payments of £25 or less relating to telephone calls, parking fees or purchases made through coin-operated machines.

(3)

(ii) If a VAT return is made which understates the VAT payable (or overstates the VAT repayable) and the amount of tax which would have been lost if the inaccuracy had not been detected is at least:

- 30% of the "gross amount of tax" (ie the total of input tax and output tax) for the period concerned, or
- £1,000,000

whichever is the lower, a penalty may be exacted of up to 15% of the tax which would have been lost. *2*

Also, HM Customs and Excise may issue a "penalty liability notice" if a "material inaccuracy" is found in a VAT return. A material inaccuracy is defined as one which, if undiscovered, would have resulted in a loss of tax equal to at least 10% of the gross amount of tax for the period in question, or £500,000, whichever is the lower. If at least two further material inaccuracies are made during the "penalty period" specified in the notice, a penalty may be exacted of up to 15% of the tax which would have been lost. *2*

Interest is not charged if the company discloses errors in previous tax returns and the total amount of those errors is £2,000 or less. In these circumstances, the required adjustment can be included in the next VAT return. *1*

(5)

(iii) A £100 fixed penalty is imposed if a tax return is submitted late and a further fixed penalty of £100 is imposed if the return is more than 6 months late. If the return is more than 12 months late, an additional penalty may be imposed of up to 100% of the tax liability for the year. *2*

Furthermore, the General or Special Commissioners may direct that a penalty of up to £60 per day should be imposed, running from the date of the Commissioners' direction to the date on which the tax return is submitted. *1*

(3)

(c) Tax avoidance is the reduction of a tax liability by legal means. For example, a taxpayer may move funds from a taxable savings account to a tax-free ISA. Since tax avoidance is not illegal it cannot be punished by the courts. However, courts currently take the view that totally artificial tax avoidance schemes consisting of a preconceived series of transactions which have no aim other than tax avoidance should be ineffective for tax purposes. *1*

Tax evasion (which is illegal) involves dishonest conduct and includes actions such as concealing income or claiming reliefs to which the taxpayer is not entitled. The courts take a very serious view of tax evasion and can inflict substantial fines and/or terms of imprisonment on the perpetrators. *1*

(2)

(25)