

Diploma in Financial Planning

Unit J03 – The tax and legal aspects of business

October 2013 examination

SPECIAL NOTICES

All questions in this paper are based on English law and practice applicable in the tax year 2013/2014, unless stated otherwise in the question, and should be answered accordingly.

It should be assumed that all individuals are domiciled and resident in the UK unless otherwise stated.

Instructions

- Two hours are allowed for this paper.
- **Do not begin writing until the invigilator instructs you to.**
- **Read the instructions on page 3 carefully before answering any questions.**
- Provide the information requested on the answer book and form B.
- You are allowed to write on the inside pages of this question paper, but you must **NOT** write your name, candidate number, PIN or any other identification anywhere on this question paper.
- The answer book and this question paper must **both be handed in personally by you** to the invigilator before you leave the examination room. **Failure to comply with this regulation will result in your paper not being marked and you may be prevented from entering this examination in the future.**

Unit J03 – The tax and legal aspects of business

Instructions to candidates

Read the instructions below before answering any questions

- **Two hours** are allowed for this paper which consists of 15 short answer questions and carries a total of 130 marks.
- You are strongly advised to attempt **all** questions to gain maximum possible marks. The number of marks allocated to each question part is given next to the question and you should spend your time in accordance with that allocation.
- Read carefully all questions and information provided before starting to answer. Your answer will be marked strictly in accordance with the question set.
- You may find it helpful in some places to make rough notes in the answer booklet. If you do this, you should cross through these notes before you hand in the booklet.
- It is important to show all steps in a calculation, even if you have used a calculator.
- If you bring a calculator into the examination room, it must be a silent, battery or solar-powered, non-programmable calculator. The use of electronic equipment capable of being programmed to hold alphabetic or numerical data and/or formulae is prohibited. You may use a financial or scientific calculator, provided it meets these requirements.
- Tax tables are provided at the back of this question paper.
- Answer each question on a new page and leave six lines blank after each question part.

Subject to providing sufficient detail you are advised to be as brief and concise as possible, using note format and short sentences on separate lines wherever possible.

Attempt ALL questions

Time: 2 hours

*To gain maximum marks for calculations you **must** show **all** your workings and express your answers to **two** decimal places.*

1. Operating as a sole trader may have certain drawbacks compared to a limited company.
State **four** of these drawbacks and for each drawback state the implication for the sole trader. (8)
2. (a) List the requirements that must be met for an insolvent company to enter members' voluntary liquidation. (3)
(b) Creditors may apply for a voluntary winding up of a company when the directors are unable or unwilling to do so.
List the steps that should be taken for a creditor's voluntary liquidation to proceed. (3)
3. The Partnership Act 1890 provides a basic legal framework for partnerships.
Outline the main points covered by this legislation. (6)
4. (a) State the principle under which the relationship between partners and third parties is governed. (1)
(b) Explain how 'actual authority' arises in a partnership. (6)
(c) Explain briefly how 'apparent authority' arises in a partnership. (4)
5. (a) Explain briefly what is meant by budgetary control. (4)
(b) Explain the requirements for effective budgetary control. (6)

6. Dentists John, Geoff and Brian are partners in an ordinary partnership whose business has been valued at £160,000. The partnership agreement states that a retiring partner is entitled to a share proportionate to the capital subscribed.

When they started, John and Geoff contributed £10,000 each and Brian contributed £20,000.

Brian wants to retire and Sarah, another dentist in the practice, wishes to become a partner. John and Geoff wish the future partnership share to be equal across all three partners.

The £160,000 is made up of £120,000 practice property and deposits of £40,000. The partners do not wish to use the deposits to repay Brian.

- (a) Explain to John and Geoff the options they have for the partnership to raise cash to repay Brian's full share of the capital without having to introduce a new partner. (6)
- (b) If John and Geoff agree to admit Sarah as an equal partner on Brian's retirement;
 - (i) Calculate, **showing all your workings**, the capital sum Sarah has to contribute to become an equal partner. (2)
 - (ii) Sarah has the funds available to purchase her partnership share and Brian is willing to accept staged payments over five years. Explain how the partnership can arrange payment of Brian's share at minimum risk to Brian. (6)

7. Keith, a director of a small limited company draws a salary of £45,000 per annum. The company has taxable profits of £60,000 and wishes to award Keith £10,000.

Calculate, **showing all your workings**, the overall costs to the company of paying the £10,000 as:

- (a) gross bonus; (3)
- (b) contribution to his personal pension plan; (2)
- (c) dividend. (2)

8. James, a sole trader, is considering gifting a business property to his two children. The property was originally acquired for £120,000 and is now valued at £200,000. He is concerned about Capital Gains Tax liabilities on the gift and would like to make use of any available reliefs.

Describe briefly how the following reliefs operate and state **one** disadvantage of each.

- (a) Holdover relief. (4)
- (b) Enterprise Investment Scheme (EIS) reinvestment relief. (5)

9. Explain briefly the objectives of share protection arrangements for private limited companies which have a small number of principal shareholders. (5)

Questions continue over the page

10. Rachel and Anne operate their beauty business from rented premises. Their landlord planning to sell the premises for £200,000.

Rachel and Anne want to use their pension funds of £61,000 and £68,000 respectively to purchase the premises, as the bank has declined their application for a mortgage.

- (a) List **four** advantages and **four** disadvantages for Rachel and Anne of using their pension funds to purchase the property. (8)
- (b) Calculate, **showing all your workings**, the maximum amount they could raise using their pension funds and state if this would be sufficient to purchase the property. (5)

11. Bill, aged 60, has traded as an unincorporated electrical wholesaler throughout a successful business career. He is now retiring and will rely financially on his maximum funded pension plan. He is planning to make the following immediate gifts to members of his family and is seeking your advice on the Inheritance Tax (IHT) implications.

Table

Asset	Value (£)	Beneficiary
Cash accumulated in his business bank account	400,000	Discretionary Trust for infant grandchildren
Business and premises	800,000	His son Ben who is taking on the business
Buy to let property investments	600,000	His wife and daughter equally

To date Bill has made no previous gifts other than each year's annual exemptions.

Describe the IHT consequences of each of the following gifts from the table above:

- (a) cash to grandchildren's discretionary trust; (5)
- (b) business and premises to his son; (5)
- (c) property investments to his wife and daughter. (5)
12. (a) Explain how retained profits arise in a small limited company and the reasons they may be re-invested in the company. (5)
- (b) Apart from retained profits, state **two** main sources of finance for small companies other than external financing. (2)
13. Nicola's husband has recently taken a secondment to work abroad and she wishes to take time off work to care for her son whilst he is away.
- State the conditions that must apply for Nicola to qualify for parental leave. (5)

14. Explain briefly how UK dividends are treated for tax purposes when:
- (a) made by a UK company;
 - (b) received by a shareholder. (4)
15. Rhodea Ltd, is a small manufacturing company and their accounting year end is 31 March.
- (a) State when their Corporation Tax self assessment must be filed and when their Corporation Tax is due for the financial year ending 31 March 2013. (2)
 - (b) List the circumstances under which HM Revenue & Customs can impose a penalty on Rhodea Ltd in respect of its Corporation Tax return and payment. (5)
 - (c) State the minimum fixed penalty for filing a Corporation Tax self-assessment return late. (1)

The Tax Tables can be found on pages 9 – 13

INCOME TAX

RATES OF TAX	2012/2013	2013/2014
Starting rate for savings*	10%	10%
Basic rate	20%	20%
Higher rate	40%	40%
Additional rate	50%	45%
Starting-rate limit	£2,710*	£2,790*
Threshold of taxable income above which higher rate applies	£34,370	£32,010
Threshold of taxable income above which additional rate applies	£150,000	£150,000
Child benefit charge from 7 January 2013: 1% of benefit for every £100 of income over	£50,000	£50,000

*Restricted to savings income only and not available if taxable non-savings income exceeds starting rate band.

MAIN PERSONAL ALLOWANCES AND RELIEFS

Income limit for Personal Allowance §	£100,000	£100,000
Personal Allowance (basic if born after 5 April 1948) §	£8,105	£9,440
Personal Allowance (if born between 6 April 1938 and 5 April 1948) §	£10,500	£10,500
Personal Allowance (if born before 6 April 1938) §	£10,660	£10,660
Married/civil partners (minimum) (if born before 6 April 1935) at 10% †	£2,960	£3,040
Married/civil partners (if born before 6 April 1935) at 10% †	£7,705	£7,915
Income limit for age-related allowances	£25,400	£26,100
Blind Person's Allowance	£2,100	£2,160
Enterprise Investment Scheme relief limit on £1,000,000 max	30%	30%
Seed Enterprise Investment relief limit on £100,000	50%	50%
Venture Capital Trust relief limit on £200,000 max	30%	30%
§ the Personal Allowance reduces by £1 for every £2 of income above the income limit irrespective of age (under the income threshold).		
† where at least one spouse/civil partner was born before 6 April 1935.		
Child Tax Credit (CTC)		
- Child element per child (maximum)	£2,690	£2,720
- family element	£545	£545
Threshold for tapered withdrawal of CTC	£15,860	£15,910

NATIONAL INSURANCE CONTRIBUTIONS

Class 1 Employee	Weekly	Monthly	Yearly
Lower Earnings Limit (LEL)	£109	£473	£5,668
Primary threshold	£149	£646	£7,755
Upper Accrual Point	£770	£3,337	£40,040
Upper Earnings Limit (UEL)	£797	£3,454	£41,450

Total earnings £ per week	CLASS 1 EMPLOYEE CONTRIBUTIONS	
	Contracted-in rate/contracted-out (money purchase)	Contracted-out rate (final salary)
Up to 149.00*	Nil	Nil
149.01 – 770.00	12%	10.6%
770.01 – 797.00	12%	12%
Above 797.00	2%	2%

*This is the primary threshold below which no NI contributions are payable. However, the lower earnings limit is £109 per week. This £109 to £149 band is a zero rate band introduced in order to protect lower earners' rights to contributory State benefits e.g. Basic State Pension.

Total earnings £ per week	CLASS 1 EMPLOYER CONTRIBUTIONS		
	Contracted-in rate	Contracted-out rate	
		<i>Final salary</i>	<i>Money purchase</i>
Below 148.00**	Nil	Nil	Nil
148.01 – 770.00	13.8%	10.4%	13.8%
770.01 – 797.00	13.8%	13.8%	13.8%
Excess over 797.00	13.8%	13.8%	13.8%

** Secondary earnings threshold.

Class 2 (self-employed)	Flat rate per week £2.70 where earnings exceed £5,725 per annum.
Class 3 (voluntary)	Flat rate per week £13.55.
Class 4 (self-employed)	9% on profits between £7,755 - £41,450 2% on profits above £41,450.

PENSIONS

TAX YEAR	LIFETIME ALLOWANCE	ANNUAL ALLOWANCE
2006/2007	£1,500,000	£215,000
2007/2008	£1,600,000	£225,000
2008/2009	£1,650,000	£235,000
2009/2010	£1,750,000	£245,000
2010/2011	£1,800,000	£255,000
2011/2012	£1,800,000	£50,000
2012/2013	£1,500,000	£50,000
2013/2014	£1,500,000	£50,000

ANNUAL ALLOWANCE CHARGE

20% - 45% member's tax charge on the amount of total pension input in excess of the annual allowance.

LIFETIME ALLOWANCE CHARGE

55% of excess over lifetime allowance if taken as a lump sum.

25% of excess over lifetime allowance if taken in the form of income, which is subsequently taxed under PAYE.

INHERITANCE TAX

RATES OF TAX ON DEATH TRANSFERS

2012/2013 2013/2014

Transfers made after 5 April 2013

- Up to £325,000	Nil	Nil
- Excess over £325,000	40%	40%
- Lifetime transfers to and from certain trusts	20%	20%

**For deaths after 5 April 2013, a lower rate of 36% applies where at least 10% of deceased's net estate is left to charity.*

MAIN EXEMPTIONS

Transfers to

- UK-domiciled spouse/civil partner	No limit	No limit
- non-UK-domiciled spouse/civil partner (from UK-domiciled spouse)	£55,000	£325,000
- UK-registered charities	No limit	No limit

Lifetime transfers

- Annual exemption per donor	£3,000	£3,000
- Small gifts exemption	£250	£250

Wedding/civil partnership gifts by

- parent	£5,000	£5,000
- grandparent	£2,500	£2,500
- other person	£1,000	£1,000

100% relief: businesses, unlisted/AIM companies, certain farmland/building

50% relief: certain other business assets

Reduced tax charge on gifts within 7 years of death:

- Years before death	0-3	3-4	4-5	5-6	6-7
- Inheritance Tax payable	100%	80%	60%	40%	20%

CAR BENEFIT FOR EMPLOYEES

The charge for company car benefits is based on the carbon dioxide (CO₂) emissions. There is no reduction for high business mileage users.

For 2013/2014:

- Cars that cannot emit CO₂ have a 0% charge.
- The percentage charge is 5% of the car's list price for CO₂ emissions of 75g/km or less.
- For cars with CO₂ emissions of 76g/km to 94g/km the percentage is 10%.
- For cars with CO₂ emissions of 95g/km to 99g/km the percentage is 11%.
- Cars with CO₂ emissions of 100g/km have a percentage charge of 12% and thereafter the charge increases by 1% for every complete 5g/km to a maximum of 35% (emissions of 215g/km and above).

There is an additional 3% supplement for diesel cars not meeting Euro IV emission standards. However, the maximum charge remains 35% of the car's list price.

Car fuel The benefit is calculated as the CO₂ emissions % relevant to the car and that % applied to a set figure (£21,100 for 2013/2014) e.g. car emission 100g/km = 12% on car benefit scale. 12% of £21,100 = £2,532.

1. **Accessories** are, in most cases, included in the list price on which the benefit is calculated.
2. **List price** is reduced for capital contributions made by the employee up to £5,000.
3. **Car benefit** is reduced by the amount of employee's contributions towards running costs.
4. **Fuel scale** is reduced only if the employee makes good **all** the fuel used for private journeys.
5. **All car and fuel benefits** are subject to employers National Insurance Contributions (Class 1A) of 13.8%.

PRIVATE VEHICLES USED FOR WORK

	2012/2013 Rates	2013/2014 Rates
Cars		
On the first 10,000 business miles in tax year	45p per mile	45p per mile
Each business mile above 10,000 business miles	25p per mile	25p per mile
Motor Cycles	24p per mile	24p per mile
Bicycles	20p per mile	20p per mile

MAIN CAPITAL AND OTHER ALLOWANCES

	2012/2013	2013/2014
Plant & machinery (excluding cars) 100% annual investment allowance (first year)	£25,000	£250,000
Plant & machinery (reducing balance) per annum	18%	18%
Patent rights & know-how (reducing balance) per annum	25%	25%
Certain long-life assets, integral features of buildings (reducing balance) per annum	8%	8%
Energy & water-efficient equipment	100%	100%
Zero emission goods vehicles (new)	100%	100%
Qualifying flat conversions, business premises & renovations	100%	100%

Motor cars: Expenditure on or after 01 April 2013 (Corporation Tax) or 06 April 2013 (Income Tax)

CO ₂ emissions of g/km:	95 or less*	96-130	131 or more
Capital allowance:	100%	18%	8%
	first year	reducing balance	reducing balance

*If new

Research & Development: Capital expenditure 100%

MAIN SOCIAL SECURITY BENEFITS

		2012/2013	2013/2014
		£	£
Child Benefit	First child	20.30	20.30
	Subsequent children	13.40	13.40
	Guardian's allowance	15.55	15.90
Employment and Support Allowance	Assessment Phase		
	Age 16 – 24	Up to 56.25	Up to 56.80
	Aged 25 or over	Up to 71.00	Up to 71.70
	Main Phase		
	Work Related Activity Group	Up to 99.15	Up to 100.15
	Support Group	Up to 105.05	Up to 106.50
Attendance Allowance	Lower rate	51.85	53.00
	Higher rate	77.45	79.15
Retirement Pension	Single	107.45	110.15
	Married	171.85	176.15
Pension Credit	Single person standard minimum guarantee	142.70	145.40
	Married couple standard minimum guarantee	217.90	222.05
	Maximum savings ignored in calculating income	10,000.00	10,000.00
Bereavement Payment (lump sum)		2,000.00	2,000.00
Widowed Parent's Allowance		105.95	108.30
Jobseekers Allowance	Age 16 - 24	56.25	56.80
	Age 25 or over	71.00	71.70
Statutory Maternity, Paternity and			

CAPITAL GAINS TAX

EXEMPTIONS	2012/2013	2013/2014
Individuals, estates etc	£10,600	£10,900
Trusts generally	£5,300	£5,450
Chattels proceeds (restricted to five thirds of proceeds exceeding limit)	£6,000	£6,000

TAX RATES

Individuals:		
Up to basic rate limit	18%	18%
Above basic rate limit	28%	28%
Trustees and Personal Representatives	28%	28%
Entrepreneurs' Relief* – Gains taxed at:	10%	10%
Lifetime limit	£10,000,000	£10,000,000
*For trading businesses and companies (minimum 5% employee or director shareholding) held for at least one year.		

CORPORATION TAX

	2012/2013	2013/2014
Full rate	24%	23%
Small companies rate	20%	20%
Small companies limit	£300,000	£300,000
Effective marginal rate	25%	23.75%
Upper marginal limit	£1,500,000	£1,500,000

VALUE ADDED TAX

	2012/2013	2013/2014
Standard rate	20%	20%
Annual registration threshold	£77,000	£79,000
Deregistration threshold	£75,000	£77,000

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