TAXATION REPUBLIC OF IRELAND

Diploma stage
December 2005

MARKING SCHEME

Question 1

(a)

		€	€	
Pre-tax profit per accounts			594,330	½
Add:	Legal fees (€2,500 + €8,000 + €2,700)		13,200	*1*
	Entertaining (€3,270 + €4,800)		8,070	½
	Royalties		50,000	*1*
	Motor expenses		-	½
	Amortisation		900	*2*
	Depreciation		113,340	½
	Loss on disposal of equipment		2,820	½
	Interest payable		-	*1*
			782,660	
Less:	Decrease in general provision	500		½
	Profit on disposal of motor car	440		½
	Royalties receivable	-		½
	Profit on sale of freehold property	105,000		½
	Profit on sale of shares	12,000		½
	Irish dividends received	43,110		½
	Interest receivable	14,840	175,890	½
Schedule D Case I profit (before capital allowances)			606,770	*1*

Additional 1 mark for recognizing that MD's car has no implications on the tax computation.
(13)

(b) Capital allowances on plant and machinery:

	Equipment	**Motor Vehicles**	**Furniture**	**Total**	
y/e 31/12/04					
Cost	224,000	16,229	2,743	242,972	½
Disposals @ cost	(8,000)	(16,229)	(2,743)	(26,972)	½
	216,000	0	0	216,000	
WDV b/f	89,600	14,200	2,400	106,200	½
disposals @twdv	(3,600)	(14,200)	(2,400)	(20,200)	½
WDV c/f	86,000	0	0	86,000	½
Additions	46,700	50,150	0	96,850	½
W&T @20%/	(43,200)	0	0	(43,200)	½
W&T @ 12.5%	(5,838)	(6,269)		(12,107)	½
TWDV @ 31.12.04	83,662	43,881	0	127,543	½
Total wear and tear allowances				**55,307**	½

Balancing Allowances/Charges

Car

Cost	€16,229	
Twdv	€14,200	
Proceeds	€15,800	
Balancing charge	**€1,600**	
		1

Equipment

Cost	€8,000	
Twdv	€3,600	
Proceeds	€4,450	
Balancing charge	**€850**	
		1

Office Furniture

Cost	€2,743
Twdv	€2,400
Proceeds	€1,100
Balancing allowance	**€1,300**

Summary of capital allowances

Wear and tear	€55,307	
Balancing charges	(€2,450)	
Balancing allowance	€1,300	
Total allowance	**€54,157**	
		(8)

(c) Building sold September 1998

		€	
Disposal proceeds		310,000	½
Less: Cost	125,000		
	Index 1.502	(187,750)	*1*
		122,250	
Losses brought forward		(96,215)	½
Capital gain previously deferred due to rollover relief		26,035	½

Building sold October 2004

		€	
Disposal proceeds		400,000	½
Less: Cost	295,000		
	Index 1.212	(357,540)	*1*
Chargeable Gain		42,460	½

Shares in Bodmin plc – FIFO applies (1 mark for recognising FIFO) *1*

Sale proceeds		€52,000	
Cost	€40,000		
Index	1.583	(63,320)	½
Capital gain/loss		NG/NL	½

The shares were sold for €52,000, so there is an unindexed gain of €12,000. The result is No loss, no gain.

Summary of capital gains

On previous building sold in 1998	€26,035	
On building sold in 2004	€42,460	
Total gain	**€68,495**	
		1
		(7)

(d) Corporation tax computation:

	€	
Schedule D Case I	606,770	
Less: Capital allowances	54,157	
Case I	552,613	*½*
Schedule D Case III	0	*1½*
Chargeable gains (68,495 x20%/12.5%)	109,592	*1 ½*
Total Profits	662,205	*1*
Corporation tax due:		
€662,205 @ 12.5%	82,776	*1*

This corporation tax is due *in installments – 21 November 2004, 21 June 2005 and 21 September 2005.* *1 ½*

(7)

(e) In 2006, all companies will be required to pay 90% of the final corporation tax liability for a period one month before period end. There are transitional arrangements in place until 2006. For accounting periods ending in 2004, companies (which are not small companies) will have to pay the following amount of their final CT liability on the following dates;

21st day of the month before accounting period end – 54%
21st day of the sixth month after accounting period end – 36%
21st day of the ninth month after accounting period end –10% *(5)*

(40)

Question 2

(a) With a salary of €45,000, Robert has already used up the whole of the income tax basic rate bands. Similarly, his income exceeds the PRSI upper earnings limit. Therefore, any further pay will be subject to income tax at 42% and the 2% health levy. *1 ½*

If he accepts the payrise, the only effect will be that his net pay will rise by €2,240 (€4,000 @ 56%). *½*

If Robert accepts the car, there will be additional tax of €2,310 ((€17,500 x 30%) x 42% tax and 2% health levy). *3*

If he accepts the car, Robert will lose the mileage allowance of €1,200 (with no tax consequences) so his net pay would fall by a total of €3,510. However, he would save €6,500 in motor expenses, so he would be €2, 990 better off overall. *1 ½*

On balance, Robert might be advised to accept the car, since this is worth €680 more to him (€2,990 - €2, 240) than the company car. *½*

(7)

(b) The main tests which are used to distinguish employment from self-employment are as follows:

- Control
- Financial risk
- Provision of equipment
- Work performance and correction
- Holidays and sickness
- Exclusivity

½ mark for identification of each test + further ½ mark for relating to Rita's case (6)

(c)

	James	**Jean**	
	€	**€**	
Pensions	17,360		*½*
Building society interest:			
€4,160 x 100/80	5,200		*½*
€2,160 x 100/80		2,700	*½*
Schedule F:			
€1,710 x 100/80	2,138		*½*
€4,230 x 100/80		5,288	*½*
Taxable income	24,698	7,988	*½*

Income tax due:

Total Income €32,685

Income tax 20%	€6,537	*1*
Personal tax credit	(€3,160)	*1*
Age tax credit	(€410)	*1 ½*
DIRT	(€1,580)	*1*
Dividend tax credits	(€1,485)	*1*
Refund due (before deducting PAYE)	(€98)	*1 ½*

Notes:

(i) James is entitled to the age tax credit as he is over 65. He gets double the allowance as he is married. *(10)*

(d) The main features of the PAYE system are as follows:

- Employers deduct income tax, PRSI and the health levy from employees when paying their wages and salaries. The sums deducted in a tax month (together with the employer's PRSI) must be paid over to the Revenue Commissioners within 14 days of the end of that month.

- The PAYE system applies to all payments assessable as employment income, including "payments" taking the form of assets which are readily convertible into cash.

- Each employee is issued with a certificate by the Revenue which states the standard rate cut off point and the tax credits for the employee. This code reflects the employee's entitlement to allowances and reliefs. The tax credits may be adjusted to collect tax due on non PAYE income or to account for tax under-paid or over-paid in previous years.

- The system is cumulative in nature. With the aid of tax deduction cards provided by the Revenue Commissioners, the employer is able to determine the amount of tax-free pay to which an employee is entitled for the tax year to date. This amount is then subtracted from the employee's gross pay to date, giving the taxable pay to date.

- The aim is that, at any time of year, the tax paid so far during the year should accord with the amount due so far for that year. At the end of the year, the system should have automatically collected the correct amount of tax and it should not be necessary to issue the employee with a further tax demand or make a tax repayment.

- At the end of each tax year, employers are required to submit an end-of-year return to the Revenue, summarising all employees' gross pay and tax paid for the year. A certificate of gross pay and tax deducted must also be provided to each employee at the end of the tax year on form P60.

- The system as originally designed revolves around the use of printed tax tables and forms. However, many employers now run computer-based payroll systems in which disk files have replaced the printed tables. Similarly, there is an increasing trend for end-of-year PAYE returns to be submitted to the Revenue by electronic means.

1 mark for each valid point up to a maximum of (7)

(30)

Question 3

(a)

	y/e 30/6/03	**1/7/03 to 31/12/03**	**y/e 31/12/04**	
	€	**€**	**€**	
Schedule D Case I	2,050,000	260,000	-	*1*
Schedule D Case III	51,600	39,000	28,700	*1*
Chargeable gains	-	-	8,700	*2*
	2,101,600	299,000	37,400	
Less: Charges	10,000	8,000	5,000	*1*
PCTCT and profits	2,091,600	291,000	32,400	

Notes:

(i) Capital losses carried forward at 30 June 2003 are €35,300 (€67,300 - €32,000). Therefore net chargeable gains for the year to 31 December 2004 are €8,700 (€47,000 - €35,300 - €3,000). *1*

	y/e 30/6/03	**1/7/03 to 31/12/03**	**y/e 31/12/04**	
	€	**€**	**€**	
Corporation tax @ 12.5%	2,050,000	260,000	0	*½*
Corporation tax @ 25%	41,600	31,000	23,700	*2*
Capital gains @ 20%			8,700	*½*
Corporation tax liability	266,650	40,250	7,665	*1*

Higher mark of 2 given to corporation tax @ 25% as it recognizes that non trade charges should be offset against non trading income before trading income to maximize the benefit/minimize the liability

(9)

(b) The order in which loss claims relating to trading losses should be made is as follows:

Against:

- Trading income of the current period (s.396A)
- Trading income of the preceding period (of corresponding length) (s.396A)
- Total profits of the current period on a credit and value basis (s.396B)
- Total profits of the preceding period (of corresponding length) on a credit
- and value basis (s.396A)
- Carry forward for offset against income from the same trade (s.396) *5*

(c)

	y/e 30/6/03	**1/7/03 to 31/12/03**	**y/e 31/12/04**	
	£	**£**	**£**	
Schedule D Case I	2,050,000	260,000	-	
s.396 A	(635,000)	(260,000)		*2*
	1,415,000	0		
Schedule D Case III	41,600	31,000	23,700	*1*
Chargeable gains	-	-	8,700	*1*
	1,456,600	31,000	32,400	*1*
Tax	176,875			*1*
12.5%				
25%	10,400	7,750	5,925	*1*
20%		-	1,740	*1*
Revised Corporation tax liability	187,275	7,750	7,665	*1*

Notes:

(i) Non trade charges should be offset against income taxed at the higher rate in priority to offset against trading income.

(iii) Losses can only be offset against profits of accounting periods of corresponding length. The second accounting period (31.12.03) is only a six month period, therefore the loss incurred in the period ended 31.12.04 can be offset against a maximum of 6/12ths of the trading profits for the period ended 30.06.03. *(9)*

(d) The reduction in the total corporation tax liability over the three periods is €111,875 (€895,000 x 12.5%). *3*

(e) Tax avoidance (which is legal) involves arranging a taxpayer's financial affairs in such a way as to minimise the amount of tax payable. For example, income tax would be legally avoided (reduced) by a taxpayer who invested in a property which had, say, section 23 or similar type of capital allowances (urban renewal allowances).

Tax evasion (which is illegal) involves reducing tax payments by means of dishonest conduct. For example, income tax could be evaded by claiming tax relief on an expense which has not actually been incurred.

Although tax avoidance is legal, the Government takes a dim view of complex and highly artificial tax avoidance schemes which are devised by tax advisors to exploit "loopholes" in the tax law. In an attempt to curb the use of such schemes, each Finance Act comes with new anti-avoidance legislation. *4*

(30)

Question 4

(a) A company which makes wholly taxable supplies (whether at the standard rate, lower rate or zero rate) must generally register for VAT if its turnover exceeds a prescribed threshold and may register voluntarily even if turnover does not exceed this threshold. *1*

Having registered, the company will charge VAT (at the appropriate rate) to its customers and must account for this "output tax" to Revenue Commissioners. The company will also be able to reclaim the "input tax" which it suffers on the goods and services which it buys. *1*

A company which makes only exempt supplies is not making taxable supplies and cannot register for VAT. The company must not charge VAT to customers and cannot reclaim input tax. *1*

Examples of zero-rated supplies include most food and drink of a kind used for human consumption. Examples of exempt supplies include insurance and banking activities. *1*

(4)

(b) 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)

(c) Output tax is €74,260 x 21/121 = €12,888 and so standard-rated supplies (excluding VAT) are €61,372. Total taxable supplies, including zero-rated supplies, exclusive of VAT are €78,172 and total supplies of all types, including exempt supplies, are €60,672. Therefore the calculation of the VAT liability for the Nov/Dec 2004 period is as follows: *2*

	€	€	
Output tax:			
Standard-rated supplies		12,888	
Zero-rated supplies		0	
		12,888	*1*
Input tax:			
Attributed to taxable supplies:			
Purchase of van	1,710		*1*
Petrol for van	0		*1*
Other input tax attributed to taxable supplies	3,320		*½*
Unattributed tax:			
Customer entertaining	0		*½*
Staff entertaining	0		*½*
Other unattributed input tax:			
€1,260 x €78,172/€90,672	1,086		*1 ½*
		3,116	*½*
Payable to the Revenue Commissioners		9,765	*½*
			(9)

(d) Local authorities are not taxable persons and cannot normally be so, unless they are made so by order of the Minister for Finance.

Irish VAT law in this area seems to be at variance with the EC Sixth Directive on VAT which provides that Member States and local authorities are liable on certain activities.

Local authorities may be made liable to VAT on the provision of facilities for sporting and physical activities. From 1 January 1996, the Revenue Commissioners are empowered to review, on a case by case basis, sporting and physical education facilities provided by either State and local authorities or non profit making organisations. As a result of the review they will decide whether the exemption gives one provider of such facilities an unfair advantage over another. If such a distortion of competition arises the Revenue Commissioners will make a determination under Section 11(1B) (b) that the supplier of the service in question is liable to VAT.

(3)

(e) **(i)** direct taxes and indirect taxes

(ii) taxes levied on income, wealth, capital gains, expenditure etc.

(iii) progressive, regressive and proportional taxes

(iv) taxes based on weight/size of the tax base or on monetary value.

1 mark for explaining each classification
+ further ½ mark for correctly classifying VAT (6)

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

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

1 mark for explaining each feature (4)

(30)