TAXATION
REPUBLIC OF IRELAND

Diploma stage examination

11 December 2006

From 2.00pm to 4.00pm
plus ten minutes reading time from 1.50pm to 2.00pm

Instructions to candidates

*Answer **three** questions in total:*
One** compulsory question from **Section A
Two** of the three questions from **Section B

The question in Section A carries, in total, 40 marks
The questions in Section B each carry a total of 30 marks

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 or report, 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.

AT THE HEART OF
YOUR CAREER

SECTION A (Compulsory)

1

Trent Trading Ltd has always prepared accounts to 31 December each year. It has no associated companies and is small for financial reporting purposes. An extract from the company's profit and loss account for the year to 31 December 2005 is shown below:

	€	€	*Note*
Turnover		2,270,340	
Cost of sales		1,306,150	1
Gross profit		964,190	
Distribution costs	307,330		2
Administrative expenses	332,760	640,090	3
		324,100	
Other operating income		133,660	4
Operating profit		457,760	
Interest receivable		4,430	5
Interest payable		(4,110)	6
Profit before taxation		458,080	

Notes:

1 All of the expenses included in the cost of sales figure are allowable trading expenses under the rules of Schedule D Case I.

2 Distribution costs are as follows:

	€
Depreciation of delivery vans	26,110
Profit on disposal of delivery van	(2,400)
General distribution costs (all allowable)	283,620
	307,330

3 Administrative expenses are as follows:

	€
Depreciation:	
Administrative equipment	16,350
Directors' motor cars (i)	11,440
Other motor cars	9,770
Profit on disposal of administrative equipment	(1,390)
Loss on disposal of director's motor car (i)	3,510
Amortisation of lease premium (ii)	15,000
Expenses relating to rented property (see Note 4)	39,130
Bad and doubtful debts:	
Trade debts written off	28,220
Trade debt recovered	(3,000)
Decrease in general provision for doubtful debts	(1,950)
Entertaining and gifts:	
Customer entertaining	5,960
Staff entertaining	3,750
Gifts of whisky to customers at Christmas	2,700
Charitable donations paid in the year to approved bodies	2,000
c/f	131,490

b/f	131,490
Legal and professional fees:	
Relating to tax appeal	12,500
Audit and accountancy fees	35,000
Motor expenses:	
Running costs of directors' motor cars (i)	9,640
Running costs of other motor cars	17,390
Car rental costs (iii)	3,420
General administrative expenses (all allowable)	123,320
	332,760

(i) There is 25% private use of the directors' motor cars.

(ii) On 1 October 2003, a premium of €180,000 was paid to acquire a 12 year lease on a property to be used for trade purposes. This premium is being written off to administrative expenses over the period of the lease.

(iii) A motor car was rented during the year which would have cost €22,800 to buy. This car was used entirely for trade purposes.

4 Other operating income is as follows:

	€
Rental income re properties let unfurnished:	
Prepaid at 31 December 2004	23,500
Received during the year to 31 December 2005	181,800
Prepaid at 31 December 2005	(31,640)
Premium received 1 October 2005 (i)	60,000
Premium paid 1 January 2005 (i)	(100,000)
	133,660

(i) On 1 January 2005, the company paid a premium of €100,000 to acquire a 10-year lease on a commercial property. This property remained empty until 1 October 2005, when it was sublet to a tenant. The tenant paid a premium of €60,000 on the grant of a 5-year lease.

(ii) Expenses incurred during the year in connection with rented properties were €39,130. These expenses are included in administrative expenses.

5 Interest receivable (which was not subject to to Deposit Interest Retention Tax) is as follows:

	€
Accrued at 31 December 2004	(1,370)
Received during the year	4,290
Accrued at 31 December 2005	1,510
	4,430

6 Interest payable consists of bank overdraft interest of €3,440 (incurred for trade purposes) and interest of €670 on overdue corporation tax.

7 After deducting capital allowances for the year to 31 December 2004, the cost and the tax written down values of the company's equipment and motor vehicles were:

	Cost	**TWDV**
	€	**€**
Equipment (all acquired post 1 January 2003)	180,000	135,000
Jaguar motor car (acquired in 2002 (prior to 4 December 2002))	50,000	8,800
Audi motor car (acquired in 2002 (prior to 4 December 2002))	30,000	8,800
VW motor car (acquired in 2003)	25,000	16,500

Transactions in plant and machinery during the year to 31 December 2005 were as follows:

(i) A piece of equipment which had originally been bought for €14,900 in 2003 was sold for €9,450. A new piece of equipment was acquired at a cost of €15,200.

(ii) The Audi motor car was sold for €12,500 and replaced by a new Toyota costing €28,340.

(iii) Equipment, which was acquired for €20,000 in 2003, was sold for €15,600. New equipment was bought for €87,200.

The company claims maximum capital allowances on plant and machinery but claims no industrial buildings allowances.

8 There were no chargeable disposals during the year to 31 December 2005. Capital losses brought forward at 1 January 2005 were €37,240.

9 A trading loss of €133,900 was incurred in the year to 31 December 2004. The whole of this loss was carried forward.

10 The company's chargeable profits for the year to 31 December 2004 were €247,700. The equivalent figure for the year to 31 December 2003 was €1,729,460.

11 There was no franked investment income in any year.

- **Requirement for question 1**

(a) Prepare a capital allowances computation for the year to 31 December 2005. *8*

(b) Compute the Schedule D Case I trading profit for the year to 31 December 2005 (your computation should start with the pre-tax profit of €458,080). What difference would it have made if the accounting period had been greater than 12 months and discuss the implications? *11*

(c) Compute the chargeable profit for the year to 31 December 2005, stating the amount of any losses carried forward. *7*

(d) Compute the corporation tax liability for the year to 31 December 2005, stating the date on which this tax is due for payment. *4*

(e) Transitional arrangements with regard to the payment of preliminary tax are in place until 2006. Set out the dates and the amounts that are required to be paid on those dates in relation to companies with an accounting period in 2005 and outline the dates for payments going forward. *4*

(f) State the date by which the company must submit its tax return for the year to 31 December 2005 and explain the consequences of submitting a late or an incorrect return. *6*

(40)

SECTION B (Answer two questions from this section)

2

Terry is a director of Turner Ltd. He is married and has a 10-year-old son. Both Terry and his wife were born in 1958. Terry's basic salary in tax year 2005 was €4,000 per month and PAYE of €15,000 was deducted during the year. The information given below relates to the benefits in kind which he received from his employer during the year and the expenses he incurred. His wife does not earn any extra income and they are jointly assessed.

1 Until 2005, Terry had used his own car on business trips and was paid a mileage allowance of 50 cent per mile. As from 1 January 2005, he was offered a company car instead. However, he could decline the company car and continue to use his own car, if he preferred. The details of these arrangements would be as follows:

- The company car would have a list price of €15,500. The company would pay all running costs, but Terry would be required to pay €50 per month for private use of the car and a further €50 per month towards the cost of fuel used for private motoring. This contribution would not fully reimburse the company for the cost of private fuel. Terry would be able to dispose of his own car, which would save him €6,000 per annum in running costs (including depreciation).
- If Terry chose to retain his own car rather than taking the company car, he would receive a mileage allowance of 50 cent per mile for 5,000 business miles driven during 2005.

2 Throughout 2005, Terry (in common with all staff working for Turner Ltd) was entitled to free lunches in the staff dining room. These meals would cost the company a total of €1,000 during the year. However, if he preferred, Terry could take his lunches in a local restaurant and the company would pay him a lunch allowance of €1,000.

3 In July 2005, the company required Terry to relocate to a different part of the country. This required a house move and the company paid his removal costs of €7,320.

4 Terry spent 130 nights away from Ireland on company business during 2005 and he was paid €5 per night to cover his personal incidental expenses. He was also provided with a mobile telephone. The company paid the full cost of all calls made on this telephone during 2005, of which €390 related to private calls. In the previous tax year, Terry spent 100 nights away from Ireland on company business.

5 On 1 January 2005, the company granted Terry an interest-free loan of €50,000 which was not considered a home loan. In March 2005 he won a €20,000 Premium Bond prize and he used this to repay €20,000 of the loan on 1 April 2005.

6 Terry pays 7% of his salary into the company's Revenue approved pension scheme each year and the company contributes a further 13%. Other expenses during 2005 were as follows:

(i) €7,150 of travelling and subsistence expenses incurred in connection with necessary business travel, all reimbursed by the company

(ii) a professional subscription of €164, all reimbursed by the company

Throughout 2005, Terry rented out a spare room in his house and received rents of €600 per month. His only other income in 2005 consisted of preference dividends of €27,000. He made a charitable donation of €1,000 to an approved charitable body during the year.

Terry would like to reduce his tax burden and for this reason he is thinking of transferring the preference shares to his wife who has no income for tax purposes.

- **Requirement for question 2**

(a) If Terry is considered Irish tax resident, determine whether he should accept the company car or whether he should continue to use his own car, taking into account the income tax and PRSI consequences of each course of action. *8*

(b) Assuming that Terry chooses the most efficient options with regard to the car and the lunches and is considered Irish tax resident, calculate the amount of his income tax liability remaining to be paid at the end of 2005. If any of his income is not taxable (or if any of his expenses are not deductible) explain why this is the case. *15*

(c) Give reasons for and against the belief that PRSI and Health Levy contributions are a form of taxation. *4*

(d) Comment on whether Terry's proposed transfer of the preference shares would succeed in reducing his tax liability. *3*

(30)

3

Timberlake Ltd prepares accounts to 31 December each year. The company made the following disposals of chargeable assets in the year to 31 December 2005:

1. In February 2005, a rare Bentley motor car used by the company's Managing Director for the business was sold for €55,000. This car had cost €30,000 in November 1997.

2. In October 2005, an office building was sold for €1,200,000. The building had been acquired in January 1968 for €100,000 and was extended in July 1970 at a cost of €10,000 and again in September 1988 at a cost of €40,000. The market value of the building on 6 April 1974 was €135,000.

3. In May 2005, a plot of land was sold for €120,000. This land had cost €42,000 in November 1997. There was no development value attached to the land.

4. In May 2005, plant and machinery bought for €19,500 in May 2004 was sold for €22,500. In December 2005, plant and machinery bought for €16,000 in March 1995 was sold for €9,000. Capital allowances had been claimed in relation to both of these items.

5. In August 2005, Government Securities, which were bought for €100,000 in August 2003, were sold for €110,500.

6. In November 2005, 3,000 ordinary shares in Theta plc were sold for €10 per share. Timberlake Ltd had bought ordinary shares in Theta plc as follows:

		€
June 1995	Bought 2,500 shares	12,500
January 2002	Bought 3,000 shares	18,000

On 1 January 2005, the company had capital losses brought forward of €156,200.

- **Requirement for question 3**

(a) Compute the chargeable gain or allowable loss arising on each of the disposals made during the year to 31 December 2005. If any of these disposals do not rank as chargeable disposals, explain why this is the case. Also explain any other tax consequences of each disposal. Indexation factors are provided. *20*

(b) Compute the chargeable gains figure which should be included in the company's chargeable profits for the year to 31 December 2005. *4*

(c) Briefly discuss the application of indexation relief. Provide two exceptions to the application of indexation relief when calculating a chargeable gain or loss. *6*

(30)

4

Toucan Ltd began trading on 1 January 2005. Taxable turnover for the seven months to 31 July 2005 exceeded the VAT registration threshold and therefore the company notified the Revenue of this fact in August 2005 and applied for VAT registration on 10 September 2005. Prior to registration, the company had bought goods (for resale or consumption) and services as follows:

	Goods	*Services*
	€	**€**
January 2005	2,200	800
February 2005	2,300	1,100
March 2005	1,700	1,300
April 2005	2,100	700
May 2005	1,900	1,400
June 2005	2,300	1,200
July 2005	2,700	1,500
August 2005	3,200	700

Toucan Ltd was charged VAT on all of these items, but the figures shown above are VAT-exclusive. The cost of the goods not sold or consumed at 1 September 2005 was €4,600 (excluding VAT).

The following information relates to the company's first VAT return, which covered the two-month period to 31 October 2005. All figures are exclusive of VAT unless stated otherwise.

1 Standard-rated supplies made to customers were €28,800. A cash discount of 2.5% was offered to customers who paid within 28 days and this discount was taken advantage of by customers who bought 50% of the supplies made during the two month period.

   The above figure of €28,800 includes a €1,600 sale made to a customer in September 2005. This customer went bankrupt in October 2005 and a bad debt of €1,600 was written off in the company's books on 31 October 2005.

   On 15 October 2005, a customer was invoiced for €4,800 in relation to a sale of standard-rated goods. The customer paid for these goods on 4 November 2005 and the goods were made available to the customer on 10 November 2005. This sale is NOT included in the above figure of €28,800 and was NOT eligible for the 2.5% cash discount.

2 Standard-rated goods bought for resale or consumption cost €9,280. Standard-rated services cost €5,200.

3 On 1 September 2005, the company was charged VAT of €1,960 on the purchase of a van for use in the business.

4 In October 2005, the company bought a new fixed asset for a VAT-inclusive price of €14,100.

- **Requirement for question 4**

(a) Once the threshold is exceeded, when must Toucan register for VAT? Explain the consequences which would have ensued if Toucan had failed to register for VAT when its taxable turnover reached the registration threshold. If Toucan registered on 10th September, from what date is Toucan registered for VAT and explain whether Toucan is able to claim an input credit on the goods and services purchased from the date of trading to the date of registration? *6*

(b) Compute the amount of VAT payable to (or repayable by) the Revenue for the two months to 31 October 2005 and state the date on which any amount payable would be due for payment. *9*

(c) Discuss the treatment of the 2.5% discount and explain the VAT relief available in relation to the bad debt written off on 31 October 2005 *4*

(d) List SIX items that the company must show on the VAT invoices issued to customers, other than the company's own name and address, the customer's name and address and a description of the goods or services supplied. *3*

(e) Describe the conditions which must be satisfied in order for more than two persons to qualify to become members of a VAT Group. *4*

(f) Outline the main features of the cash accounting scheme. *4*

(30)

SUMMARY OF TAX DATA

Corporation Tax

	Financial Year 2005	*Financial Year 2004*	*Financial Year 2003*
Standard rate	12.5%	12.5%	12.5%
Higher rate	25%	25%	25%

Capital Allowances

Date expenditure incurred	***Rate***	***Basis***
Plant & Machinery		
6 April 1996 – 31 December 2000	15%	Straight Line
1 January 2001 – 4 December 2002	20%	Straight Line
On or after 4 December 2002	12.5%	Straight Line
Motor Vehicles		
Pre 1 January 2001	20%	Reducing Balance
1 January 2001 to 4 December 2002	20%	Straight Line
On or after 4 December 2002	12.5%	Straight Line

Maximum qualifying cost of Motor Vehicles for capital allowance purposes

2005	€22,000
2004	€22,000
2003	€22,000
2002	€22,000
2001	€21,585

Income Tax

	2005	*2004*
Rates – First Amounts:	**20%**	**20%**
Single/Widowed	29,400	28,000
Married Couples/One Income	38,400	37,000
Married Couples/Two Income	58,800	56,000
One-Parent Family	33,400	32,000
Balance	**42%**	**42%**

Income Tax Credits	**€**	**€**
Single Person	1,580	1,520
Married Person	3,160	3,040
Age Credit (over 65)		
Single/Widowed Person	205	205
Married	410	410
PAYE	1,270	1,040

Preferential Loans (Specified Interest Rates)

	2005	*2004*
Residential Home Loan	3.5%	3.5%
Other Loan	11%	11%

PRSI Rates and Levies

Employee – Class A1			
	PRSI		**Health Levy**
	Employer	Employee (Income Limit)	Employee
2005	10.75%	4% (€44,180)	2%

Self Employed			
	Income	**PRSI (Min)**	**Health Levy**
2005	If Income < €20,800	3%	Nil
	Otherwise	3%	2%

Value Added Tax
Standard rate - 21%

Capital Gains Tax

Rate – 20%

Indexation Factors

1974/75	7.528
1975/76	6.080
1976/77	5.238
1977/78	4.490
1978/79	4.148
1979/80	3.742
1980/81	3.240
1981/82	2.678
1982/83	2.253
1983/84	2.003
1984/85	1.819
1985/86	1.713
1986/87	1.637
1987/88	1.583
1988/89	1.553
1989/90	1.503
1990/91	1.442
1991/92	1.406
1992/93	1.356
1993/94	1.331
1994/95	1.309
1995/96	1.277
1996/97	1.251
1997/98	1.232
1998/99	1.212
1999/00	1.193
2000/01	1.144
2001	1.087
2002	1.049
2003 et seq	1.000

Note: No indexation is available for expenditure made within 12 months prior to the date of disposal.