PUBLIC POLICY AND TAXATION

Professional 2 examination
10 December 2004

From 10.00 am to 1.00 pm,
plus 10 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 examination room.

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

CIPFA

SECTION A (Answer two questions)

1

The relationship between local and central government is complex, but many analysts assert that, despite policies of regional devolution, there has been a general trend in which central government has assumed increasing control over local government.

- **Requirement for question 1**

(a) Outline the primary roles of local government. *6*

(b) Identify and briefly explain the alternative models that attempt to explain the relationship between local and central government. *6*

(c) Explain with the aid of examples what is meant, in local government, by the term "democratic deficit". *3*

(d) A number of differing relationships between local authorities and the communities they serve have been recognised. Identify and explain these alternative relationships and assess their relative impact upon the "democratic deficit" in local government. *6*

(e) Discuss the assertion that the nature of the relationship between local authorities and the communities they serve, especially their willingness to recognise particular local interests, is heavily influenced by the political complexion of the local authorities. *4*

(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.* *6*

(b) Distinguish, with examples, the main types of pressure groups in terms of:

(i) what the groups represent. *4*

(ii) the groups' strategies and relations with government. *4*

(c) A number of different models seek to explain the ways in which pressure groups interact with government. Identify these models, setting out the main features of each one and commenting on the extent to which each model accurately reflects the relationship between pressure groups and government. *11*

(25)

3

During and since the 1980s, successive UK governments have given considerable emphasis to strengthening the efficiency and effectiveness of public services through *marketisation* and *privatisation* policies.

- **Requirement for question 3**

(a) Define the policies of marketisation and privatisation. *2*

(b) Outline examples of policies and programmes used by UK governments to implement *marketisation*. *7*

(c) Evaluate, with examples, the extent to which you believe the policies of *marketisation* and *privatisation* have been successful. *8*

(d) The policy of privatising and marketising public services has been accompanied by increased regulation of these services.

(i) Summarise the economic case for regulation. *2*

(ii) Outline, with the aid of examples, the criticisms that are typically made of the UK regulatory framework. *6*

(25)

SECTION B (Answer two questions)

4 JBC Ltd is a UK resident trading company with no associated companies. It is medium-sized for financial reporting purposes. Results for the 18 months to 31 March 2004 are as follows:

	£	Notes
Trading profit (before deduction of capital allowances)	864,000	1,5
Debenture interest receivable	40,000	2
UK dividends received	126,900	3
Gift Aid donation	10,000	4

Notes:

1 Trading profit has been adjusted for tax purposes but capital allowances have not yet been deducted. Information relating to capital allowances on plant and machinery is given in Note 5. Maximum capital allowances are claimed. The company owns no industrial buildings.

2 £400,000 of 10% debentures was acquired (not for trade purposes) on 1 April 2003. Interest is receivable half-yearly on 31 March and 30 September.

3 The figure shown for UK dividends is the total amount actually received during the 18 months, with no adjustment for tax credits. Amounts received were as follows:

	£
30 September 2003	54,900
1 October 2003	22,050
6 January 2004	49,950

4 The Gift Aid donation of £10,000 was made on 31 December 2002.

5 On 1 October 2002, the tax written down values of the company's plant and machinery were as follows:

	£
General pool	113,330
Jaguar car used by Managing Director	27,200

The company bought and sold the following plant and machinery during the 18 months to 31 March 2004:

		£
16 October 2002	Bought plant	23,500
23 January 2003	Sold Jaguar car	22,500
23 January 2003	Bought replacement Jaguar car	36,800
17 June 2003	Sold plant (original cost £5,000 in 1998)	1,200
8 September 2003	Bought car	9,270
19 November 2003	Bought motor van	14,000
27 January 2004	Bought plant	6,400
29 March 2004	Sold plant (original cost £2,000 in 2001)	750

There is 30% private use of the Jaguar motor cars by the Managing Director.

6 On 30 November 2003 (RPI 183.1) the company sold land for £300,000. This land had been bought for £50,000 in May 1980 and had a market value on 31 March 1982 (RPI 79.44) of £40,000.

No election has been made (or will be made) to re-base the cost of assets held on 31 March 1982 to their market values on that date.

7 On 29 January 2004, the company bought further land for £225,000. An election has been made to minimise the chargeable gain arising on the disposal of land in November 2003.

8 Losses brought forward on 1 October 2002 were as follows:

	£
Trading losses	438,550
Capital losses	40,290

- **Requirement for question 4**

(a) Differentiate between a period of account and an accounting period for corporation tax purposes and state **two** occasions on which an accounting period is deemed to end.

Hence, explain why the company's period of account for the 18 months to 31 March 2004 is divided into two accounting periods and identify these accounting periods. *3*

(b) Prepare a capital allowances computation for each accounting period. *6*

(c) Compute the chargeable gain arising on the disposal of land in November 2003 and state the base cost (for tax purposes) of the land acquired in January 2004. *4*

(d) Compute the chargeable profits for each accounting period. *5*

(e) Compute the corporation tax liability for each accounting period, stating the due date of payment in each case. *4*

(f) Evaluate the extent to which the trading losses brought forward of £438,550 have been used effectively and outline the circumstances in which a different form of loss relief might have been more effective. (Detailed calculations are not required). *3*

(25)

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5 Jonathan was born on 5 February 1943. His wife, Jennifer, was born on 2 April 1939. Throughout 2003/04, Jonathan was employed as a director of Alpha Ltd at a salary of £50,000 pa. He is not a member of a pension scheme and is not contracted out of the State Second Pension. The following information relates to the benefits received by Jonathan during 2003/04 in addition to his salary:

(i) Between 6 April 2003 and 5 November 2003, Alpha Ltd provided Jonathan with a petrol-engined motor car with a list price of £18,500 and an emission rating of 202g/km. The company paid for the whole of the car's running costs during this period, amounting to £3,200. This included £1,150 for fuel used on private journeys.

(ii) Between 6 November 2003 and 5 April 2004, Alpha Ltd provided Jonathan with a diesel-engined motor car with a list price of £20,400 and an emission rating of 184g/km. Jonathan reimbursed the company for the cost of all diesel fuel used on private journeys during this period. The company paid all of the car's other running costs, amounting to £860.

(iii) Since 1 September 1995, Jonathan and his wife have lived in a house provided by Alpha Ltd. This house has an annual rateable value of £6,800. Alpha Ltd bought the house for £120,000 in 1990 and it was valued at £160,000 on 1 September 1995. The company refurnished the house in June 2002 at a cost of £14,350. During 2003/04, Jonathan paid all of the house's running costs (which amounted to £3,770) out of his salary.

(iv) On 6 June 2003, Alpha Ltd provided Jonathan with a £24,000 loan at an interest rate of 2% pa. Jonathan repaid £6,000 of this loan on 6 September 2003.

(v) On 6 April 2001, Alpha Ltd lent Jonathan a brand-new home entertainment system for personal use costing £2,700. On 6 January 2004, the company sold the system to Jonathan for £750. Its market value on that date was £1,000.

In addition to his employment income, Jonathan also derives income from a holiday cottage which he owns and lets furnished to tenants. During 2003/04, this cottage was let for 48 weeks and generated rental income of £9,670. Jonathan and his wife occupied the cottage themselves for the remaining four weeks of the year. Expenses incurred in relation to the cottage in 2003/04 were as follows:

	£
Council tax	860
Water rates	310
Insurances	450
Installation of central heating system	2,760
Advertising for tenants	280
Cleaning (only when the cottage was let)	1,200
Painting and decorating	330
	6,190

Jonathan has Schedule A losses brought forward from 2002/03 of £1,150.

Jennifer's income for 2003/04 consisted of:

- a salary from a part-time job of £80 per week for 52 weeks
- net building society interest of £7,664
- UK dividends of £4,590

She made Gift Aid donations totalling £390 during the year.

- **Requirement for question 5**

(a) Calculate Jonathan's employment income for 2003/04. *9*

(b) Calculate Jonathan's property income for 2003/04. *4*

(c) Calculate the amount of income tax borne by Jonathan and Jennifer in 2003/04 and explain why they cannot claim the married couple's allowance for 2003/04. *6*

(d) Calculate the National Insurance contributions payable in relation to Jonathan by himself and his employer in 2003/04 and explain why no National Insurance contributions are payable in relation to Jennifer for 2003/04. *2*

(e) In an attempt to reduce his tax liability, Jonathan is considering:
- Transferring his holiday cottage to his wife’s name
- Reducing the amount of his loan from Alpha Ltd
- Buying a car of his own (which he would use for both business and private motoring) rather than using a car provided by Alpha Ltd.

Assess the extent to which each of these suggestions would be successful in reducing Jonathan’s tax liability. (Detailed calculations are not required). *4*

(25)

6

(a) For many years, corporation tax legislation has contained special rules relating to "close companies".

When corporation tax self-assessment (CTSA) was introduced in 1999, special rules regarding the due date of payment of corporation tax were brought in for "large companies".

Furthermore, the value added tax system includes special rules regarding the due date of payment of VAT by companies which account for substantial amounts of VAT.

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

(i) Explain the meaning of the term "close company" and suggest a reason for the existence of a special tax regime in relation to such companies. Outline **two** of the special tax rules which apply only to close companies. *6*

(ii) Explain the meaning of the term "large company" for CTSA purposes and outline the special rules which are used to determine the due date (or dates) of payment of corporation tax for such companies. *4*

(iii) Explain the special rules which are used to determine the due date (or dates) of payment of value added tax by companies which account for substantial amounts of VAT. *2*

(b) A company which is VAT registered will be visited from time to time by HM Customs and Excise. The main purpose of such a "control visit" is to examine the company's accounting records and hence to check the accuracy of its VAT returns. Penalties and interest may be charged if the visit reveals inaccuracies in the returns.

Similarly, penalties and interest may be charged if an individual taxpayer fails to submit his or her tax return on time or fails to pay tax on time.

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

(i) List the main accounting records which must be kept for VAT purposes by registered companies. *3*

(ii) Explain the penalties which may be charged if an inaccuracy is discovered in a VAT return and explain the circumstances in which interest is NOT charged if a company has underpaid VAT as a result of an error in a VAT return. *5*

(iii) Explain the penalties which may be charged if an individual fails to submit a tax return on time. *3*

(c) The UK tax system is equipped with numerous anti-avoidance provisions which are intended to block tax avoidance. However, the ever-changing nature of the tax system constantly offers new opportunities for avoidance and some taxpayers will seek to exploit these opportunities until each new "loophole" is closed. The more determined taxpayer may resort to complex tax avoidance schemes devised with great ingenuity by those who specialise in such matters.

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

Distinguish between tax avoidance and tax evasion, giving at least one example of each. Also state the view currently held by the courts with regard to the efficacy of complex tax avoidance schemes. *2*

(25)

SUMMARY OF TAX DATA

Corporation Tax

	Financial Year 2003	*Financial Year 2002*	*Financial Year 2001*
Full rate	30%	30%	30%
Small company rate	19%	19%	20%
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	1/40
Starting rate	0%	0%	10%
Lower limit	£10,000	£10,000	£10,000
Upper limit	£50,000	£50,000	£50,000
Marginal relief fraction	19/400	19/400	1/40

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 businesses:	
Acquired on or after 2 July 1998	40%
ICT acquired 1 April 2000 to 31 March 2004	100%

Income Tax

			2003/04	*2002/03*
Starting rate	10%	first	£1,960	£1,920
Basic rate	22%	next	£28,540	£27,980
Higher rate	40%	over	£30,500	£29,900

	2003/04	2002/03
Personal allowance:		
Age 0 to 64	£4,615	£4,615
Age 65 to 74	£6,610	£6,100
Age 75 or over	£6,720	£6,370
Married couple's allowance:		
Age under 75 and born before 6 April 1935	£5,565	£5,465
Age 75 or over	£5,635	£5,535
Minimum amount	£2,150	£2,110
Children's tax credit	-	£5,290
Income limit for age-related allowances	£18,300	£17,900

Car benefit

Emission rating	*Taxable percentage of list price*
Up to 155 g/km	15%
Each additional 5g/km	1% increase
Diesel engine	3% increase
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

	2003/04	*2002/03*
Primary threshold (annual)	£4,615	£4,615
Secondary threshold (annual)	£4,615	£4,615
Upper earnings limit (annual)	£30,940	£30,420
Employee contribution rates:		
On earnings up to primary threshold	0%	0%
On remainder up to UEL (Not contracted out)	11%	10%
On remainder up to UEL (Contracted out)	9.4%	8.4%
On earnings above the UEL	1%	-
Employer contribution rates:		
On earnings up to secondary threshold	0%	0%
On remainder up to UEL (Not contracted out)	12.8%	11.8%
On remainder up to UEL (Contracted out)	9.3%	8.3%
On earnings beyond UEL	12.8%	11.8%

Class 1A National Insurance Contributions

	2003/04	*2002/03*
Employer contribution rate	12.8%	11.8%

Value Added Tax

Standard rate (from 1 April 1991)	17.5%
Registration threshold (from 10 April 2003)	£56,000
Deregistration threshold (from 10 April 2003)	£54,000