November 2018 Examination

PAPER 2

Business Taxation and Accounting Principles

Part I Suggested Answers

1. Costs incurred before trading commences are not allowable as an expense as they are treated as capital in nature (½) i.e. they are putting the taxpayer in the position to start trading and not incurred as an expense of the business. Therefore, John will not be able to claim a deduction against income for his initial training costs. (½)

   Once John has started trading, any further training costs will be allowed (½) as an expense of that business as long as they are relevant to the trade. (½)

   Training costs may include not just course fees but related costs such as travel and accommodation while on a course or books and equipment. The treatment of the associated costs follows the treatment of the training costs. (½)

   Training costs of an employee are allowable as a deduction from business income (½) irrespective of whether the training is to gain new expertise or to keep up to date on current skills. (½)

Max (3)

2. As Sheila's turnover does not exceed £150,000 for the year ended 31 March 2018 (½) she can elect for the cash basis of assessment to apply by ticking a box on her next self-assessment tax return. (½) It will then apply for that year and all subsequent years until the year following that in which her turnover exceeds £300,000 (½) or there is a change in circumstances which makes it more advantageous (½) for her to revert to the accruals basis.

(2)

   Advantage - Under the cash basis income and expenses are based on receipts and payments so she will not be assessed to tax on income which has not been received. (1)
   Although she will not receive tax relief on expenses until she has paid for them, as she has few overheads it is unlikely to be disadvantageous for her. (½) She can still claim mileage in respect of her motor expenses. (½)

   Disadvantage - Sale proceeds of any old equipment sold will be included as part of income, rather than as a main pool disposal.(1)
   Capital allowances (½) (apart from that on cars) are not claimed under the cash basis but expenditure is treated as a cost so any new computer equipment will be treated as an expense.

Max (1)

Total max (3)

3. Spacebarre Ltd – costs deductible year ended 31 March 2018.

	£
Premium paid	50,000
Less:	
2% (½) x £50,000 (½) x (10 – 1) (½)	(9,000)
	41,000

Alternative:

50-9/50 x £50,000	£41,000
(½) (½) (½)	

Period 1.10.17 to 31.3.18

Rent due	£2,000 x 6/12	1,000 (½)
Premium	£41,000 x 1/10 (½) x 6/12 (½)	2,050
Amount deductible		£3,050

(3)

4.
Mirabain Ltd made up accounts for a period greater than 12 months so there were two Corporation Tax returns due. One for the year to 31 December 2016 and the second for the three month period to 31 March 2017. (½)

The filing date for both Corporation Tax returns was 31 March 2018. (½) Under the unified scheme for penalties there is an initial penalty of £100 (½) for missing the filing deadline which will apply to each return. (½)

(2)

5. Disposals of assets by a partnership are treated as being disposals by the partners individually (½) and charged on them separately from the partnership. All disposals between partners are treated as at market value. (½)

   The transfer of the property from the partnership to Simon will be shown as a disposal on the partnership tax return. (½)

   Liam and Cheryl will be assessed on their share of any gain as individuals and will need to report it on their self-assessment tax return. (½)

   Simon will treat his share of any gain as a notional gain (½) and deduct it from the market value of the property (½) so that effectively it will be rolled over.

   If a loss is made, Liam and Cheryl will have an actual loss, and Simon's notional loss will be added to his base cost. (½)

Max (3)

6. Harry Smith – capital gain 2017/18

		£	
Proceeds		60,000	(½)
Cost	£40,000 (½) x $\frac{68.697}{87.330}$ (½) (½)	(31,465)	(½)
Gain		£28,535	(½)

(3)

7. A ‘taxable person’ is any individual, partnership, LLP, company or association which either is registered for VAT or is required to be registered for VAT. (½)

   A person is required to be registered for VAT if the value of their supplies in the previous 12 months exceeded the annual registration threshold (£85,000) (½) or if at any time there are reasonable grounds for believing that the value of taxable supplies to be made in the next 30 days will exceed the annual registration threshold. (½)

   Claire currently does not exceed the annual registration threshold (£5,000 x 12 = £60,000) (½) and so is not a taxable person for the purposes of VAT. (½) The partnership with Ann will be considered separately (½) to determine whether it is a taxable person and should be registered. (½) It is likely to exceed the annual registration threshold at the end of month 10 (£9,000 x 10 = £90,000) (½). Max (3)

8. Deregistration is compulsory when a person is no longer entitled to register. (½) There are three circumstances in which this applies:
   - On the disposal (sale or transfer) of the business. (½)
   - On changing the status of the business (½) (e.g. changing from trading as a sole trader to trading through a limited company) (½)
   - On ceasing to make taxable supplies. (½)

   HM Revenue & Customs must be notified within 30 days (½) of the event and deregistration takes effect from the date of the event (½) (ie sale of business, change of status or ceasing to make taxable supplies).

Max (3)

9. Stuart Trading Ltd: Stuart is the sole director but the company has one other employee and both are paying over the secondary threshold for National Insurance:

	£	
Secondary Class 1 NIC	2,500	
Employment allowance	(3,000)	(½)
Payable	nil	(½)

Susan: sole trader with one employee:

	£	
Secondary Class 1 NIC	3,500	
Employment allowance	(3,000)	(½)
Payable	£500	(½)

Note - Any unused allowance at the end of the tax year is lost.

(2)

10. Jason will be able to pay a rate of 0% (½) on the earnings of both Peter and Betty between the secondary threshold (½) and the upper secondary threshold (½) as long as Peter is under the age of 21 (½) and Betty is under the age of 25 (½) and is working towards an apprenticeship (½) in the United Kingdom which follows a government approved framework or standard.

If any part of their earnings exceeds the upper secondary threshold then secondary class 1 contributions will be payable on that part at the normal rate (13.8%) (½).

Max (3)

11.

Bank

Receipt of money from Sheldon	10,000	Purchase of van	20,000	½
Receipt of loan from bank	10,000	Loan and interest paid	450	½ + ½

Capital

		Money introduced by Sheldon	10,000	½

Asset

Purchase of van	20,000			½

Bank loan

Repayment	425	Loan from bank	10,000	½ + ½

Interest (profit and loss)

Interest	25			½

(4)

12. The answer should be any four of:

1) Owners of the business (½) – to evaluate how their business is performing. (½)

2) Management (½) – to evaluate how they are running the business and whether it is profitable and they are running it efficiently. (½)

3) Employees (½) – to evaluate whether they will continue to be remunerated and whether their jobs are secure. (½)

4) Creditors (½) - to evaluate whether the business can pay the amounts owed and on time. (½)

5) HM Revenue and Customs (½) – to evaluate the amount of tax which should be paid on the business transactions. (½)

6) Banks (½) – to evaluate whether it is safe to lend money to the company. (½)

Max (4)

13. The answer should be any four of:

1) Predetermined (½) – the life of the asset is determined by certain factors eg a legal contract such as a lease. (½)

2) Depletion (½) – the extraction of resources from the asset (eg coal, sand and gravel) will determine the useful life dependent on the rate of extraction and the amount of the resource. (½)

3) Physical deterioration (½) – the erosion of the asset through use or the passing of time due to physical processes such as rust, rot, and general decay through exposure to the elements. (½)

4) Time (½) – the life of the asset is set by the flow of benefits within a predetermined time period e.g. patents and copyrights. (½)

5) Economic obsolescence (½) – although the asset may remain in good physical condition, its useful life is reduced by economic or technological obsolescence eg computers. (½)

Max (4)

November 2018 Examination

PAPER 2

Business Taxation and Accounting Principles

Part II Suggested Answers

Question 1

1)

Sloth Ltd

		£	
Profit per accounts		241,000	
Add:			
Depreciation	81,700		(1/2)
Entertaining	2,000		(1/2)
Interest	5,000		(1/2)
		88,700	
Less:			
Profit on disposal		(3,000)	(1/2)
Less: capital allowances		(225,440)	(1/2)
Trading profit		101,260	
Non trading loan deficit		(5,000)	(1/2)
		96,260	
CT due			
10/12 x £96,260 x 20% (FY16)		16,043	(1/2)
2/12 x £96,260 x 19% (FY17)		3,048	(1/2)
		19,091	

The bonus paid to the director is tax-deductible as it was paid within 9 months of the year end. (1/2)

The hotel costs represent entertaining and, as such, are not allowable. (1/2)

Both overdraft interest and HP interest are trading items and no adjustment is necessary. (1/2)

The debenture was issued for investment (ie non-trade) purposes so is a non-trading deficit (1/2)

No adjustment is needed for rental income received as it is for the temporary letting of surplus trading premises (1)

Note - The depreciation charge for the year is £81,700 with the profit on disposal being £3,000.

Capital allowances

	Main pool	Special rate pool	Allowances	
	£	£	£	
WDV b/f	25,000	18,000		
Disposal	(5,000)			(1/2)
	20,000			
Addition:				
New press	280,000			(1/2)
Qualifying for AIA	(200,000)		200,000	(1/2)
New car		75,000		(1/2)
	100,000	93,000		
WDA 18%	18,000		18,000	(1/2)
WDA 8%		7,440	7,440	(1/2)
WDV c/f	82,000	85,560		
Total allowances			225,440	

(10)

2)

Sloth Ltd's corporation tax liability of £19,091 was due in four equal instalments of £4,773 each on the following dates: (1)

14 December 2016

14 March 2017

14 June 2017

14 September 2017 (1)

Interest will be charged on the first instalment as follows:

From 14 December 2016 to 14 April 2017 (4/12 months x £4,773 x 1.25%) = £20. (1)

Fourth instalment paid early.

Repayment interest is due from 14 July 2017 to 14 September 2017.
(2/12 months x £4,773 x 0.5%) = £4. (1)

(4)

3)

Should any deficit arise on non-trading loan relationships, this may be:

- Set off against any other income of the current accounting period. (1)
- Carried back against non-trading loan relationship income of the previous 12 months (1).
- Carried forward against any future non-trading profits. (1)

(3)

4)

The directors should consider:

- The consequences of decisions in long term
- The interests of their employees
- The need to develop good relationships with suppliers and customers
- The impact of the company on the local community and the environment
- The desirability of maintaining high standards of business conduct and a good reputation
- The need to act fairly as between all members of the company

Any three of the above 1 mark each max (3)

Total (20)

Question 2

To: Sam

From: Tax Adviser

Your accounts to 31 March 2018 (1) format

I refer to our meeting today and am sorry you have had difficulty with one of your big projects.

Below I note the matters arising from our meeting.

1) <u>Claim for remedial costs</u>

You anticipate knowing whether you will have to accept this most recent claim by 31 March 2019. Accordingly, if necessary, a specific provision should be made in those accounts, based on the anticipated outcome. That provision will be fully deductible for tax purposes (1/2) provided that it is made in accordance with Generally Accepted Accounting Principles (i.e. FRS 102). (1/2) The amount of the provision will be the best estimate of the remedial costs at the balance sheet date. (1/2)

Max (2)

2) Calculations of revised net income for 2016/17 and 2017/18

If the loss is to be used as early as possible, it must first be set against the net income (1/2) for the previous tax year. (1/2)

	£	
Profits 2016/17	62,000	(1/2)
Add: other income (£15,000 + £40,000)	55,000	(1/2)
Net income	117,000	
Loss relief (£62,000 + £50,000)	(112,000)	(1/2 + 1/2)
Revised net income	5,000	

There is no restriction for relief against trading profits. (1/2) Loss relief against other income is calculated as the greater of £50,000 (1/2) or 25% of the adjusted total income. (1/2)

The remaining loss may be set against the pension income of 2017/18.

Total income 2017/18 = nil (£15,000 – loss £15,000) (1/2)

	£	
Loss for year	145,000	
Used 2016/17	(112,000)	
Used against pension income 2017/18	(15,000)	
Loss carried forward against profits same trade only (1/2)	£18,000	(1/2)

Max (5)

3) Filing your tax return

Your 2017/18 tax return must be filed with HM Revenue & Customs by 31 January 2019 (1/2), or 3 months after HMRC issued you with a notice requiring you to file the return. (1/2)

You are now too late to file a return on paper, since this needed to be filed by 31 October 2018 (1/2) unless the notice to file was not issued until on or after 1 August 2018, in which case it must be filed 3 months after that. (1/2)

The tax return may be amended by you at any time up to 12 months from the due filing date (i.e. up until 31 January 2020), (1/2) while HMRC have nine months from the date the return is actually filed (1/2) or nine months from the date an amendment to a return is filed. (1/2)

Max (3)

Please do not hesitate to contact me if you have any questions.

Kind regards

Tax adviser

Total (10)

Question 3

1)

Retreat partnership

Profit and Loss account for the year ended 30 April 2017 (1/2 format)

	£	£	
Turnover		650,000	
Purchases		(49,000)	
		601,000	
Sundry income			
Rental income		8,000	(1/2)
Interest receivable		375	(1/2)
		609,375	
Salaries	210,000		
Utilities and insurance	37,500		
Motor expenses	22,000		
Depreciation	12,250		
		(281,750)	
Net profit for year		327,625	

Appropriation account:

		Azra	Kellie	Eduardo	Total	
		£	£	£	£	
Salaries to 30 June	2/12	5,000	5,000	0	10,000	(1)
Profit share to 30 June	2/12	26,762	17,842	0	44,604	(1)
Total to 30 June		31,762	22,842	0	54,604	
Profits to 30 April	10/12	91,007	91,007	91,007	273,021	(1/2)
Total profit share		122,769	113,849	91,007	327,625	

Retreat Partnership

Balance sheet as at 30 April 2017 (1/2 format)

		£ Cost	£ Dep'n	£ NBV	
Fixed assets					
Office building		140,000	6,300	133,700	(1/2)
Fixtures and fittings		48,000	19,650	28,350	
Goodwill				19,000	(1)
Current assets					
Work in progress	(270,000 + 25,000)	295,000			(1/2)
Debtors and prepayments	(120,000 + 8,000)	128,000			(1/2)
Accrued income		375			(1/2)
Bank		106,000			(1/2)
		529,375			
Current liabilities					
Creditors and accruals	(344,000 + 2,000)	346,000			(1/2)
Deferred income		8,000			(1/2)
		354,000			
Net current assets				175,375	
Net assets				356,425	

Represented by:		
Capital accounts	120,000	(1/2)
Current accounts	236,425	(1/2)
	356,425	

Current account workings

	Azra	Kellie	Eduardo	Total	
	£	£	£	£	
Opening	72,000	32,500	0	104,500	(1/2)
Profit share	122,769	113,849	91,007	327,625	(1/2)
Drawings	(45,000)	(49,700)	(21,000)	(108,500)	(1/2)
Transfer to capital	(40,000)	(40,000)	0	(80,000)	(1/2)
	109,769	56,649	70,007	236,425	

Workings (marks shown on the face of the accounts)

(a) Goodwill on purchase

	£
Price paid	50,000
Net assets acquired	(31,000)
Goodwill	19,000

(b) Deposit account interest for year = £100,000 x 1.5% = £1,500. Partnership has held deposit for 3 months, hence due to be paid £375 at balance sheet date.

(c) Rental income: £16,000 x 6/12 = £8,000. The remaining £8,000 is included in deferred income on the balance sheet.

(12)

2)

Goodwill is the difference between the value of the business as a whole and the sum of the values of its individual parts. (1/2)

Purchased goodwill is an intangible asset (1/2) and should be capitalised on the balance sheet. It should be considered to have a finite useful life (1/2) and if that life cannot be reliably estimated, the life will be assumed to be ten years (1/2).

The goodwill should be amortised over its useful life (1/2). The value of the goodwill should be reviewed annually to establish if an impairment provision is required. (1/2)

Inherent goodwill is the expected value of goodwill in an ongoing business (1/2), but this value would be unreliable and so is not placed in the business's balance sheet. (1/2)

Max (3)

3)

Any three of the following:

- Agree fees before issuing fee notes
- Give indicative fees before work is started and keep the client informed regularly
- Issue fee notes without delay
- Ensure your records are sufficient to support a fully detailed fee note.

Marks will be awarded for other relevant comments.

1 mark each — Max (3)

Total (18)

Question 4

1)

Warehouse

		£	
Proceeds		600,000	
Costs of sale		(25,000)	(1/2)
		575,000	
Cost		(250,000)	(1/2)
improvement	(60,000 + 5,000)	(65,000)	(1/2) + (1/2)
Chargeable gain		260,000	
Loss b/f		(3,000)	(1/2)
Annual exempt amount		(11,300)	(1/2)
Taxable gain		245,700	
Tax payable at 10%		24,570	(1/2)

Notes

Entrepreneurs' relief is available as Mrs Blue is disposing of the whole of a business which she has owned for at least one year. (1/2)

Neither work in progress (1/2) nor other net assets (1/2) are chargeable assets.

(5)

2)

2015/16 – year ended 31 December 2015 £89,000 (1/2)

2016/17 – year ended 31 December 2016 £95,000 (1/2)

2017/18 - Six months to 30 June 2017 (1/2). £44,300 (W) (1/2) less overlap profits £8,000 (1/2) = £36,300.

Working

	General pool	
	£	
TWDV @1 January 2017	8,500	
Addition – machine (no AIA in period of cessation)	1,200	(1/2)
	9,700	
Sale proceeds	(10,000)	(1/2)
Balancing charge	(300)	(1/2)
Trading profit	44,000	
Add balancing charge	300	(1/2)
Tax adjusted trading profit	44,300	

Max (4)

3)

Mrs Blue will be able to claim relief for these expenses as post-cessation expenses, (1/2) provided that they are incurred within 7 years of her ceasing to trade. (1)

She will claim the expenses against her net income (1/2) in the year in which they are incurred (1/2) by the first anniversary of 31 January following the end of the tax year. (1/2)

(3)

Total (12)