Answers

1 (a) (1) Auy will be treated as resident in the United Kingdom for 2009–10 as she was present in the United Kingdom for 183 days or more.

(2) Bim will be treated as resident in the United Kingdom for 2009–10 as she has made substantial visits to the United Kingdom. Her visits have averaged 91 days or more over four consecutive years.

(b) Trading profit for the year ended 5 April 2010

	£	£
Net profit	82,000	
Depreciation	3,400	
Input VAT	0	
Motor expenses (2,600 x 30%)	780	
Entertaining employees	0	
Appropriation of profit	4,000	
Excessive salary (15,000 – 10,000)	5,000	
Capital allowances (working)		15,180
	95,180	15,180
	(15,180)	
Trading profit	80,000	

Tutorial notes:

(1) No adjustment is required in respect of the input VAT as the expense figures are already exclusive of VAT.

(2) The only exception to the non-deductibility of entertainment expenditure is when it is in respect of employees.

Working – Capital allowances

	£	Main pool £	Motor car [1] £	Motor car [2] £	Special rate pool £	Allowances £
WDV brought forward		3,100	18,000	14,000		
Additions						
Motor car [4]		14,200				
Motor car [5]					8,700	
		17,300				
Proceeds – Motor car [2]				(13,100)		
Balancing allowance				(900) x 70%		630
WDA – 20%		(3,460)				3,460
WDA – restricted			(3,000) x 70%			2,100
WDA – 10%					(870)	870
		13,840				
Addition qualifying for FYA						
Motor car [3]	11,600					
FYA – 100%	(11,600) x 70%					8,120
		–				
WDV carried forward		13,840	15,000		7,830	
Total allowances						15,180

Tutorial notes:

(1) Motor car [1] was owned at 6 April 2009 and therefore continues to qualify for writing down allowance at the rate of 20% subject to a maximum of £3,000.

(2) Motor car [3] has CO_2 emissions of less than 110 grams per kilometre and therefore qualifies for the 100% first year allowance.

(3) Motor car [4] has CO_2 emissions between 111 and 160 grams per kilometre, and therefore qualifies for writing down allowances at the rate of 20%.

(4) Motor car [5] has CO_2 emissions over 160 grams per kilometre and therefore qualifies for writing down allowances at the rate of 10%.

Trading income assessments 2009–10

	Total	Auy Man	Bim Men
	£	£	£
Salary	4,000		4,000
Interest (56,000/34,000 at 5%)	4,500	2,800	1,700
Balance (80%/20%)	71,500	57,200	14,300
	80,000	60,000	20,000

(c) (1) Auy's class 4 NIC for 2009–10 will be £3,214 ((43,875 – 5,715 = 38,160 at 8%) + (60,000 – 43,875 = 16,125 at 1%)).

(2) Bim's class 4 NIC for 2009–10 will be £1,143 (20,000 – 5,715 = 14,285 at 8%).

(d) (i) Tax point

(1) The basic tax point is the date when services are completed.

(2) If an invoice is issued or payment received before the basic tax point, then this becomes the actual tax point.

(3) If an invoice is issued within 14 days of the basic tax point, the invoice date will usually replace that in (1).

(ii) VAT paid for the year ended 5 April 2010

(1) The partnership's output VAT is £21,600 and its total input VAT is £320 (180 + 140).

(2) Therefore VAT of £21,280 (21,600 – 320) will have been paid to HM Revenue & Customs during the year ended 5 April 2010.

(iii) Flat rate scheme

(1) The partnership can join the flat rate scheme if its expected taxable turnover (excluding VAT) for the next 12 months does not exceed £150,000.

(2) The partnership can continue to use the scheme until its total turnover (including VAT, but excluding sales of capital assets) for the previous year exceeds £225,000.

(3) If the partnership had used the flat rate scheme throughout the year ended 5 April 2010 then it would have paid VAT of £18,018 (142,200 + 21,600 = 163,800 x 11%).

(4) This is a saving of £3,262 (21,280 – 18,018) for the year.

2 (a) (i) Mice Ltd – Property business profit for the year ended 31 March 2010

	£	£
Premium received for sub-lease		18,000
Less: 18,000 x 2% x (8 – 1)		(2,520)
		15,480
Rent receivable – Property 1 (3,200 x 4)		12,800
– Property 2		6,000
– Property 3		–
		34,280
Business rates	2,200	
Repairs	1,060	
Rent paid	7,800	
Advertising	680	
Insurance (460 + 310 + (480 x 3/12))	890	
Loan interest	–	
		(12,630)
Property business profit		21,650

(1) The enlargement of the car park is capital expenditure which cannot be deducted when calculating the property business profit.

Tutorial note: Interest paid in respect of a loan used to purchase property is set off under the loan relationship rules.

(ii) Mice Ltd – Profits chargeable to corporation tax for the year ended 31 March 2010

	£
Property business profit	21,650
Loan interest (6,400 + 3,200 – 1,800)	7,800
Overseas income	–
Chargeable gain	10,550
	40,000
Loss relief (s.393A)	(40,000)
Profits chargeable to corporation tax	–

Tutorial note: The overseas dividend is exempt. However, it is treated as franked investment income when calculating the applicable rate of corporation tax.

Mice Ltd – Profits chargeable to corporation tax for the periods ended 31 March 2007, 2008 and 2009

	Period ended 31 March 2007	Year ended 31 March 2008	Year ended 31 March 2009
	£	£	£
Trading profit	83,200	24,700	51,200
Property business profit	2,800	7,100	12,200
	86,000	31,800	63,400
Loss relief (s.393A)	(18,200)	(31,800)	(63,400)
	67,800	–	–
Gift aid donations	(1,000)	–	–
Profits chargeable to corporation tax	66,800	–	–

(1) There is no restriction to the amount of loss relief that can be claimed for the year ended 31 March 2009 as this is within the normal 12 month carry back period.

(2) For the period ended 31 March 2007 loss relief is restricted to £18,200 (50,000 – 31,800), being the balance of the £50,000 limit.

Tutorial note: The trading loss of £180,000 for the year ended 31 March 2010 is relieved as follows:

	£
Loss	*180,000*
Year ended 31 March 2010	*(40,000)*
Year ended 31 March 2009	*(63,400)*
Year ended 31 March 2008	*(31,800)*
Period ended 31 March 2007	*(18,200)*
Unrelieved as at 31 March 2010	*26,600*

(b) (1) For the three-month period ended 30 June 2009 group relief is restricted to the profit of £28,000, as this is lower than the loss of £45,000 (180,000 x 3/12) for the corresponding period.

(2) For the year ended 30 June 2010 group relief is restricted to the loss of £135,000 (180,000 x 9/12) for the corresponding period, as this is lower than the corresponding profit of £168,000 (224,000 x 9/12).

(c) Equipment

(1) The first £50,000 of expenditure will qualify for the annual investment allowance at the rate of 100%, whilst the balance of expenditure will qualify for the first year allowance at the rate of 40%.

(2) Capital allowances will therefore be £60,000 (50,000 + (25,000 at 40%)).

Ventilation system

(1) The annual investment allowance will be available as above. The ventilation system will be integral to the factory, and so the balance of expenditure will only qualify for writing down allowances at the rate of 10%.

(2) Capital allowances will therefore be £52,500 (50,000 + (25,000 at 10%)).

(d) (1) The managing director's additional income tax liability for 2009–10 will be £16,000 (40,000 at 40%).

(2) The additional employee's Class 1 NIC will be £400 (40,000 at 1%).

(3) The additional employer's Class 1 NIC will be £5,120 (40,000 at 12·8%).

3 (a) Easy plc

1985 Pool	Number	Cost	Indexed cost
		£	£
Purchase June 1994	15,000	12,600	12,600
Indexation to September 2006			
12,600 x (200·1 – 144·7)/144·7			4,824
Rights issue September 2006			
15,000 x 1/3 = 5,000 x £2·20	5,000	11,000	11,000
	20,000	23,600	28,424
Indexation to June 2009			
28,424 x (213·0 – 200·1)/200·1			1,832
			30,256
Disposal June 2009			
Cost x 16,000/20,000	(16,000)	(18,880)	(24,205)
Balance carried forward	4,000	4,720	6,051

	£
Disposal proceeds	54,400
Cost	(18,880)
	35,520
Indexation (24,205 – 18,880)	(5,325)
Chargeable gain	30,195

Office building

(1) The insurance proceeds of £36,000 received by Problematic Ltd have been fully applied in restoring the office building.

(2) There is therefore no disposal on the receipt of the insurance proceeds.

Freehold factory

	£
Disposal proceeds	171,000
Indexed cost	(127,000)
	44,000
Rollover relief (44,000 – 16,200)	(27,800)
Chargeable gain	16,200

(1) The sale proceeds are not fully reinvested, and so £16,200 (171,000 – 154,800) of the capital gain cannot be held over.

Land

	£
Disposal proceeds	130,000
Incidental costs of disposal	(3,200)
	126,800
Indexed cost	(81,250)
	45,550

(1) The cost relating to the acre of land sold is £81,250 (300,000 x 130,000/480,000 (130,000 + 350,000)).

Profits chargeable to corporation tax

(1) For the year ended 31 March 2010 Problematic Ltd has chargeable gains of £91,945 (30,195 + 16,200 + 45,550).

(2) The company's profits chargeable to corporation tax are therefore £200,000 (108,055 + 91,945).

(b) (1) The 4,000 £1 ordinary shares in Easy plc have an indexed base cost of £6,051.

(2) The indexed base cost of the office building is £174,000 (169,000 – 36,000 + 41,000).

(3) The leasehold factory is a depreciating asset, and so there is no adjustment to the base cost of £154,800.

(4) The indexed base cost of the remaining three acres of land is £218,750 (300,000 – 81,250).

Tutorial note: When a replacement asset is a depreciating asset then the gain is not rolled over by reducing the cost of the replacement asset. Instead, the gain is deferred until it crystallises on the earliest of:

– *The disposal of the replacement asset.*
– *The date the replacement asset is no longer used in the business.*
– *Ten years after the acquisition of the replacement asset, which in this case is 10 December 2019.*

4 **(a)** (1) Tax evasion is illegal and involves the reduction of tax liabilities by not providing information to which HMRC is entitled, or providing HMRC with deliberately false information.

(2) In contrast, tax avoidance involves the minimisation of tax liabilities by the use of any lawful means. However, certain tax avoidance schemes must be disclosed to HMRC.

(3) If Ernest makes no disclosure of the capital gain then this will be viewed as tax evasion as his tax liability for 2009–10 will be understated by £18,000.

(b) (1) The matter is one of professional judgement, and a trainee Chartered Certified Accountant would be expected to act honestly and with integrity.

(2) Ernest should therefore be advised to disclose details of the capital gain to HMRC.

(3) If such disclosure is not made you would be obliged to report under the money laundering regulations, and you should also consider ceasing to act for Ernest. In these circumstances you would be advised to notify HMRC that you no longer act for him although you would not need to provide any reason for this.

(c) (1) HMRC can request information from Ernest by issuing a written information notice.

(d) (1) A discovery assessment can be raised because Ernest's self-assessment tax return did not contain sufficient information to make HMRC aware of the capital gain.

(2) The normal time limit for making a discovery assessment is four years after the end of the tax year, but this is extended to 20 years where tax is lost due to deliberate behaviour.

(e) **(i)** (1) Interest will run from the due date of 31 January 2011 to the payment date of 31 July 2011.

(2) The interest charge will therefore be £225 (18,000 x 2·5% x 6/12).

(ii) (1) The amount of penalty is based on the tax due but unpaid as a result of the failure to notify. The maximum penalty is therefore the CGT liability of £18,000.

(2) However, the actual penalty payable will be linked to Ernest's behaviour.

(3) Since Ernest would appear to have deliberately failed to notify HMRC of his capital gain, the actual penalty is likely to be 70% of the tax unpaid which is £12,600 (18,000 x 70%). This assumes that there is no attempt at concealment.

(4) The penalty would have been substantially reduced if Ernest had disclosed the capital gain, especially if the disclosure had been unprompted by HMRC prior to discovery. The maximum reduction would be to 20% of the tax unpaid.

5 **(a)** (1) Large companies have to make quarterly instalment payments in respect of their corporation tax liability. A large company is one paying corporation tax at the full rate.

(2) Quagmire plc has one associated company, so the upper limit is reduced to £750,000 (1,500,000/2). Corporation tax will therefore be at the full rate for the year ended 31 January 2010.

(3) There is an exception for the first year that a company is large, provided profits do not exceed £10 million. No exception applies because Quagmire plc was also a large company for the year ended 31 January 2009.

(b) (1) Quagmire plc's corporation tax liability for the year ended 31 January 2010 is £336,000 (1,200,000 at 28%).

(2) The company will have paid this in four quarterly instalments of £84,000 (336,000/4).

(3) The instalments will have been due on the 14th of August 2009, November 2009, February 2010 and May 2010.

(c) (1) Quagmire plc's profit for the year ended 31 January 2010 is £1,400,000 (1,200,000 plus franked investment income of £200,000).

(2) Quagmire plc is no longer a large company since its profits are below the upper limit of £1,500,000. The corporation tax liability will therefore be due in one amount on 1 November 2010.

(3) The corporation tax liability will be £334,500 calculated as follows:

	£
Corporation tax (1,200,000 at 28%)	336,000
Marginal relief	
7/400 (1,500,000 – 1,400,000) x 1,200,000/1,400,000	(1,500)
	334,500

			Marks	
1	**(a)**	Auy Man	1	
		Bim Men	1	
				2
	(b)	**Trading profit**		
		Depreciation	½	
		Input VAT	½	
		Motor expenses	1	
		Entertaining employees	½	
		Appropriation of profit	½	
		Excessive salary	½	
		Deduction of capital allowances	½	
		Capital allowances – Main pool	2	
		– Motor car [1]	1½	
		– Motor car [2]	2	
		– Special rate pool	1½	
		– FYA	1½	
		Trading income assessments		
		Salary	½	
		Interest on capital	1	
		Balance of profits	1	
				15
	(c)	Auy Man	2	
		Bim Men	1	
				3
	(d)	**(i) Tax point**		
		Basic tax point	1	
		Payment received or invoice issued	1	
		Issue of invoice within 14 days	1	
				3
		(ii) Vat paid		
		Output VAT and input VAT	1	
		Calculation	1	
				2
		(iii) Flat rate scheme		
		Joining the scheme	1	
		Continuing to use the scheme	1½	
		Vat payable	2	
		VAT saving	½	
				5
				30

				Marks	
2	**(a)**	**(i)**	Lease premium received	1½	
			Rent receivable – Property 1	1	
			– Property 2	½	
			– Property 3	½	
			Business rates	½	
			Repairs	1	
			Rent paid	½	
			Advertising	½	
			Insurance	1½	
			Loan interest	½	
					8
		(ii)	**Year ended 31 March 2010**		
			Property business profit	½	
			Loan interest	1½	
			Overseas income	½	
			Chargeable gain	½	
			Loss relief	½	
			Other periods		
			Trading profit	½	
			Property business profit	½	
			Loss relief	2	
			Gift aid donation	½	
					7
	(b)		Period ended 30 June 2009	1½	
			Year ended 30 June 2010	1½	
					3
	(c)		Equipment	2	
			Ventilation system	2	
					4
	(d)		Income tax	1	
			Employee's NIC	1	
			Employer's NIC	1	
					3
					25

			Marks	
3	**(a)**	**Easy plc**		
		1985 pool – Purchase	½	
		– Rights issue	1½	
		– Indexation	2	
		– Disposal	1	
		Chargeable gain	1½	
		Office building		
		Proceeds fully reinvested	1	
		No gain no loss	1	
		Freehold factory		
		Disposal proceeds	½	
		Indexed cost	½	
		Rollover relief	2	
		Land		
		Proceeds	½	
		Incidental costs of disposal	1	
		Cost	2	
		Profits chargeable to corporation tax		
		Chargeable gains	½	
		Calculation	½	
				16
	(b)	Ordinary shares in Easy plc	½	
		Office building	1½	
		Leasehold factory	1	
		Land	1	
				4
				20
4	**(a)**	Tax evasion	1	
		Tax avoidance	1	
		Non-disclosure of disposal	1	
				3
	(b)	Professional judgement	1	
		Advise disclosure	1	
		Obligation to report	1	
				3
	(c)	Written information notice	1	
				1
	(d)	Lack of sufficient information	1	
		Time limits	1	
				2
	(e)	**(i)** Interest period	1	
		Calculation	1	
				2
		(ii) Maximum penalty	1	
		Link to behaviour	1	
		Actual penalty	1	
		Disclosure	1	
				4
				15

			Marks	
5	(a)	Large companies	1	
		Associated company	1	
		No exception	1	
				3
	(b)	Corporation tax liability	1	
		Instalments	1	
		Due dates	1	
				3
	(c)	Profit	1	
		No longer a large company	½	
		Due date	1	
		Corporation tax	1½	
				4
				10