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# **Taxation I**

## **Northern Ireland**

1<sup>st</sup> Year Examination

**May 2011**

**Paper, Solutions & Examiner's Report**



### NOTES TO USERS ABOUT THESE SOLUTIONS

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There are often many possible approaches to the solution of questions in professional examinations. It should not be assumed that the approach adopted in these solutions is the ideal or the one preferred by us. Alternative answers will be marked on their own merits.

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**Accounting Technicians Ireland**  
**1<sup>st</sup> Year Examination : Summer 2011**  
**Paper : TAXATION I (Northern Ireland)**

Thursday 19<sup>th</sup> May 2011 : 9.30 a.m. to 12.30 p.m.

**INSTRUCTIONS TO CANDIDATES**

*PLEASE READ CAREFULLY*

**For candidates answering in accordance with the law and practice of Northern Ireland.**

**Candidates should answer the paper in accordance with the appropriate provisions up to and including the Finance Act 2010. The provisions of the Finance Act 2011 should be ignored.**

**Allowances and rates of taxation to be used by candidates are set out in a separate booklet supplied with the examination paper.**

**Answer ALL THREE QUESTIONS in Section A, and ANY TWO of the THREE questions in Section B. If more than TWO questions are answered in Section B, then only the first two questions, in the order filed, will be corrected.**

**Candidates should allocate their time carefully.**

**All workings should be shown.**

**All figures should be labelled as appropriate e.g. £s, units etc.**

**Answers should be illustrated with examples, where appropriate.**

**Question 1 begins on Page 2 overleaf.**

**The following inserts are enclosed with the paper:**

- **Tax Reference Material**
- **VAT 100 (QUESTION 2)**
- **Form P11 (x 3 copies) (QUESTION 4)**
- **P45 (QUESTION 4)**

**SECTION A****Answer ALL THREE questions in this Section****QUESTION 1 (Compulsory)**

Graeme owns a retail distribution business selling luxury confectioneries, cheeses and wines. His profit & loss account for the year to 31<sup>st</sup> July 2010 was as follows:

	£	£
<b>Sales</b>		575,902
Cost of Sales		<u>241,280</u>
<b>Gross Profit</b>		334,622
<b>Other Income</b>		
Profit on disposal of display equipment (1).....	240	
Disposal of antique vase (2).....	5,420	
Bank interest (3).....	<u>540</u>	<u>6,200</u>
		340,822
<b>Expenses</b>		
Staff Wages (4).....	120,413	
Rent & Rates (5).....	22,240	
Light & Heat (6).....	17,100	
Motor Expenses (7).....	33,600	
Telephone (8).....	3,950	
Postage & Stationery.....	1,236	
Repairs & Renewals (9).....	15,848	
Bad Debts (10).....	3,588	
Miscellaneous (11).....	9,460	
Advertising.....	24,000	
Interest (12).....	12,189	
Depreciation.....	21,327	
Redundancy Payments (13).....	9,154	
Insurance (14).....	18,560	<u>312,665</u>
<b>Net Profit</b>		<u>28,157</u>

**Note          Narrative**

- 1**          Graeme sold some of his older display equipment from his warehouse for a nominal sum. The equipment had been fully depreciated in his books which resulted in the small profit.
- 2**          This antique vase was jointly owned by Graeme & his partner Freda and sold on an internet auction site for £5,420 less selling expenses of £54.20 & delivery expenses of £25.

**QUESTION 1 (Cont'd)**

- 3** The bank interest relates to accrued interest on a savings account in the joint names of Graeme & Freda. On discussing the issue of additional income with Graeme you establish that an invoice to a customer for wine & cheeses in the amount of £2,495, dated 31<sup>st</sup> July (and dispatched on that day) had not been included in the above accounting records.

	£
<b>4</b> Staff wages	50,564
Freda's wages	9,320
Graeme's management salary	39,500
Staff Pension Costs	2,998
Staff NIC expense	7,665
Graeme's pension contribution (net)	<u>10,366</u>
	<u>120,413</u>

Graeme's partner, Freda, is employed part-time as an administrative assistant working week-days in the morning only.

	£
<b>5</b> Rent (including rent accrual £1,253 re: warehouse)	16,840
Rates	<u>5,400</u>
	<u>22,240</u>

The rent expense, noted above, also includes a payment of rent on temporary accommodation for Graeme & Freda of £1,875 when they moved out of their main residence which was being renovated in September & October 2009.

	£
<b>6</b> Electricity	6,539
Boiler Replacement	5,650
Boiler Maintenance	180
Solid Fuel (wood pellets)	2,475
Oil	<u>2,256</u>
	<u>17,100</u>

After having the oil boiler serviced during the year, Graeme elected to replace it with an environmentally friendly wood chip burning boiler in April 2009. Freda uses storage space at the warehouse to keep a sun-bed which she occasionally uses. Graeme believes that the sun-bed uses an insignificant amount of electricity of perhaps 0.5%.

**QUESTION 1 (Cont'd)**

		£
<b>7</b>	Purchase of Nissan Pathfinder	26,895
	Tax	435
	Insurance	450
	Diesel	<u>5,820</u>
		<u>33,600</u>

Graeme purchased the new jeep in August 2009. Despite having a high fuel consumption (CO<sub>2</sub> emissions of 264 grams/km) Graeme finds the vehicle very useful for delivering bulk supplies of wine and consumables at peak times and for transporting bulky equipment

when Graeme & Freda go mountaineering. He estimates their private use of the vehicle at 75%.

		£
<b>8</b>	Telephone (line rental & calls)	1,938
	Broadband	240
	Website design & maintenance	500
	Mobile phone (rental, calls, text messaging & mobile internet)	<u>1,272</u>
		<u>3,950</u>

The mobile bills refer to mobiles owned by Graeme, Freda and the warehouse manager. The total bill is approximately equally split between the three of them and business use of their mobile phones for all three is approximately 55%.

		£
<b>9</b>	Painting of administrative office & showroom	800
	New display equipment for warehouse & showroom	2,750
	New computers for administrative office	1,655
	Repair of old forklift truck	913
	Purchase of second hand delivery van	8,995
	Repair to delivery van before it was roadworthy	<u>735</u>
		<u>15,848</u>

		£
<b>10</b>	Decrease in general provision for doubtful debts	(376)
	Specific provision for bad debts	1,475
	Bad debt write-off	1,739
	Loan to customer written off	<u>750</u>
		<u>3,588</u>

**QUESTION****1 (Cont'd)**

		£
<b>11</b>	Salt for car park during cold weather	179
	Registering patent for truffle making	350
	Staff Christmas party	675
	Customer entertainment	1,978
	Gifts of bottles of wine to 100 best customers	475
	Cost of trip to South Africa	3,350
	Donation to 'Children in Need'	1,500
	Chamber of commerce subscription	250
	Legal expenses re: debt recovery	<u>703</u>
		<u>9,460</u>
	<p>The trip to South Africa was taken by Graeme &amp; Freda in January 2010. They were there for two weeks during which time, amongst trips for relaxing and taking in the sights, they visited four vineyards and sampled a great many wines which they were considering buying in to the Northern Ireland warehouse.</p>	
		£
<b>12</b>	Interest on bank loan (used to buy a large shipment of wine)	3,879
	Business overdraft & banking charges	4,327
	Freda's credit card repayments for April - June	<u>3,983</u>
		<u>12,189</u>
<b>13</b>	<p>A van driver in the warehouse was made redundant before Christmas 2009 and this payment represents his final months salary and termination payment.</p>	
		£
<b>14</b>	Insurance on warehouse & employers compulsory liability insurance	13,824
	Car insurance for Graeme's car	679
	Van insurance	1,254
	Keyman insurance	1,908
	Graeme & Freda's household insurance	<u>895</u>
		<u>18,560</u>

**Required**

Prepare an adjusted profits computation for Graeme's business for the year to 31<sup>st</sup> July 2010.

**Total 20 Marks**

**QUESTION 2 (Compulsory)**

John McCreesh, now trading as MACAREESH & Sons, pre-registered for VAT in September 2010 and commenced to trade on 1<sup>st</sup> October 2010. MACAREESH elected to account for VAT in the normal manner and John has asked for your help in preparing the business VAT return for the quarter ended 31<sup>st</sup> December 2010. In particular, the following transactions are giving John cause for concern as he, like his clerk, has little idea how to go about completing a VAT return.

Note: all amounts are inclusive of VAT unless otherwise stated.

- 1 The office clerk has supplied you with the following purchase invoices:

<b>Supply of:</b>	<b>Gross Amount</b>	<b>Invoice Date(s)</b>
Stock	4,850	23/9/10
Plant & Machinery	14,100	12/9/10
Computers	4,171.25	31/8/10
Fixtures & Fittings	8,078.13	20/9/10 & 19/9/10
Website Development	1,116.25	28/8/10

Most of these invoices were paid during the quarter to 31<sup>st</sup> December with the exception of the stock which was paid when it was bought on September 1<sup>st</sup> (the stock was delivered on 23<sup>rd</sup> September).

The fixtures & fittings invoiced on September 19<sup>th</sup> (for a net amount of £2,514) did not have a valid supplier VAT number displayed.

- 2 Perusal of the sales day books revealed that goods with a NET value of £18,800 were sold on credit to UK customers during the quarter to 31<sup>st</sup> December. MACAREESH & Sons made cash purchases of goods (detailed below) from cash sales to local customers.

<b>Narrative</b>	<b>Amount</b>
Office Supplies	£205
Drawings	£6,000
Sundry bills (unsupported by invoice)	£875

- 3 A purchase invoice from LUND GmbH, a German supplier, for goods with a net value of £1,500 was received on 1/12/10. The goods were not received until December 31<sup>st</sup>.
- 4 MACAREESH sold goods to a French customer with a net value of £1,395 on 3<sup>rd</sup> December. The French customer has supplied MACAREESH with a valid French VAT number.

**QUESTION 2** (*Cont'd*)

- 5 A Spanish customer bought goods with a net value of £1,750 on 28<sup>th</sup> November. The customer has not been able to supply MACAREESH with a valid Spanish VAT number.
- 6 MACAREESH had given commercial samples out of purchases to numerous customers. The net value of these samples equated to approximately £25 per customer and had been given to the businesses making the first 50 enquiries about MACAREESH products.
- 7 John McCreesh leases his car and the expense is included in payments made through MACAREESH & Sons. John uses this car for both private and business related journeys. The expense of the car is £305.50 per month and the vehicle has an official CO<sub>2</sub> emissions rating of 167 grams/km. All of the fuel for the car is paid for by MACAREESH & Sons. Garage bills relating to the consumption of this fuel during the quarter came to £796.65.
- 8 Utility bills during the quarter came to:
- | <b>Supplier</b> | <b>Amount</b> |
|-----------------|---------------|
| NIE             | £1968         |
| BT              | £671          |
- 9 Staff wages paid during the quarter came to £6,825 excluding employer secondary class 1 National Insurance contributions.

**Required**

Explain how MACAREESH & Sons should deal with each of the above issues detailed at 1-9, calculate the business VAT liability owing or refund due for the quarter ended 31<sup>st</sup> December 2010, complete the VAT 100 form for this quarter and note by which date the VAT return should be submitted.

**Total 20 Marks**

**QUESTION 3** *(Compulsory)*

Raymond, born in July 1964, is married to Patricia who was born in October of the following year and they live in Banbridge with their two children Brian (9) and Sophie (3). Raymond is the managing director of BLANTHAM Ltd, an online retailer specialising in giftware. The company is very successful and Raymond's basic salary in 2010/11 was £78,000 (gross). In addition to his basic salary Raymond received performance related bonuses of £9,800 (received on 30<sup>th</sup> September 2009 in respect of the company's annual profits to the accounting year end 30<sup>th</sup> June 2009) and £11,450 (received on 30<sup>th</sup> September 2010 in respect of the company's results for the accounting year end 30<sup>th</sup> June 2010). Raymond pays 5% of his gross basic salary into BLANTHAM's company pension scheme and had tax deducted under PAYE of £29,130 in 2010/11.

At the end of June 2010 BLANTHAM Ltd supplied Raymond with an Audi A6 which has a list price of £27,220 and a CO2 emissions rating of 167 grams/km. Prior to receiving this car, Raymond had been driving his own private car for all work and personal use.

Now that Raymond is driving a company car BLANTHAM Ltd supply Raymond with all petrol. When Raymond drove his own car he submitted mileage claims for all business related mileage that he did in his own car. Mileage claims in the period April – June 2010 showed that Raymond drove 1,145 miles for business purposes and had been reimbursed £744.25.

Throughout 2010/11 Raymond was in receipt of a round sum allowance of £100 per month and for which he submitted supporting invoices of £962 (including VAT).

Since Sophie has not yet reached school age, the company pay £45 per week to an approved childminder to help with childcare for Sophie as Patricia volunteers two days per week in a local charity shop.

Raymond and Patricia's home PC had been borrowed from the company on 1<sup>st</sup> November 2009 and had originally cost the company £1,450. In 2010/11 Raymond bought the computer from the company for £250. The market value of the computer at the date of purchase by Raymond was £450.

Raymond had borrowed £3,000 from BLANTHAM Ltd in 2009 and repaid £1,000 in August 2010. Raymond is not paying any interest on this loan.

**QUESTION 3** (*Cont'd*)

Raymond and Patricia are avid savers and occasional investors and received the following sums during 2010/11 on savings and investments which they hold in joint names:

Building Society Interest.....	£ 3,440.00
Interest on NSB Investment Account.....	£ 2,372.00
UK Dividends Received.....	£ 10,800.00

When each of Raymond's children were born he opened building society savings accounts in their names and, in 2010/11, the interest received on these accounts was £2,920 (split equally between Brian & Sophie).

Raymond made a gift aid payment in 2010/11 to a recognised charity of £1,600 (net).

Patricia had inherited some wealth from her late father and this is now invested in an interest bearing building society account (amount received in 2010/11 was £7,200) and in some UK shares (from which she received dividends of £6,372 in 2010/11).

**Required**

Complete income tax computations for 2010/11 for both Raymond and Patricia showing clearly their tax liabilities and the balance of any tax owing or refundable.

**Total 20 Marks**

**SECTION B****Answer ANY TWO of the three questions****QUESTION 4**

Jay, Catherine & Frances are employees of PAPERTHIN Ltd, a wholesale paper & office supplies distributor for whom you complete the payroll.

You have been given the following relevant details for month 3 of 2010/11.

	<b>Jay</b>	<b>Catherine</b>	<b>Frances</b>
Gross Salary to Date	£6,250	-	£9,687
Company Pension Contribution	6%	-	6%
Payroll giving Scheme (per month)	£20	-	-
Childcare Vouchers (per month)	-	-	£243
Tax Code	299L	-	647L
Tax Paid to Date	£1,013	-	£1,352
Salary in Month 4	£2,750	£4,450	£3,300

Catherine has just joined the company as a manager from INKSPOT Ltd and her details up to cessation of her previous employment are contained in the copy P45 (see below). Catherine has had no other employment in 2010/11. Catherine will be joining the company pension scheme at PAPERTHIN Ltd (she had not been a member of the INKSPOT pension scheme) as well as maintaining her existing private pension contributions of (net) £480 per month.

Frances will be leaving PAPERTHIN Ltd in 2010/11 at the end of month 4.

Catherine's P45 showed the following:

<b>Name</b>	Catherine
<b>NI Number</b>	NR 83 67 10 Z
<b>Tax Code</b>	K75
<b>Cumulative Pay to Date</b>	£13,185
<b>Tax Paid to Date</b>	£3,480

**Required**

Complete all relevant sections of forms P11 for each employee up to the end of month 4 and Form P45 for Frances in respect of her leaving the company. Please show all workings with respect to tax and NIC deductions.

**Total 20 Marks**

Nathan, your friend, is considering starting a business after many years of working in a large company but doesn't believe that he would be able to manage on his own in the venture as the workload would be too great. Nathan cannot rely on family members to help out in the business and wants to retain sole control of it and he realises that this means he will have to employ staff.

**Required**

Email Nathan outlining what his obligations would be as an employer, making sure to address the following specific issues he has raised with you:

- (i) How can I differentiate between someone who I have engaged casually to help out and someone who is genuinely my employee?  
**3 Marks**
  
  - (ii) I have paid tax on my earnings as an employee for many years but, now that I may be become a small employer, do I still have to deduct tax from my employee's wages, no matter how small the wages may be? If so, when would this start?  
**3 Marks**
  
  - (iii) On what employee receipts or benefits do I have to calculate any PAYE deductions and how often are such calculations/deductions made? Do National Insurance Contributions have any relevance in this process? Please do not go into detail as to how to actually perform any calculations!  
**4 Marks**
  
  - (iv) What would my monthly/annual obligations be with respect to any payments I may have to make or forms to complete and return to HMRC?  
**6 Marks**
  
  - (v) How would I deal with joining or leaving employees?  
**4 Marks**
- Total 20 Marks**

**(a)**

Fred invested in a large commercial property some years ago. He has named the building Fred Towers Mall and, as it is located in a prime retail location, the building is usually fully occupied. The building is let to a range of commercial tenants who carry on retail, professional and service related businesses. Details of the six relevant leases in force during 2010/11 are as follows:

**Lease Details**

- 1** Let during 2010/11 to single tenant at an annual rate of £25,000 per annum.
- 2** Let at an annual rate of £21,000 on a lease which ceased on 31/12/10. Let to a new tenant at an annual rate of £24,000 on a lease commencing 1/2/11.
- 3** Let at an annual rate of £20,000 per annum on a lease which ceased on 31/10/10.
- 4** Let at an annual rate of £28,000.
- 5** Let at an annual rate of £30,000.
- 6** Let at an annual rate of £45,000 – this is the anchor tenant.

The tenants under lease 2 (the original tenant which expired on 31/12/10) & lease 3 went into liquidation and it is believed that the final three and five months rent, respectively, will be uncollectable on these two leases.

Fred has a contract with CLEAN-U-LIKE, an agency who clean and maintain the whole property. The annual cost of this contract is £7,500. Fred also pays to insure the building, at a cost of £12,995 in 2010/11 and incurred an electricity & heating expense relating to common areas in the building at a cost of £3,950 in 2010/11.

The lift system in the building was upgraded during 2010/11 at a cost of £75,000 and Fred pays an annual maintenance contract to MARVIN Ltd to maintain the lift system. In 2010/11 the lift maintenance contract cost £3,150.

Fred uses LA Ltd, property managers and letting agents, to manage the property, relationships with tenants, CLEAN-U-LIKE and relevant stakeholders and who charge Fred 10% of rents for the service.

Fred mortgaged the building to part-finance its acquisition in 2004 and his loan repayments in 2010/11 consisted of:

Capital	£1,181
Interest	£5,469

**QUESTION 6** (*Cont'd*)**Required**

Calculate the property income assessable on Fred during 2010/11.

**14 Marks****(b)**

Fred also owns a holiday cottage on the north coast. He is thinking of letting the property for some of the year when he is unlikely to be using it and has heard that if the property constitutes a 'furnished holiday let' there may be some specific tax consequences.

**Required**

Outline to Fred how his holiday home could qualify as a furnished holiday let and what the tax consequences would be for him.

**6 Marks****Total 20 Marks**

# 1st Year Examination: May 2011

## Taxation I (NI)

### Suggested Solutions

**Students please note:** These are suggested solutions only; alternative answers may also be deemed to be correct and will be marked on their own merits.

#### Question 1

<b>Net Profit per the accounts</b>						£ 28,157.00
<b>Add: Disallowed Expenses</b>						
Drawings				£	39,500.00	
Graeme's pension contribution				£	10,366.00	
Private rent				£	1,875.00	
Boiler replacement				£	5,650.00	
Electricity	0.50%	6539		£	33.00	
Jeep				£	26,895.00	
Vehicle Expenditure		435				
		450				
		5820	75%	£	5,029.00	
Mobile bills		424	45%	£	191.00	
Display equipment				£	2,750.00	
Computers				£	1,655.00	
Delivery van				£	8,995.00	
Repair before use				£	735.00	
Bad debt general provision				-£	376.00	
Customer loan written off				£	750.00	
Customer entertainment				£	1,978.00	
Gifts of wine				£	475.00	
South African trip				£	3,350.00	
Charitable donation				£	1,500.00	
Depreciation				£	21,327.00	
Car Insurance		679	75%	£	509.00	
Keyman Insurance				£	1,908.00	
Private Insurance				£	895.00	£ 135,990.00
<b>Less: Non-trading Income</b>						
Profit on disposal				£	240.00	
Vase				£	5,420.00	
Bank Interest				£	540.00	£ 6,200.00

<b>Add: Unbilled Income</b>				
Unrecorded Invoice				<u>£ 2,495.00</u>
Adjusted Profits				<u>£ 160,442.00</u>

## Question 2

Inputs	Note	Narrative	Net	VAT	Gross
	1	Stock	£ 4,127.66	£ 722.34	£ 4,850.00
	1	P&M	£ 12,000.00	£ 2,100.00	£ 14,100.00
	1	Computers	£ 3,550.00	£ 621.25	£ 4,171.25
	1	F&F	£ 6,875.00	£ 1,203.13	£ 8,078.13
	1	F&F - invalid invoice	-£ 2,514.00	-£ 439.95	-£ 2,953.95
	1	Website Devel	£ 950.00	£ 166.25	£ 1,116.25
	2	Office Supplies	£ 174.47	£ 30.53	£ 205.00
	3	EU Purchase	£ 1,500.00	£ 262.50	£ 1,762.50
	7	Car lease	£ 780.00	£ 68.25	£ 916.50
	7	Fuel	£ 678.00	£ 118.65	£ 796.65
	8	NIE	£ 1,674.89	£ 293.11	£ 1,968.00
	8	BT	<u>£ 571.06</u>	<u>£ 99.94</u>	<u>£ 671.00</u>
		<b>Total Input VAT</b>		<b>£ 5,246.00</b>	
Outputs	Note	Narrative	Net	VAT	Gross
	2	Sales	£ 18,800.00	£ 3,290.00	£ 22,090.00
	2	Cash Sales	£ 6,025.53	£ 1,054.47	£ 7,080.00
	3	EU Purchase	£ 1,500.00	£ 262.50	£ 1,762.50
	4	EU Sale (VAT number)	£ 1,395.00	£ -	£ 1,395.00
	5	EU Sale (No VAT number)	£ 1,750.00	£ 306.25	£ 2,056.25
	7	Fuel scale charge	<u>£ 265.53</u>	<u>£ 46.47</u>	<u>£ 312.00</u>
		<b>Total Output VAT</b>		<b>£ 4,959.69</b>	
		<b>VAT Refundable</b>		<b>-£ 286.31</b>	

This VAT return should be completed & returned by 31st January 2011.

**QUESTION 3**

<b>W1</b>	Salary		£ 78,000.00			
	Bonus		£ 11,450.00			
	Pension		<u>-£ 3,900.00</u>			
			<u>£ 85,550.00</u>			
<b>W2</b>	<b>Car Benefit (Audi)</b>					
	£27,220 x 22% x 9/12		£ 4,491.00			
<b>W3</b>	<b>Fuel</b>					
	£18,000 x 22% x 9/12		£ 2,970.00			
<b>W4</b>	<b>Mileage</b>					
	Reimbursed		£ 744.00			
	Allowable reimbursement					
	1,145 miles @ 40p/mile		<u>£ 458.00</u>			
	Excess		<u>£ 286.00</u>			
<b>W5</b>	<b>Round-sum Allowance</b>		£ 1,200.00			
	Supporting Invoices		<u>-£ 962.00</u>			
			<u>£ 238.00</u>			
<b>W6</b>	<b>Computer</b>					
	Original cost	£ 1,450.00				
	Less: Loaned Benefit 09/10					
	£1,450 x 20% x 5/12	-£ 121.00				
	Less: Price Paid	<u>-£ 250.00</u>				
		<u>£ 1,079.00</u>				
	MV at transfer	£ 450.00				
	Less: Price Paid	<u>-£ 250.00</u>				
		<u>£ 200.00</u>				
	Benefit is greater of:		£ 1,079.00			
<b>W7</b>	<b>Benefits</b>					
	Car	W2	£ 4,491.00			
	Fuel	W3	£ 2,970.00			
	Excess Mileage	W4	£ 286.00			
	Excess Round Sum Allowance	W5	£ 238.00			

	Transferred Asset	W6	<u>£ 1,079.00</u>			
			<u>£ 9,064.00</u>			
<b>W8</b>	<b>Gift Aid</b>					
	£1,600 x 100/80		<u>£ 2,000.00</u>			
	Note that the payments for childcare & the loan are both exempt.					
	<b><u>Income Tax Computation Raymond 2010/11</u></b>					
W1	Salary & Bonus		£ 85,550.00			£ 85,550.00
W7	Benefits		<u>£ 9,064.00</u>			£ 9,064.00
	Building Society Interest	£3,440 x 100/80 x 1/2		£ 2,150.00		£ 2,150.00
	NSB Account	£2,372 x 1/2		£ 1,186.00		£ 1,186.00
	Dividends	£10,800 x 100/90 x 1/2			<u>£ 6,000.00</u>	£ 6,000.00
	Parental Disposition	£2,920 x 100/80		<u>£ 3,650.00</u>		<u>£ 3,650.00</u>
			£ 94,614.00	£ 6,986.00	£ 6,000.00	£ 107,600.00
<b>W8</b>	<b>Personal Allowance</b>					
	Total Taxable Income	£ 107,600.00				
	Less: Gift Aid	-£ 2,000.00				
	Less: Pension		Already deducted, see W1			
	Adjusted Net Income	£ 105,600.00				
	Earnings Threshold	<u>£ 100,000.00</u>				
	Excess	£ 5,600.00				
	1/2 excess	<u>£ 2,800.00</u>				
	PA	£ 6,475.00				
	Less: Restriction	<u>-£ 2,800.00</u>				
	PA (restricted)		<u>-£ 3,675.00</u>			<u>-£ 3,675.00</u>
	Taxable Net income		<u>£ 90,939.00</u>	<u>£ 6,986.00</u>	<u>£ 6,000.00</u>	<u>£ 103,925.00</u>
	<b>Taxes As Per:</b>					
	£37,400 @ 20%		£ 7,480.00			
	£2,000 @ 20%		£ 400.00			
	£51,539 @ 40%		£ 20,616.00			
	£6,986 @ 40%		£ 2,794.00			
	£6,000 @ 32.5%		<u>£ 1,950.00</u>			
			£ 33,240.00			
	Less: TaxCredit		<u>-£ 600.00</u>			
	<b>Tax Liability</b>		£ 32,640.00			
	Less: Paid at source	PAYE	-£ 29,130.00			
		BSI	-£ 430.00			
		Parental Disposition	<u>-£ 730.00</u>			

	<b>Balance of tax due</b>		<u>£ 2,350.00</u>			
	<b><u>Income Tax Computation Patricia 2010/11</u></b>					
	BSI - Joint Interest	£3,440 x 100/80 x 1/2		£ 2,150.00		£ 2,150.00
	NSB - Joint Interest	£2,372 x 1/2		£ 1,186.00		£ 1,186.00
	Dividends - Jointly Held	£10,800 x 100/90 x 1/2			£ 6,000.00	£ 6,000.00
	BSI	£7,200 x 100/80		<u>£ 9,000.00</u>		£ 9,000.00
	Dividends	£6,372 x 100/90			<u>£ 7,080.00</u>	<u>£ 7,080.00</u>
				£ 12,336.00	£ 13,080.00	£ 25,416.00
	PA			<u>-£ 6,475.00</u>		<u>-£ 6,475.00</u>
	Taxable Income			£ 5,861.00	£ 13,080.00	£ 18,941.00
	<b>Taxed as Per:</b>					
	£2,440 @ 10%			£ 244.00		
	£3,421 @ 20%			£ 684.20		
	£13,080 @ 10%			<u>£ 1,308.00</u>		
				£ 2,236.20		
	Less: Tax Credit			<u>-£ 1,308.00</u>		
	<b>Tax Liability</b>			£ 928.20		
	Less: Tax Paid at Source					
	BSI			<u>-£ 2,230.00</u>		
	<b>Refund Due</b>			<u>-£ 1,301.80</u>		

#### Question 4

Income Tax		Jay	Catherine	Frances
Gross Salary to M3		6250	13185	9687
Pension Contributions (6%)		-375	0	-537.48
Payroll giving scheme	£20 x 3	-60	0	0
Childcare Vouchers	£243 x 3	<u>0</u>	<u>0</u>	<u>-729</u>

		<u>5815</u>	<u>13185</u>	<u>8420.52</u>
Pay in M4		2750	4450	3300
Pension		-165	-267	-183.42
Payroll giving		-20	0	0
Childcare Vouchers		<u>0</u>	<u>0</u>	<u>-243</u>
		<u>2565</u>	<u>4183</u>	<u>2873.58</u>
		<u>8380</u>	<u>17368</u>	<u>11294.1</u>
FreePay	£2,999 x 4/12	<u>-999.67</u>		
	£6,479 x 4/12			<u>-2159.67</u>
Additional Pay	£759 x 4/12		<u>253</u>	
Taxable Pay		<u>7380.33</u>	<u>17621</u>	<u>9134.43</u>
<b>Taxed as per:</b>				
£7,380 @ 20%		1476.07		
£12,466.67 (£37,400 x 4/12) @20%			2493.33	
£5,154.33 @ 40%			2061.73	
£9,134.43 @ 20%				1826.89
<b>Total Cumulative Tax to M4</b>		<b>1476.07</b>	<b>4555.06</b>	<b>1826.89</b>
Less: Tax Paid to Date		<u>-1013</u>	<u>-3480</u>	<u>-1352</u>
<b>Tax Due in M4</b>		<b><u>463.07</u></b>	<b><u>1075.06</u></b>	<b><u>474.89</u></b>
<b>National Insurance Contributions</b>				
Relevant Pay in M4		2750	4450	3057
<b>Primary Contributions</b>				
£(2,750 - 476) x 0.11		<u>250.14</u>		
£(3,656 - 476) x 11%			349.8	
£(4,450 - 3,656) x 1%			<u>7.94</u>	
£(3,057 - 476) x 11%				<u>283.91</u>
		<u>250.14</u>	<u>357.74</u>	<u>283.91</u>
<b>Secondary contributions</b>				
£(2,750 - 476) x 12.8%		<u>291.07</u>		
£(4,450 - 476) x 12.8%			<u>508.67</u>	
£(3,057 - 476) x 12.8%				<u>330.37</u>
<b>Total NIC Contribution</b>		<b><u>541.21</u></b>	<b><u>866.41</u></b>	<b><u>614.28</u></b>

**Question 5**

- It can help to make the decision between employment and self-employment by considering the following factors:
  - What is the degree of control over person carrying on the work?
  - Do the individuals have to provide their own equipment?
  - Can the person hire their own helpers?
  - Who bears the burden of financial risk?
  - Are they entitled to holiday pay or sick pay?
  - Do they exclusively work for one person?
  
- Once the decision has been made that an individual is an employee (rather than a self-employed contractor), all employers are obliged to operate the pay as you earn (PAYE) system on payments made to their employees – this is to ensure correct collection of income tax & NIC.
  
- This operation/application of PAYE starts immediately on employing an individual & making payments to them. Bear in mind that if the employee certifies that the job is their only or main job, tax would not have to be deducted until their weekly pay exceeded £124.50. Note also that NIC would not be deducted until the employee's weekly pay exceeded £110. Appropriate and relevant tax & NIC is otherwise deducted each time an employee is paid. Income tax & NIC so collected must be paid over to HMRC by 19<sup>th</sup> of the month following payment to the employee (22<sup>nd</sup> for electronic payments). Large employers (more than 250 employees) are obliged to make electronic PAYE payments. Small employers (average PAYE payments less than £1,500) may make quarterly PAYE payments.
  
- Pay for income tax purposes is the employee's pay received as reward for services rendered less pension contributions deducted under net pay arrangements, payroll giving & childcare vouchers. Pay for NIC purposes is broadly as above with the exception that pension & payroll contributions would not be deductible.
  
- Only limited employee benefits are processed through payroll and would include circumstances where the employer pays a bill on behalf of the employee for example. Other employee benefits are reported to HMRC on form P9D or P11D (by 5<sup>th</sup> July following the tax year) with relevant NIC (class 1A) paid by 19<sup>th</sup> July.
  
- Payroll should be operated weekly, fortnightly, four-weekly or monthly as appropriate.
  
- Employers must keep records of their monthly payments in respect of net income tax and class 1 NIC payments. The totals should be recorded monthly or quarterly on the employer payment record (or form P32 or payslip booklet). Employers are obliged to keep PAYE records for at least the current tax year and the three previous years.
  
- Details must be provided to HMRC of all those employees who have earned at a rate equal to (or above) the NIC LEL.

- End of year returns include forms P14/35/60. Form P14 is in three parts. Two parts (P14) are sent to HMRC (one of which is for NIC) and the third part is form P60 which must be given to the relevant employee (by 31<sup>st</sup> May following the tax year for the P60, 19<sup>th</sup> May for P14). P14/60 show total pay (including SSP/SMP/SPP/SAP), student loan deductions and tax/NIC deductions. Form P35 shows, for all employees (current & former), the total tax, NIC and student loan deductions and amounts recovered in respect of SSP/SMP etc.
- Additional year end forms include P9D/P11D/P11D(b). P9D/P11D is relevant to all current & former employees and shows details of expenses reimbursed and benefits in kind. P11D(b) shows all employer's class 1A contributions and the filing date for all these forms is 6 July following the tax year.
- When an employee joins, it is important to obtain the employee's P45 form from their previous employment. Form P45 shows the employee's total pay, cumulative tax, code number & whether student loan deductions are to be made. For the new employer (and the employee) this facilitates a seamless continuation of the application of the PAYE system to the employee's earnings from the previous & subsequent employment. If an employee cannot provide a P45, the new employer must ask the employee to complete & sign form P46 indicating whether they have student loan and if:
  - A The subsequent job is first since 6 April & they have not received pension or benefits;
  - B The subsequent job is now their only job but they have had others since 6 April or received certain benefits but do not receive a pension(s);
  - C They have another job or receive a pension

The P46 procedure allows employers to deduct tax on a cumulative basis straight away when box 'A' is ticked. When the employee ticks box 'B' they are taxed on an emergency code on a week 1/month 1 basis. When an employee ticks box 'C', they are taxed at the basic rate. When HMRC receive form P46, they will issue revised tax codes as appropriate so as to subsequently facilitate deduction of tax on a cumulative basis for the relevant employee.

- When an employee leaves, they must be issued with a form P45 as above.
- Form P45 is in four parts (one part is sent to HMRC and the other three parts are given to the employee, two of which will be given to the subsequent employer and the fourth part will be retained by the employee)

(a) Question 6	1	2	3	4	5	6	Total
Property/Lease							
<b>Rental Accrual</b>							
£25,000 (12 month let)	£ 25,000.00						£ 25,000.00
£21,000 x 9/12	£ 15,750.00						£ 15,750.00
£24,000 x 2/12	£ 4,000.00						£ 4,000.00
£20,000 x 7/12			£ 11,667.00				£ 11,667.00
£28,000 (12 month let)				£ 28,000.00			£ 28,000.00
£30,000 (12 month let)					£ 30,000.00		£ 30,000.00
£45,000 (12 month let)						£ 45,000.00	£ 45,000.00
<b>Total Accrued Rental Income</b>							<b>£ 159,417.00</b>
<b>Bad Debts Written Off</b>							
£21,000 x 3/12	-£ 5,250.00						-£ 5,250.00
£20,000 x 5/12			-£ 8,333.33				-£ 8,333.33
<b>Cleaning contract</b>							-£ 7,500.00
<b>Insurance</b>							-£ 12,995.00
<b>Electricity</b>							-£ 3,950.00
<b>Elevator maintenance</b>							-£ 3,150.00
<b>Letting agents comission (10% of rents)</b>							-£ 14,583.37
<b>Mortgage Interest</b>							-£ 5,469.00
<b>Assessable Property Income</b>							<b>£ 98,186.30</b>
<b>(b)</b>							
<b>Property qualifies as FHL if:</b>							
		Furniture available to tenants					
		Available for letting 140 days in the year					

					Actually let for 70 days in the year			
					Not normally let for more than 31 days consecutively to the same tenant			
					Let on a commercial basis with a view to the realisation of profit			
					<b>Tax consequences:</b>			
					Treated as trading income so business loss relief available			
					Income is considered pensionable income			
					Class 4 NIC not payable			
					Class 2 NIC payable			
					Capital allowances may be claimed on relevant expenditure			
					Some capital gains reliefs may be available			

# 1st Year Examination: May 2011

## Taxation I (NI)

### Examiner's Report

#### General

The overall standard of scripts at this sitting was very creditable albeit that the pass rate wasn't quite as high in the summer sitting 2011 (68.4% and perhaps more in keeping with a longer term average) compared to the equivalent sitting in 2010 (82.4%). Similarly, the average score wasn't quite as high in 2011 (52.5 %) relative to the equivalent statistic in 2010 (66%). These statistics do not, however, offer enormous insight into the performance of this diet of candidates and it is interesting to delve into the figures in some more depth to gain a more complete picture. To that end consider the following:

- The average score achieved by candidates who had passed was 62% while that achieved by those who were unsuccessful was 32%.
- Generalising, this offers some substance to the long held opinion of the examiner that candidates are either presenting themselves for the examination in a robust state of readiness (as the majority are) or are clearly not (as a minority appear to be) – this gap in 2011 (between the stronger and weaker performers) was, however, very marked. Consider that the average score among successful candidates was 12% better than the pass mark but that the average score among the unsuccessful candidates was 18% *worse* than the pass mark.
- The inclusion of VAT as a compulsory question at this sitting once again appears to have caught out a number of candidates. It was pointed out in the 2010 examiners report that the performance of many students in the VAT question was not that which would be expected (it was the second worst answered question in 2010) and this performance, sadly, was replicated overall in 2011. It is completely unacceptable that, in a syllabus where only two taxes are examined (income tax and VAT) many examination candidates apparently choose to ignore one of the taxes (VAT).
- Going further, it is interesting to consider the performance of unsuccessful candidates in the VAT question (referring to those who were unsuccessful in the overall examination). To this end, anecdotally, consider one of the smaller exam venues where 2/3<sup>rds</sup> of the unsuccessful candidates achieved an overall aggregate score in the range 40-44 (out of the 50 marks required in order to pass) but who, without exception, achieved scores in the VAT question which ranged from 0-2.5 marks (out of 20 available marks). In the same centre, the successful candidates who had attempted the VAT question achieved a score in the VAT question which ranged from 10-17 marks (out of the 20 available marks). Clearly, had the unsuccessful candidates, referred to above, replicated this performance in the VAT question, they would all have passed the examination. This would have produced an overall pass rate for that centre of 88% (eclipsing the overall average from 2010 of 82.4%) rather than the overall pass rate for that exam centre of 64% which actually prevailed.
- The above observation could be made with many unsuccessful candidates who had achieved scores in the 40-45% range. Further, when an unsuccessful candidate (scoring in the 40-45% range) was observed to have achieved a respectable score in the VAT question, they appeared incapable of capitalising on their performance in the VAT question by achieving a

good score in the other staple questions for this examination (adjusted profits, income tax computations and payroll calculations). Such apparent *unrounded* ability across the syllabus had, very obviously, cost a number of candidates a pass in the examination and it is the opinion of the examiner that this had chiefly contributed to the overall pass rate at this sitting (relative to summer 2010). It can only be hoped that future candidates take note of this!

- Please note that it is not the opinion of the examiner that the standard of VAT knowledge is to blame for the more subdued overall performance of exam candidates at this sitting relative to 2010. Rather, the markedly *unrounded* relevant tax knowledge of unsuccessful candidates is very evident. Among the unsuccessful candidates the average mark for every question was less than a 'pass' mark for the individual question (10/20) and with the exception of Q1 the average mark wasn't even close to a pass mark for the question!
- As one question which clearly stands out in this regard, the general standard of answers given to the narrative question was extremely poor at this sitting, albeit with some notable exceptions. When candidates chose the narrative question as one of their optional (section B) questions it was, very often, a choice which did them no favours in bolstering their overall mark for the examination. If allied to a poor VAT (or other) question(s) in the compulsory section, it often left candidates seriously struggling to pass the examination and I would refer future exam candidates (and re-sitting candidates) to the points made immediately above!

I give my analysis of questions on this paper below. The average marks for each question (out of 20) are given for both successful & unsuccessful candidates in brackets. For example, if the average score for successful candidates was 15/20 in any given question, and the average score for the unsuccessful candidates was 7/20, the results would be presented thus: (15/7).

### Question 1

This was a very standard 'adjusted profits' style of question which produced very good solutions on the whole and was the second best answered question at this sitting. Mistakes made at this question included applying a non-standard (and wholly unacceptable) approach to adjusting profits whereby candidates attempted to reconstruct the profit and loss account rather than using the 'add-back' method for dealing with disallowed expenses. Very few candidates actually got the correct mobile phone adjustment and some more bizarre mistakes included using Co2 emissions to calculate the deductibility of car/vehicle expenses, assuming that net pension contributions had to be adjusted after grossing up for VAT (!) or income tax or allowing Graeme's 'management salary' or 'pension contribution' as a deductible expense on the justification that they weren't actually drawings! It can also be noted that, just as a non-standard approach to adjusting profits isn't acceptable, neither is adding back all expenses on, presumably, the assumption that the correct adjustments have to be identified in amongst all the expenses!

### Question 2

This question required candidates to piece together some straight-forward information in order to submit the first VAT return for a new business and was answered quite poorly on average in fact, some candidates appear not to have studied VAT at all and this was the second worst answered question at this sitting! Some candidates somehow managed to imagine that the question had something to do with partial exemption while others displayed the depressingly common confusion between VAT and income tax. Furthermore, far too many candidates failed to score simple marks by failing to state the due submission date for the VAT return or carry out the very straight forward task of indicating how to complete the VAT 100 form.

Another well answered question on the whole (as one would expect for an income tax computation) and the third best answered question at this sitting. Where students made mistakes they involved around the following:

- Ignoring gift aid
- Not sharing income from jointly owned investments and savings accounts
- Grossing up NSB interest
- Calculating a BIK on a loan of < £5,000
- Not pro-rating the car & fuel benefit
- Assuming that the cash equivalent of BIK's are pensionable income
- Ignoring the parental disposition
- Assuming that Raymond would receive a PAA/MCAA!
- Not attempting to adjust Raymond's PA for receipt of income in excess of £100,000
- Too many students did not apply the starting rate (10%) for Patricia's savings income

#### **Question 4**

This was a standard payroll calculation question which was often answered well and was the best answered question at this sitting. The one new payroll entry in the question was the inclusion of the childcare vouchers although the marks available for this dealing item were inconsequential and had minimal impact on the average marks scored by candidates. Where candidates presented poor solutions to this question it laid bare their obvious lack of preparation or understanding of payroll calculations – which in some cases was very marked indeed. Some of the more noteworthy mistakes included the following:

- Taxing Catherine on a M1 basis – even though she had joined with a P45.
- Deducting private pension contributions from salary for the purposes of the payroll calculation.
- Providing no workings what-so-ever.
- Extending the basic rate band in the payroll calculation.
- Making no attempt to complete form P45 &, in a few instances, the P11 form.

#### **Question 5**

As noted, above, this was a very poorly answered question (the worst at this sitting) which often displayed an inability to articulate or make effective written communication and, equally often, indicated a very poor understanding of, or absence of, relevant tax knowledge. The average marks (indicated above) needs no further elaboration, in fact, this was the one question where the average mark among even successful candidates wasn't a pass mark for the question!

#### **Question 6**

This was, on the whole, a well answered question and often a very fruitful question for candidates to attempt in so far as the accumulation of marks was concerned. It was notable that this question was extremely unpopular in some exam centres which begs the question had those candidates actually covered the taxation of property income? Following on from the point made with respect to question 5, the narrative part of this question was often poorly answered or ignored.