TAXATION

Diploma stage examination
13 June 2005

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** question 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 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.

CIPFA

SECTION A (Compulsory)

1 High Peak Trading Ltd began trading on 1 October 2003. Accounts were prepared for the six months to 31 March 2004 and then to 31 March each year. Results for the first two periods of account were as follows:

	£	***Notes***
Six months to 31 March 2004:		
Trading loss	(1,400)	1,2,3,4
Chargeable gain on disposal of land	22,600	3
Year to 31 March 2005:		
Trading profit	161,180	1,2,3
Income from property (amount received)	18,000	5
Bank interest received	880	6

Notes:

1 The trading loss and the trading profit have both been adjusted for tax purposes but capital allowances have not yet been computed. The company is a small company as defined by the Companies Acts and maximum capital allowances are claimed.

2 The company bought the following plant and machinery during its first two periods of account:

		£
1 October 2003	Machinery	16,000
1 October 2003	Office furniture	2,000
23 October 2003	Motor van	14,500
15 November 2003	Ford motor car	12,400
1 February 2004	Nissan motor car	8,800
17 April 2004	Machinery	56,000
9 May 2004	Office computer system	3,400
3 March 2005	VW motor car	10,300

The Ford motor car is diesel-powered and has an emission rating of 172 g/km. It is subject to 30% private use by a director. The Nissan and VW cars are petrol-powered and have emission ratings of 131 g/km and 117g/km respectively. Both are used wholly for business purposes.

On 8 February 2005, the company sold machinery for £2,100. This machinery had cost £3,000 in October 2003.

3 On 1 October 2003, the company bought a brand-new factory unit from a firm of builders. The price paid was £250,000, made up as follows:

	£
Land	45,000
Factory	125,000
Drawing offices	25,000
General offices	55,000

The company used this unit for manufacturing purposes as from 1 October 2003. Part of the land was surplus to the company's requirements and was sold in March 2004, yielding a chargeable gain of £22,600.

On 1 November 2004, the company bought a nearby building from Beta plc for £124,000 (excluding land) and began to use this building for the storage of raw materials. Beta plc (which prepares accounts to 31 December each year) had constructed the building in 1999 at a cost of £160,000 (excluding land) and had used it for industrial purposes since 1 November 1999. However, the unit had been used for a non-industrial purpose from 1 October 2001 to 31 July 2002.

4 The company has not made (and does not intend to make) any claim with regard to its trading loss for the six months to 31 March 2004.

5 The company began renting spare general office space to a tenant on 1 January 2005. The agreed rent was £8,000 per annum payable annually in advance. No expenses were incurred in connection with the rented property during the year to 31 March 2005. The property was let on a ten-year lease and the company received a £10,000 premium on 1 January 2005.

6 Bank interest received in the year to 31 March 2005 was £880. A further £220 of interest was accrued at the end of the year.

7 The company made a Gift Aid donation of £500 on 12 March 2005.

8 No dividends were paid or received in either period of account.

9 The company is hoping for rapid growth over the next few years and expects that chargeable profits will exceed £1 million per annum within two years and £2 million per annum within five years.

- **Requirement for question 1**

(a) Compute the company's corporation tax liability for the six months to 31 March 2004 and state the date on which this tax is due for payment. *10*

(b) Compute the company's corporation tax liability for the year to 31 March 2005 and state the date on which this tax is due for payment. *18*

(c) Briefly explain the tax consequences (if any) which would have ensued if the company had paid a dividend to individual shareholders in either of the two periods of account. *3*

(d) Identify the claim which the company might have made with regard to the trading loss incurred in the six months to 31 March 2004. Would such a claim have been advisable? *3*

(e) In April 2005, the company received a notice requiring it to submit a corporation tax return for the year to 31 March 2005. State the date by which this return must be submitted and explain the penalties which the company would incur for late submission. *3*

(f) Assuming that corporation tax law remains unchanged, explain when the company might have to begin paying corporation tax by instalments. Also explain how these instalments would be calculated and identify the dates on which they would be due for payment. *3*

(40)

SECTION B (Answer two questions from this section)

2

Jean Horton and John Ribble both work for Pen-y-ghent Ltd, which is currently preparing forms P11D for tax year 2004/05. The following information is available in relation to these two employees:

Jean Horton

1 Jean was born in 1955 and has worked for the company since 1984. Her gross pay in 2004/05 was £42,000. Income tax of £9,410 was deducted via the PAYE system. She pays 10% of her gross pay into the company's occupational pension scheme and is contracted out of the State Second Pension.

2 Jean is provided with a company car for both business and private motoring. The cars provided during 2004/05 were as follows:

	List price £	**Emissions g/km**	**Fuel used**
6 April 2004 to 5 July 2004	11,200	187	Petrol
6 July 2004 to 5 April 2005	14,700	179	Diesel

The company paid for all of the running costs of these cars but Jean contributed £100 per month for private use of the cars and a further £50 per month towards fuel costs. The fuel used for private motoring cost the company £1,270 during the year. Jean also paid £2,000 towards the purchase price of the latter of the two cars so that she could have a better car than would normally be provided.

3 On 6 October 2002, the company lent Jean a brand-new multi-gym machine for use at home. This machine had cost the company £1,000. On 6 January 2005, the machine was sold to Jean for £100. Its market value on that date was £400.

4 During 2004/05, Jean received a long-service award in recognition of 20 years of loyal service to the company. The award consisted of a gold watch which cost the company £800.

5 Jean's only other income for 2004/05 consisted of UK dividends of £3,015 and ISA interest of £230. She made Gift Aid donations to the RSPCA of £10 per month throughout the year and to Oxfam of £15 per month for the last five months of the year.

John Ribble

1 John was born in 1973 and joined the company on 1 May 2004. His gross pay for 2004/05 was £27,500 and income tax of £4,871 was deducted via PAYE. He has not yet joined the company pension scheme and he is not contracted out of the State Second Pension.

2 John is not provided with a company car but he uses his own car for business journeys and is paid 30p per mile by the company. He drove 12,000 business miles during 2004/05.

3 Before taking up his employment with the company, John had lived in a city over 100 miles away. In May 2004, the company reimbursed his relocation expenses of £5,800. All of this sum was spent on legal fees, estate agent's fees and other moving costs.

4 On 6 June 2004, the company lent John £50,000 at an interest rate of 2% per annum. John won a £10,000 premium bond prize in August 2004 and used this to repay £10,000 of the loan on 6 September 2004.

5 John is provided with a mobile telephone and is allowed to use this telephone to make both business and private calls. The company did not have to pay for the telephone itself but paid call charges of £840 during the year (of which £290 related to private calls).

6 In June 2004, John bought a new suit of clothes for work use. The suit cost him £350 and he wears it only when he is working. All of the company's staff are required to wear formal clothing at work.

7 John's only other income for 2004/05 consisted of gross pay from his previous employer of £1,920 (PAYE paid £315) and net building society interest of £1,680.

- **Requirement for question 2**

(a) Explain the purpose of a form P11D and specify the types of employee for whom such a form must be completed. Also state the date by which P11Ds must be submitted to the tax authorities and to the employees concerned. *3*

(b) Prepare an income tax computation for Jean for tax year 2004/05. If any of her income is not taxable, explain why this is the case. *13*

(c) Prepare an income tax computation for John for tax year 2004/05. If any of his income is not taxable, explain why this is the case. *7*

(d) Explain why employees such as Jean and John might still owe some income tax at the end of the year (despite the operation of the PAYE system) and explain how this tax is likely to be collected. *3*

(e) Calculate the National Insurance contributions (NICs) payable in relation to Jean and John for 2004/05. *4*

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3 PCC Ltd is a manufacturing company which prepares accounts to 31 December each year. The company made the following disposals of chargeable assets in the year to 31 December 2004:

1 On 12 September 2004, 7,500 ordinary shares in Epsilon plc were sold for £6.50 each. PCC Ltd had bought ordinary shares in Epsilon plc as follows:

		£
14 January 1981	Bought 2,000 shares	4,000
27 June 1991	Bought 3,000 shares	15,000
10 March 2001	Bought 4,000 shares	28,000

The shares had a market value on 31 March 1982 of £2.50 per share.

2 On 9 October 2004, two watercolour paintings (which do not form a set) were sold at auction. In each case, the auctioneer charged a 10% commission. The paintings had been acquired for £2,000 each in May 1995 and had been hanging in the company's reception area ever since. The net proceeds of the paintings (after deducting commission) were £5,175 and £5,805 respectively.

3 On 1 June 2004, a short lease was assigned for £7,000. The lease had been acquired as a 20-year lease on 1 January 1990 at a cost of £20,000.

4 On 25 November 2004, a freehold property was sold for £115,000. The building had been acquired in August 1997 for £50,000. In February 2004 the company bought fixed plant for £100,000.

PCC Ltd has not made (and does not intend to make) a "re-basing" election to the effect that assets acquired before 31 March 1982 should be treated as if acquired on 31 March 1982 at a cost equal to their market value on that date. However, the company does intend to make any other election which will reduce the amount of gains chargeable to corporation tax in the year to 31 December 2004.

On 1 January 2004, the company had capital losses brought forward of £6,646.

- **Requirement for question 3**

(a) Compute the chargeable gain or allowable loss arising on each of the above disposals. Hence compute the net chargeable gains figure which should be charged to corporation tax for the year to 31 December 2004. Assume Retail Price Indices as follows: *16*

March 1982	79.44	March 2001	172.2
January 1990	119.5	June 2004	185.8
June 1991	134.1	September 2004	187.0
May 1995	149.6	October 2004	187.4
August 1997	158.5	November 2004	187.8

Extracts from the short lease amortisation table given in Schedule 8 of the Taxation of Chargeable Gains Act 1992 are as follows:

5 years	26.722	6 years	31.195	20 years	72.770

(b) Explain the factors which should have influenced the company's decision not to make the "re-basing" election referred to above. Would the election have been beneficial or detrimental if it had been in force during the year to 31 December 2004 and could the company still make the election if it so wished? *3*

(c) Explain how the gain arising on the disposal of the freehold property is treated for tax purposes. *3*

(d) List and explain the set of tests known as the "badges of trade" which are used to distinguish between trading and non-trading activities. Also explain why it is important to distinguish trading profits from chargeable gains. *8*

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4 Parkside Products Ltd is a small company which began trading on 1 January 2003. The company was not VAT registered at first but registration was eventually required and took effect as from 1 January 2005. The information given below relates to the company's first VAT return, which covers the three months to 31 March 2005. All figures are exclusive of VAT unless stated otherwise.

1 Standard-rated supplies made to customers totalled £12,000. Zero-rated supplies were £4,000. The company offers a 3% discount to customers who pay within 30 days and this was taken advantage of by customers who bought 60% of the standard-rated supplies and 70% of the zero-rated supplies made by the company during the quarter.

2 Standard-rated goods were sold for £2,400 to a customer who paid in advance on 17 March 2005. The goods were not made available to the customer until 7 April 2005 and were not invoiced until 14 April 2005. This sale is not included in the £12,000 total mentioned above and this customer was not offered a discount for prompt payment.

3 Standard-rated goods for resale bought in the quarter totalled £3,200. Standard-rated goods for resale bought during 2003 and 2004 totalled £15,000, of which goods costing £1,400 were still in stock on 1 January 2005.

4 Staff wages for the quarter were £6,600.

5 On 1 January 2005, the company was charged £1,000 of VAT in relation to the purchase of a 1,600cc diesel-engined motor car. This car was acquired primarily for business use but private journeys by the company's managing director account for 25% of its mileage. Repairs and maintenance charges in relation to this car were £320 for the quarter.

6 Other overhead expenses (all standard-rated) were £2,800. This figure includes the £480 cost of all the fuel used by the above motor car for both business and private journeys during the quarter. The company has decided to reclaim the input tax on this fuel as far as is possible. The figure of £2,800 also includes £180 in relation to an equipment maintenance contract which began on 1 April 2004 and for which the company is charged £60 per month.

7 In February 2005, the company bought a computer system (a fixed asset) for a VAT-inclusive price of £1,880.

Parkside Products Ltd is anxious to minimise the administrative costs associated with VAT registration and is considering joining the annual accounting scheme or the flat rate scheme for small businesses as soon as possible.

- **Requirement for question 4**

(a) State the circumstances in which VAT registration is compulsory and outline the probable conditions which required the company to register for VAT with effect from 1 January 2005. *2*

(b) The VAT invoices issued by the company now that it is VAT registered must state the tax point of each supply. Explain the meaning of the term "tax point" and explain how the tax point of a supply is determined. Also explain why the tax point is important. *3*

(c) Compute the amount of VAT payable to HM Customs and Excise for the quarter and state the date by which this must be paid. *10*

(d) Explain the main features of the annual accounting scheme and the flat rate scheme for small businesses. Would Parkside Products Ltd be able to join both of these schemes simultaneously if it so wished? *7*

(e) VAT is sometimes referred to as a "regressive" tax. Explain what is meant by this term and assess the extent to which VAT is regressive. *4*

(f) Distinguish between tax avoidance and tax evasion and briefly explain the Government's recent attempt to place statutory curbs on the use of VAT avoidance schemes. *4*

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SUMMARY OF TAX DATA

Corporation Tax

	Financial Year 2004	*Financial Year 2003*	*Financial Year 2002*
Full rate	30%	30%	30%
Small company rate	19%	19%	19%
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	11/400
Starting rate	0%	0%	0%
Lower limit	£10,000	£10,000	£10,000
Upper limit	£50,000	£50,000	£50,000
Marginal relief fraction	19/400	19/400	19/400
Non-corporate distribution rate	19%	-	-

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 companies:	
Acquired on or after 2 July 1998	40%
Acquired 1 April 2004 to 31 March 2005	50%

Income Tax

			2004/05	*2003/04*
Starting rate	10%	first	£2,020	£1,960
Basic rate	22%	next	£29,380	£28,540
Higher rate	40%	over	£31,400	£30,500

	2004/05	*2003/04*
Personal allowance:		
Age 0 to 64	£4,745	£4,615
Age 65 to 74	£6,830	£6,610
Age 75 or over	£6,950	£6,720
Married couple's allowance:		
Age under 75 and born before 6 April 1935	£5,725	£5,565
Age 75 or over	£5,795	£5,635
Minimum amount	£2,210	£2,150
Income limit for age-related allowances	£18,900	£18,300

Car benefit

Emission rating	*Taxable percentage of list price*
Up to 145 g/km	15%
Each additional 5g/km	+ 1%
Diesel engine	+ 3%
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

	2004/05	*2003/04*
Primary threshold (annual)	£4,745	£4,615
Secondary threshold (annual)	£4,745	£4,615
Upper earnings limit (annual)	£31,720	£30,940
Employee contribution rates:		
On earnings up to primary threshold	0%	0%
On remainder up to UEL (Not contracted out)	11%	11%
On remainder up to UEL (Contracted out)	9.4%	9.4%
On earnings above the UEL	1%	1%
Employer contribution rates:		
On earnings up to secondary threshold	0%	0%
On remainder up to UEL (Not contracted out)	12.8%	12.8%
On remainder up to UEL (Contracted out)	9.3%	9.3%
On earnings beyond UEL	12.8%	12.8%

Class 1A National Insurance Contributions

	2004/05	*2003/04*
Employer contribution rate	12.8%	12.8%

Value Added Tax

Standard rate (from 1 April 1991)		17.5%
Registration threshold (from 1 April 2004)		£58,000
Deregistration threshold (from 1 April 2004)		£56,000
Fuel quarterly scale charges (from 1 May 2004):		
VAT due per car:		
Petrol engines:	up to 1,400cc	£34.55
	up to 2,000cc	£43.63
	2,001cc or more	£64.34
Diesel engines:	up to 1,400cc	£32.17
	up to 2,000cc	£32.17
	2,001cc or more	£40.65