TAXATION
REPUBLIC OF IRELAND

Diploma stage examination

10 December 2007

MARKING SCHEME

AT THE HEART OF
YOUR CAREER

Question 1

(a)

	€	€	
Net profit per accounts		1,490,000	*1*
Less:			
Dividends receivable	18,000		*1*
Debenture interest receivable	15,000		
Bank interest receivable	14,000		*1*
Income from rental property	26,000		*1*
Profit on sale of investments	17,500		*1*
Capital allowances	37,250		*1*
		127,750	
		1,362,250	
Add:			
Depreciation	74,000		*1*
Patent royalties	12,750	86,750	*1*
Schedule D Case I Income		1,449,000	
Less: relevant trading charges allowed against relevant trading income		(12,750)	*1*
Schedule D Case I Income		1,436,250	

Notes
1. Dividends receivable from Irish resident companies are Franked Investment Income and are not chargeable to Irish corporation tax when received by an Irish resident company. *1*
2. Bank interest receivable is assessed on the accruals basis. Therefore the amount assessed under Schedule D Case III will be €14,000, to include the accrual for interest not yet paid. *1*
3. The patent royalties are for trade purposes and are therefore allowable as a relevant trading charge to be set off against relevant trading income. *1*
4. The debenture interest payable is for trade purposes and is therefore allowable expenses. *1*

(13)

(b) Chargeable profits:

	€	
Schedule D Case I	1,436,250	*1*
Schedule D case III (15,000+14,000)	29,000	*2*
Schedule D Case V	18,200	
	1,483,450	
Chargeable gains (6,284 * 20%/12.5%)	10,054	*1*
Profits Chargeable to Corporation Tax	1,493,504	*1*

Workings:
1. Schedule D Case V income:

Schedule D Case V income (16,000 + 10,000)	€26,000	*1*
Less: reduction in premium (€10,000 x [2% x 9])	€1,800	*2*
	€24,200	
Less: Schedule D Case V losses brought forward	(6,000)	*1*
	18,200	

Premium receivable on a short-lease (<50 years) are assessed to corporation tax but reduced by 2% for every year of the lease except the first. *1*

2. Calculation of chargeable gain:

Asset 1	**€**	**€**	
Sale proceeds – May 2006		10,500	
Cost	4,250		
Less: Indexation factor – July 2000	1.144		*1*
		(4,862)	*1*
Chargeable gain		5,638	*1*
Asset 2			
Sale proceeds		21,250	
Less: part cost			
[€21,250/(€21,250 + €10,000)] x €25,000	17,000		
Less: Indexation factor – September 1998	1.212		*1*
		20,604	*1*
Chargeable gain		646	*1*
Total chargeable gains		**6,284**	

(16)

(c) Corporation tax liability:

	Profits €	Tax €	
Corporation tax at 12.5% (1,436,250+ 10,054)	1,446,304	180,788	*1*
Higher rate corporation tax at 25% (29,000 + 18,200)	47,200	11,800	*1*
	1,493,504	192,588	
Tax liability		192,588	*1*

(3)

(d) For the period ended 31 December 2006, 90% due on or before 21 November 2006, balance due on or before 21 September 2007 on the date of submitting the Corporation Tax Return. *(3)*

(e) The CT1 tax return for the year to 31 December 2006 must be submitted by 21 September 2007. A late return will attract a surcharge and restrictions on the use the company may make of certain reliefs and allowances as follows: *1*

(i) If the return is less than two months late, there will be a surcharge of 5% of the tax payable subject to a maximum of €12,695. *1*

(ii) If the return is more than two months late, there will be a surcharge of 10% of the tax payable subject to a maximum of €63,485. *1*

(iii) In addition to the above surcharges, there will be a restriction on certain allowances and reliefs, as follows:

- If the return is less than two months late, reliefs and allowances are restricted by 25% subject to a maximum in each case of €31,740.
- If the return is made more than two months late, the reliefs and allowances are restricted by 50% subject to a maximum in each case of €158,715. *2*

(5)

(40)

Question 2

(a) Tom's taxable income and tax payable for 2006

	€		€	
Schedule D – Case IV				
Regrossed Bank Interest (6,800/.8)		8,500		½
Regrossed Building Society Interest (2,100/.8)		2,625	11,125	½
Schedule D – Case V (Note 1)			15,011	*See below*
Schedule E – Income from Employment				
Salary		65,000		½
Add: Benefits in Kind				
Car benefit (Note 2)	8,100			*See below*
Beneficial loans:				
Interest Free Loan (Note 3)	275			*See below*
4% Loan (Note 3)	280			*See below*
Free use of accommodation (Note 4)	17,105	25,760	90,760	*See below*
Schedule F – Gross Dividend Income (7,200/0.8)			9,000	*1*
Taxable Income			125,896	

Tax Payable

€32,000 @ 20%	6,400	*1*
€93,896 @ 42%	39,436	*1*
	45,836	
Less		
PAYE Tax Credit	(1,490)	½
Single Allowance	(1,630)	½
DIRT	(2,225)	½
Dividend Tax Credit	(1,800)	½
Gross Tax Payable	38,691	
Less: PAYE paid	(12,000)	½
Net Income Tax Payable	26,691	½

Notes:

1. Schedule D Case V Rental Income

	€	€	
Annual rent (650 * 52)		33,800	½
Less: Allowable costs:			
Advertising	2,399		½
Gardening (€100 * 52)	5,200		½
Insurance	8,000		½
Service Charge	2,300		½
Repairs	890	(18,789)	½
		15,011	

2. Company Car

List price when new	€27,000	
Less than 15,000 miles	30%	½
Assessable benefit	€8,100	½

3. Preferential Loans

Loan Amount	Rate	Standard Rate	*Taxable Benefit*	
€2,500	0%	11.0%	*275*	½
€4,000	4%	11.0%	280	½

4. Accommodation benefit

Annual value	€12,600	½
Furniture benefit 5% x €8,500	€425	½
Ancillary services: (€1,400 + €975 + €625 + €1,080)	€4,080	*1*
Total assessable benefits-in-kind	€17,105	½

3. Bank and Building Society Interest

Paid net, so gross up to include in computation

€6,800 + €2,100 = €8,900 x 100/80 = €11,125 *1*

5. Dividends

Paid net of tax credit, so gross up to include in computation

€7,200 x 100/80 = €9,000 *1*

6. Prize Bonds

Income from Prize Bonds are received tax free *1*

(18)

(b) Miranda's taxable income and tax payable for 2006

	€		€	
Schedule D – Case IV				
Regrossed Building Society Interest (560/.8)			700	*1*
Schedule E – Income from Employment				
Salary		34,600		½
Add: Benefits in Kind				
Mileage (5,000 * 48 cent) (See below)	0			
Medical Insurance	550	550	35,150	½
Taxable Income			35,850	
Less: Pension contributions (10% * 34,600)			(3,460)	½
			32,390	

Tax Payable

€32,000 @ 20%	6,400	*1*
€390 @ 42%	164	*1*
	6,564	
Less		
PAYE Tax Credit	(1,490)	½
Single Allowance	(1,630)	½
DIRT	(140)	½
Gross Tax Payable	3,304	
Less: PAYE paid	(3,000)	½
Net Income Tax Payable	304	½

Note: Mileage – as Miranda's mileage is less than the civil service rate she is entitled to receive this amount tax free. *1*

(8)

(c) Tax relief is available for donations to charities and approved bodies. An 'approved body' is one named on a list as issued by the Revenue Commissioners. ½

Conditions of relief

- Minimum donation of €250.
- No maximum figure unless the individual is associated with the Charity in which case the max donation is capped to 10% of individuals total income;
- Donation must be in the form of money and must not be repayable;
- The donation must not confer any benefit on the donor or any person connected with the donor;
- The donation must not be conditional on, or associated with, any arrangements involving the acquisition of property by the charity or the approved body. *2*

Relief

PAYE individual

The relief is given on a 'grossed-up' basis to the eligible charity or approved body, rather than by way of a tax credit to the donor. This in effect means that the charity is treated as having received a donation net of income tax. ½

Example: Individual donates €500

(A) Individual on standard rate of income tax i.e. 20%

Charity receives €500 from the individual and claims €125 from the Revenue at the end of the tax year. ½

(B) Individual on higher rate of tax i.e. 42%

Charity receives €500 from the individual and claims €362 from the Revenue at the end of the tax year.

The PAYE individual must complete an 'Appropriate Certificate' - CHY 2 and forward it to the eligible charity or approved body so they may claim the amount of tax on the grossed up donation. ½

(4)

(30)

Question 3

(a) A company which makes both taxable supplies and exempt supplies is a "partially exempt" company and may recover only part of the input tax which it suffers. The amount of input tax which may be recovered for a tax period is the amount which is "attributed to taxable supplies". This amount is usually calculated as follows: *1*

– Input tax suffered on goods and services which are used exclusively for the purpose of making taxable supplies is attributed to taxable supplies and is recoverable in full. *1*

– Input tax suffered on goods and services which are used exclusively for the purpose of making exempt supplies is not attributed to taxable supplies and cannot be recovered at all. *1*

– A proportion of any remaining input tax (on goods and services used for making both taxable and exempt supplies (dual-use inputs)) is attributed to taxable supplies and may be recovered. This proportion is normally equal to the ratio of taxable supplies to total supplies. *1*

(4)

(b) A person who joins the cash accounting scheme accounts for output tax in the tax period in which payment is received from the customer and reclaims input tax in the tax period in which payment is made to the supplier. This allows the person to delay the payment of output tax to the Revenue Commissioners until the tax has actually been received from customers, which is beneficial if customers are given extended credit. The scheme also provides automatic relief for bad debts. On the other hand, input tax cannot be reclaimed until that tax has actually been paid to suppliers.

A registered person may not join the cash accounting scheme unless at least 90% of their turnover is derived from supplies to non-taxable persons, or the value of their turnover is less than €635,000.

A person wishing to account for VAT on a cash receipts from the sale of goods must notify the Revenue of the following;

- The nature of his business.
- The percentage turnover derived from supplies to unregistered persons in the previous 12 months (or since trading commenced) and the estimated percentage for the next 12 months.
- The amount of his debtors prior to election.

The cash receipt basis is not allowed in respect of sales of goods and services between connected persons.

1 mark per point up to a maximum of (8)

(c)

	€	€	
Output tax			
Standard-rated supplies €58,000 @ 21%		12,180.00	½
Zero-rated supplies €8,500 @ 0%		0	½
Exports to VAT registered non-EU members (a)		0	½
		12,180.00	½
Input tax			
Standard-rated purchases	27,200		½
Zero-rated purchases	0		½
Insurance (b)	0		½
Wages and salaries (c)	0		½
Motor expenses (d)	0		½
Entertaining (e)	0		½
Other expenses	6,400		½
Motor car (f)	0		½
	33,600 @		½
	21%	7,056.00	½
Payable to Revenue		5,124.00	*1*

Comments:

a) Exports of goods from Ireland to non-EU members are zero-rated
b) insurances are exempt
c) wages and salaries are exempt
d) Input tax on motor expenses are non-deductible
e) input tax on business entertaining expenses is non-deductible
f) input tax on the purchase of motor cars is non-deductible unless it is the motor vehicle is held in stock or is used in a taxi/driving school business.

1 mark per comment up to maximum of 6

(14)

(c) (i) Oral medicine is zero-rated. VAT is calculated at 0% on the taxable supply. A person marking these supplies must therefore register when their taxable turnover exceeds the prescribed threshold, and may then reclaim input tax.

(ii) The provision of banking services is exempt. VAT cannot be charged on an exempt supply. A person making only exempt supplies cannot register for VAT, charges no output tax, and cannot reclaim input tax.

½ mark for identifying VAT status of each item and ½ mark for explaining implications up to an overall maximum of (4)

(30)

Question 4

(a) Direct taxes are those which are assessed on and collected from the individual and organisations intended to bear them. They are taxes whose formal and effective incidences are intended to be the same. The main Irish direct taxes are:

- Income tax – paid by individuals on income from employment, profits from a business, income from property and savings.
- Capital Acquisitisons tax – paid by individuals on gifts and inheritances.
- Capital Gains tax – paid by individuals on net chargeable gains made on the sale of assets.
- Corporation tax – paid by companies on their income and gains.

Direct taxes can be related to the circumstances of the persons or organisations on which the incidence falls, and can therefore be used by governments to redistribute income or wealth. This is not usually possibly with indirect taxes, which are those where the formal and effective incidences of a tax are designed to be different from each other. The main Irish indirect tax is VAT, which is levied on and paid by those who add value at the various stages of production of a good or service. The effective incidence of the tax, however, is on the final consumer. Other indirect taxes are stamp duties and customs and excise duties.

1 mark per point up to a maximum of (10)

(b) Tax avoidance relates to the legitimate activities undertaken by taxpayers to organise their financial affairs in such a way that their tax burden is minimised. For example, moving funds from a bank account which pays taxable interest into an interest-free account.

Tax evasion is illegal and refers to evading payment of tax by dishonestly misleading the Revenue, by providing information which is incorrect or incomplete, for example by concealing a source of income. Evading income tax was established as a statutory offence and is punishable by law. It can lead to a fine and/or imprisonment.

Tax advisers often devise very complex and ingenious schemes to exploit loopholes in the tax legislation. There are legitimate tax incentives available, which may be availed of by taxpayers to reduce their tax bill. For example, film investment relief, BES, certain capital allowances schemes (s23 properties etc). However, over the years many artificial tax avoidance schemes have been devised with a view to reducing a person's tax liability. Although these schemes operate within the tax legislation, the Revenue finds many of them as an unacceptable form of tax avoidance and have therefore introduced anti avoidance provisions to close down loopholes being availed of by taxpayers.

General anti avoidance legislation was enacted in Finance Act 1989 (s.811, TCA 1997). This effectively empowers the Irish Revenue to prevent pure tax avoidance schemes from succeeding in circumstances where the transactions involved are entered into with the <u>sole or main objective of avoiding tax</u>, or alternatively, involve the "abuse" of relief contained in the tax legislation. Artificial tax avoidance schemes not caught by specific legislation may be caught under S.811, TCA 1997.

1 mark per point up to a maximum of (10)

(c) User charges:

- explanation of the concept of a user charge
- examples of user charges
- advantages:
  - equity (charges reflect value of benefit received)
  - rationing device
  - users more likely to economise their use of goods/services
  - enhanced public accountability
- disadvantages:
  - difficulty in collecting user charges for public goods
  - “free rider” problem
  - regressive nature of user charges.

1 mark per point up to maximum of (6)

(d) The main features of a "good" tax are:

– equity (or fairness)
– certainty
– efficiency
– low administrative cost.

1 mark for explaining each feature (4)

(30)