November 2017 Examination

PAPER 2

Business Taxation and Accounting Principles

Part I Suggested Answers

1. Interest will be charged from 31 January 2015 and 31 July 2015 on any payments on account which were due, ½ and 31 January 2016 on the balance of the income tax liability. ½ Interest runs until the date of payment ½ and is calculated at the rate of 3%. ½

   A penalty of 5% ½ is charged on the amount outstanding more than 30 days after the due date of the balancing payment (i.e. 2 March 2016) ½ A further 5% is charged on any amount outstanding more than six months after the due date ½ (ie 31 July 2016) and a final 5% is charged on any amount outstanding more than 12 months from the due date (ie 31 January 2017). ½ There is no penalty in respect of late payments on account. ½

Max (4)

2. Four examples – 1 mark each (max 4) for four out of the following:

   Profit-seeking motive: An intention to make a profit or evidence that the sole object of acquiring an asset is to re-sell at a profit. If it is apparent that Samuel bought the items with the intention of selling them at a profit, this may indicate trading.

   Frequency or number of similar transactions: Systematic and repeated transactions. If the items Samuel bought were similar in nature, it may indicate trading, although if he bought and sold only three items and there appears to be no intention for him to repeat this in the future, a trade may not have been established.

   The nature of the asset: The asset may be of a type that can only be turned to advantage by sale, or it cannot yield an income or give 'pride of possession'. If the items purchased by Samuel are unlikely to be of use to him should he retain ownership, then the subsequent sale of the items may indicate a trading transaction.

   Length of ownership: Assets that are the subject of trade will normally be sold quickly, so if the length of time between purchase and sale is relatively short, a trade may be indicated.

   Changes to the asset: An asset which is repaired, modified or improved to make it more easily saleable or to be sold at a greater profit is more likely to be the subject of trade. If Samuel has altered or modified the items to improve them before selling, a trade may be indicated.

   Organisation: If the transactions are carried out in a similar manner to that of an undisputed trader, it is likely to indicate trading. For example. If Samuel has set up a website or advertised the items in a similar manner to other undisputed traders, he is more likely to be considered trading.

   Financing arrangements – if the items were purchased on a short term loan that Samuel was unable to fund without selling the items again, this may indicate trading

   Connection with an existing trade – if the items sold by Samuel are similar in nature to an existing trade already carried on by Samuel, HMRC are more likely to tax any profit made on the sale of these three items as trading income due to the link with Samuel's existing trade

Max (4)

3.

		Main Rate	Private use car	Total Allowances	
	£	£	£	£	
Balance 6.4.16		5,500			
Disposal proceeds		(1,500)			½
		4,000			
Additions:					
Equipment	25,000				
AIA	(25,000)			25,000	½
Electric car	15,000				
FYA	(15,000)			15,000	½
Car – 140g/km			12,000		
WDA – 8% - PU 50%			(960)	480	½ + ½
WDA 18%		(720)		720	½
		£3,280	£11,040	£41,200	

(3)

4. Rental income less expenses incurred wholly and exclusively for the purpose of the rental business is treated as profits of a property business. ½ Capital allowances are deducted as an expense in arriving at the profit or loss. ½ Income and expenses are calculated on the accruals basis for the company's accounting period. ½ Max 1

   Interest on loans relating to the let property is not deducted as an expense ½ but is taken into account in arriving at the overall non-trading surplus or deficit on loans (ie the loan relationship rules). ½ Max 1

   If a loss arises then, provided that the property business is conducted on a commercial basis, the loss may be set against total profits ½ of the same accounting period ½. Any unrelieved losses are carried forward ½ against future total profits of the company (assuming the property business is still carried on). ½ Max 2

Max (4)

5. If new expenditure is incurred, it is added to the appropriate pool. ½

   No AIA, FYA ½ or WDA ½ are available in the final period.

   Disposal proceeds or deemed disposal proceeds ½ are deducted from the pools ½ subject to the amount not exceeding the asset's original cost. ½ A balancing allowance is given if a balance remains on the pool. ½

   However, a balancing charge applies if the disposal proceeds exceed the pool's value. ½

Max (3)

6.

		£	£
Disposal proceeds			300,000
Less: Cost	100,000 ½ x $\frac{300,000}{900,000 + 300,000}$ ½ ½	= 25,000	
Indexation £25,000 x 0.298 [(270.0 – 208.0) ÷ 208.0]	½ ½ ½	7,450	32,450
			£267,550

(3)

7.

	£	
Proceeds	800,000	
Cost	(200,000)	
Gain	600,000	1
Proceeds	800,000	
Reinvested	750,000	
Gain chargeable	50,000	1
Gain	600,000	
Less chargeable	50,000	
Rolled over gain	550,000	1
Purchase of new asset	750,000	
Rolled over gain	550,000	
Base cost of new asset	200,000	1

(4)

8. Records to be kept for VAT purposes:
   1) Accounting records
   2) VAT invoices issued by the business
   3) VAT invoices received by the business
   4) Documentation relating to imports and exports
   5) Credit notes and debit notes to evidence changes in consideration for supplies made or received.
   6) VAT account

   ½ mark each for four of the above.

Max (2)

9. If a supply of services is business to business, ½ it is treated as taking place where the customer is based. ½

   A supply of services between business and consumer (non business) ½ is treated as taking place where the supplier is based. ½

(2)

10. Self-employed individuals pay Class 2 contributions based on a fixed weekly amount ½ where profits are more than £5,965. ½ These are paid in one sum on 31 January following the end of the tax year ½ together with the balancing payment of income tax under self-assessment. ½

    They also pay Class 4 National Insurance contributions. These are calculated at 9% of profits ½ between specified lower and upper profit figures ½ and at 2% ½ paid on profits over the upper limit. Payment is made at the same time as income tax for self-assessment, ½ so two payments on account (31 January in year of assessment and 31 July following year of assessment) ½ with a balancing payment by 31 January following year of assessment. ½

Max (4)

11. Maintenance contract for 24 months from 1 July 2016.

Year ended 31 December 2016:

Profit and loss charge	30,000 ÷ 24 = 1,250 x 6 = £7,500	½
Prepayment	30,000 – 7,500 = £22,500	½

Bank

		Maintenance	£30,000	½

Maintenance

Bank	£30,000			½
		P&L account	£7,500	½
		Prepayments	£22,500	½

Prepayments

Maintenance	£22,500			½

Profit and loss account

Maintenance	£7,500			½

(4)

12.

A bad debt arises when a debtor is unable ½ or unwilling ½ to pay the invoice. For example: The debtor becomes insolvent ½ or there is a dispute regarding the services/goods supplied. ½ Max 1

A doubtful debt arises when a debt becomes uncertain – money may or may not be received. ½ For example, if there are many debtors, the law of averages suggests that a proportion may never be received. ½
Similarly, if a debt has remained unpaid for a considerable period of time, recovery of the debt is uncertain. ½ Max 1

In both cases, once the expectation of receiving a payment from a customer is no longer virtually certain, a debit balance on the debtors account is no longer an asset ½ – it has become a business loss, and should be excluded from the assets of the business.½

A bad debt is removed from the ledger ½, whereas when a debt is doubtful, it remains on the ledger but a provision is made ½. Max 1

Max (3)

November 2017 Examination

PAPER 2

Business Taxation and Accounting Principles

Part II Suggested Answers

1.

1) **Hop, Skip and Jump**

Profit and Loss Account for the year ended 31 May 2016 (1/2 format)

	£	£	
Sales		987,000	
Less Cost of Sales			
Opening stock	119,000		
Purchases (310,500 – 575)	309,925		
Closing stock	(125,000)		
		(303,925)	(1)
Gross profit		683,075	
Add Sundry income			
Grant		4,095	(1/2)
Employment costs (W1)	75,700		(1/2)
Office expenses (W3)	109,815		(1/2)
Depreciation (W5 & W6)	31,850		(1/2)
Accountancy	12,000		(1/2)
Travel costs	64,600		
		(293,965)	
Net profit for year		393,205	

Appropriation Account

	Hop (£)	Skip (£)	Jump (£)	Total	
Interest on capital	2,500	2,500	3,500	8,500	(1)
Balance of profits	115,412	115,412	153,881	384,705	(1)
	117,912	117,912	157,381	393,205	

Hop, Skip and Jump

Balance Sheet as at 31 May 2016 (1/2 format)

	£ Cost	£ Dep'n	£ NBV	
Fixed assets				
Plant and machinery	155,500	75,888	79,612	(1)
Office equipment	25,000	9,062	15,938	(1/2)
	180,500	84,950	95,550	
Current assets				
Stock	125,000			(1/2)
Debtors	129,680			
Prepayments (W4)	3,450			(1/2)
Bank deposit account	100,000			
	358,130			
Current liabilities				
Bank overdraft	14,975			
Accruals (W2)	11,175			
Creditors (32,250 – 575)	31,675			(1/2)
	57,825			
Net current assets			300,305	
Total assets			395,855	
Represented by:				
Capital accounts			170,000	(1/2)
Current accounts			225,855	(1/2)
			395,855	

Current account workings

	Hop (£)	Skip (£)	Jump (£)	Total (£)	
Opening balance	3,130	(8,250)	2,870	(2,250)	(1/2)
Add: profit for year	117,912	117,912	157,381	393,205	(1/2)
Less: drawings	(40,000)	(40,000)	(60,000)	(140,000)	(1/2)
Tax payments	(6,500)	(7,600)	(11,000)	(25,100)	(1/2)
Closing balance	74,542	62,062	89,251	225,855	

Capital accounts

	Hop (£)	Skip (£)	Jump (£)	Total (£)	
Opening and closing balances	50,000	50,000	70,000	170,000	(1/2)

Workings

W1 Employment costs

	£	
Per trial balance	98,300	
Less:		
Tax payments for partners (charged to current accounts)	(25,100)	(1/2)
Add: Training costs accrued	2,500	(1/2)
	75,700	

W2 Accruals

£2,500 relating to employee training provided during the year (1/2).

Plus accountancy accrual 12,000 - (6,500 – 3,175) = £8,675 (1)

W3 Office expenses

	£	
Per trial balance	109,315	
Add:		
PII prepayment b/f	3,950	(1/2)
Less: PII prepayment (£13,800 x 3/12)	(3,450)	(1/2)
	109,815	

W4 Prepayments

	£	
PII ((£13,800 x 3/12)	3,450	(1/2)

W5 P & M depreciation: £155,500 – £49,350 = £106,150 @ 25% = £26,538 (1/2)

W6 Office equipment depreciation: £25,000 - £3,750 = £21,250 @ 25% = £5,312 (1/2)

(18)

2) Jump may claim two alternative reliefs:

a) He could claim holdover relief. (1/2) This requires a joint claim by him and his son to be made within 4 years of the end of the tax year in which the gift takes place, i.e. 5 April 2021 (1/2).
b) He could claim entrepreneurs' relief. (1/2) He needs to make the claim by the first anniversary of the 31 January following the year in which the disposal is made, i.e. 31 January 2019. (1/2)

(2)

Total (20)

2. **Roundabout Ltd**

1)	£	£		
Profit per accounts		50,700		
Add:				
Depreciation	40,000		(1/2)	
Entertaining (4,500 + 1,000)	5,500		(1)	1/2 mark each
Loan written off	9,000		(1/2)	
Accrued bonuses	15,000		(1/2)	
Less:		69,500		
Profit on sale of asset	1,200		(1/2)	
Interest received	350		(1/2)	
Rental income	15,650		(1/2)	
		(17,200)		
Capital allowances		(1,359)	(1/2)	
		101,641		
Less: trading loss brought forward		(5,765)	(1/2)	
Trading profits		95,876		
Property income	15,650		(1/2)	
Non-trading deficit brought forward	(3,200)		(1/2)	
		12,450		
Non trading loan relationships				
Interest received	350		(1/2)	
Loan written off	(9,000)		(1/2)	
Loan relationship deficit available to set against total profits		(8,650)	(1/2)	
Taxable Total Profits		99,676		
Corporation tax due		£19,935	(1/2)	

Capital allowances computation:

	Main pool	Special rate pool	Allowances £	
WDV b/f	[illegible]	[illegible]		
Disposal	(1,200)			(1/2)
	[illegible]			
WDA (18%/8% x 9/12)	[illegible]		1,359	(1 ½) ½ each rate; ½ restricting by 9/12
WDV c/f	[illegible]	[illegible]		

(10)

2)

Large companies (1/2) are required to pay their corporation tax by instalments.

The profits threshold for being a large company is £1.5m (1/2) divided by the number of related 51% group companies plus one (1/2) at the end of the preceding accounting period. (1/2)

The threshold is further reduced where the accounting period is less than 12 months (1/2).

The threshold for Roundabout Ltd is therefore £1.5m / 21 x 9/12 = £53,571. (1/2)

However, Roundabout Ltd would not be liable to pay its corporation tax in instalments if either:

- Its tax liability for the year was £10,000 x 9/12 or less (1): or
- Its profits were £10m x 9/12 or less (1/2) and it was not a large company in the previous accounting period. (1/2)

Roundabout Ltd fails the first test since its tax liability exceeds the limit. (1/2) In addition, it was a large company for the previous period. (1/2)

Hence Roundabout is due to pay its corporation tax liability in instalments as follows:

The first instalment is due 6 months and 13 days from the start of the accounting period – by 14 October 2016. (1/2)

The last instalment is due 3 months and 14 days from the end of the accounting period – by 14 April 2017. (1/2)

The gap between these two instalments is 6 months, so there is a further instalment due on 14 January 2017. (1/2)

Max (6)

3)

The factors that might be considered relevant to the appointment of Mr Waltzer are:

Relevant factor	**Indication of employment**	**Indication of self-employment**
Measure of control over individual's work	Subject to management and supervision	No supervision once overall assignment is agreed
Extent of integration into the business	Integral part of business	Assignment is incidental to the business
Provision of equipment (especially major items)	Equipment is provided to individual	Individual provides equipment
Acceptance of work offered	Required to accept work	Not obliged to accept work
Work routines	Required to work specific hours and attend a place of work on a regular basis	Free to work as and when individual wishes, as long as assignment is performed
Remuneration	Paid at set regular intervals	Remunerated on a fee basis or on basis of amount of work done
Responsibility	Unable to profit from sound management of tasks; has no risk of financial loss	Able to profit from sound management; risks financial loss
Other work	Restricted to working for one person at a time	Free to undertake work for others
Separate business	Work arrangements do not indicate a separate business	Has own business address; has own capital at risk; has overheads
Liability to third parties	Covered by employer	Responsible for own work and has own appropriate insurance
Job title	Described as officer or employee	Described as contractor, adviser or consultant
Sub-contracting or hiring helpers	Cannot do this; must provide own services	Can sub-contract or use own employees to perform the assignment

1 mark each for any of the above; marks will be given for suitable alternatives Max (4)

Total (20)

3.

1)

Calculations for manager

Calculation and allocation of loss

	£	
Loss per accounts to 30 September 2016	65,000	
Add: pre-trading expenditure to increase the loss	1,500	(1)
Adjusted loss to 30 September 2016	£66,500	

Loss allocated to tax years thus:

	£	
Tax year 2015/16 (6/12 x £66,500)	33,250	(1/2)
Tax year 2016/17 (6/12 x £66,500)	33,250	(1/2)
	£66,500	

Using losses as early as possible

As the losses were incurred in the first four years of trading (1/2), they may be carried back against the total income (1/2) of the three tax years before the year of loss (1/2) starting with the earliest year first. (1/2)

Once the income for 2015/16 has been fully extinguished, a claim may be made to set the remaining loss from 2016/17 against capital gains of 2015/16. (1)

The losses are carried back against previous years' income and gains as follows:

	2012/13	2013/14	2014/15	2015/16	
	£	£	£	£	
Employment income	11,000	15,400	21,600	0	(1/2)
Bank interest	220	250	300	20	(1/2)
Total income	11,220	15,650	21,900	20	
2015/16 loss	(11,220)	(15,650)	(6,380)		(1/2) (1/2) (1/2)
2016/17 loss			(15,520)	(20)	(1/2) (1/2)
Net income	0	0	0	0	
Personal allowance	Nil	Nil	Nil	Nil	(1/2)
Taxable income	0	0	0	0	

			2014/15	2015/16	
			£	£	
Chargeable gains			12,000	20,000	(1/2)
Loss relief				(17,710)	(1)
Annual exempt amount			(11,100)	(2,290)	(1)
Taxable gains			900	0	

2015/16 trading loss

	£
	33,250
Used in 2012/13	(11,220)
Used in 2013/14	(15,650)
Used in 2014/15	(6,380)
Remaining	-

2016/17 trading loss

	£
	33,250
Used in 2014/15	(15,520)
Used in 2015/16 – income	(20)
Used in 2015/16 – gains	(17,710)
Remaining	-

Max (10)

2)

Adviser's address

Client's address

Date

Dear Mr Field (1 format)

I understand from my manager that you have a couple of queries in relation to your accounts.

Choice of accounting date

You are correct that the tax year runs to 5 April each year. You do not have to choose 5 April as the date to make up your accounts though, (1/2) as there are special rules to allocate your trading profits into the relevant tax years.

As a general rule, you will be taxed on the basis of profits earned in the accounting year that ends within the relevant tax year. (1/2) Thus for the tax year 2017/18, you will be taxed on the profits earned in the accounting year that ends on 30 September 2017, and so on. (1/2). There are special rules that apply when your business commences that I cover further below. There are also special rules that apply when the business ceases or if you decided to draw up accounts to a new accounting date, for example, that I am not going to discuss further (1/2).

As you started trading on 1 October 2015, the first tax year when you were trading was the tax year 2015/16 (1/2). Your trading results for the year to 30 September 2016 are apportioned on a time basis to provide the trading results for the 2015/16 tax year (1/2). Thus half of the loss your business incurred in the year to 30 September 2016 will be available for the tax year 2015/16 (1/2).

For 2016/17, you would normally be assessed to tax based on your trading results for the accounting period that ends in that tax year – in this case the year to 30 September 2016. (1/2) However, you will already have allocated half of the loss incurred in that accounting year to 2015/16 and so the other half of the loss is available for 2016/17 (1/2).

As I noted above, for 2017/18, you will be assessed to tax based on your trading results for the year to 30 September 2017 and so on.

I understand my manager is going to write to you illustrating how the losses may be used.

Hire purchase of car

Each payment you make on the hire purchase contract (£2,300) is split into two elements – being a part payment of the actual cost of the car (1/2) and the balance being a finance cost (1/2). It is only the finance costs of £3,340 (for the year) that will be charged as an expense in your accounts (1/2). I attach a Working showing how these finance costs are calculated.

Please do not hesitate to contact me if you need further clarification.

Kind regards

Tax Adviser

Working regarding hire purchase

	£	
Deposit	6,000	
Total instalments paid (12 x £2,300)	27,600	(1/2)
	33,600	
Purchase price of car	(30,260)	(1/2)
Thus finance cost charged to profit and loss account	£3,340	(1/2)

Max (7)

3)

Notes on ethical matters

It is essential that the client reviews his tax return (1/2) since he is responsible for its contents. (1/2).

We must draw to his attention that it is his responsibility to check that it is correct and complete. (1/2) In addition we should point out any judgmental areas or positions taken and their implications. (1/2)

It is essential that the client approves the tax return in writing, which may be by email. (1/2).

If we are going to file on his behalf, without his approval, we need to check we have the authority to do that (1/2), how the client is to take responsibility for the tax return (1/2) and any legal implications for the practice and the individual signatory. (1/2)

Max (3)

Total (20)