

# **Examination Paper, Solutions and Examiner's Report**

**Paper:**

**Certificate in Financial  
Fundamentals for Business**

**Corporate Tax**

**October 2011**

## QUESTION 1

Outline the various online filing requirements (including years when applicable) for taxation returns in both the UK and US.

**(5 marks)**

## QUESTION 2

Viera Ltd, a stand-alone UK company, has draft taxable trading profits of £1,920,000 for the year ended 31 January 2011. This is before making any necessary adjustments for the following items which are included within the company's income statement for the year:

- a profit on sale of property of £250,000 (see below)
- depreciation expense of £46,000
- client entertaining expense of £8,000
- delivery expenses of £11,000
- increase in a general stock provision of £5,000
- VAT penalty of £1,000
- dividend received of £20,000
- salary costs of employees of £950,000

The profit on the sale of property arose as a result of the sale of an investment property in Carlisle which was sold in December 2010 for £600,000 having been acquired in May 1995 for £350,000.

During the year ended 31 January 2011, Viera Ltd acquired £108,000 of plant and machinery. The brought forward balance on the plant and machinery pool was £220,000 as at 1 February 2010.

The relevant RPIs are:

December 2010	227.0
May 1995	149.6

**Required:**

**Prepare the UK corporation tax computation for Viera Ltd for the year ended 31 January 2011, calculating the corporation tax payable.**

**(10 marks)**

### **QUESTION 3**

A UK company, which has had taxable profits in excess of £3m for each of the last ten years, has changed its accounting date from 31 December to 30 April. It has done this by preparing a 16-month set of accounts from 1 January 2010 to 30 April 2011. The taxable profits for this 16-month period are £4.8m.

**Required:**

**State the chargeable accounting periods relevant for the 16-month set of accounts. In addition, state the corporation tax instalment dates and what the corporation tax payable will be on each of these instalment dates.**

**(7 marks)**

### **QUESTION 4**

Ewing Inc, a US resident company, has taxable profits for its year ended 31 December 2010 of \$16m, but has not yet filed its return. A similar level of taxable profits was earned in each of the last few years.

**Required:**

**Calculate the US corporate income tax payable, state the dates and amount of each payment, and finally outline the penalties for late filing of the return.**

**(5 marks)**

### **QUESTION 5**

Outline the criteria that are necessary for a company to be included within a UK VAT group and state the advantages and disadvantages of being included within a UK VAT group.

**(7 marks)**

## QUESTION 6

A UK group comprises five companies. Barlow Ltd is the holding company and owns 100% of the share capital of Williams Ltd, Orange Ltd and Donald Ltd. Williams Ltd owns 70% of the share capital of Howard Ltd. The remaining shares of Howard Ltd are owned by an unconnected individual.

The taxable profits/losses for the year ended 31 March 2011 are as follows:

	£
Barlow Ltd – profit	3,000,000
Williams Ltd – profit	100,000
Orange Ltd – loss	(80,000)
Donald Ltd – profit	50,000
Howard Ltd – loss	(60,000)

**Required:**

**a) State the number of associated companies and the companies which form the 75% UK group relief group. Explain the conditions in place that allow these companies to form such relationships and the impact the number of associates has on the corporation tax limits.**

**(4 marks)**

**b) Discuss the options available in respect of the losses incurred by Orange Ltd and Howard Ltd, concluding on the most tax efficient use of each loss.**

**(6 marks)**

**(Total 10 marks)**

## QUESTION 7

**a) Outline the conditions necessary to be included within a French tax group.**

**(4 marks)**

**b) Outline two transactions that are covered by the European Union's exemption from capital duties.**

**(2 marks)**

**(Total 6 marks)**

## TAX TABLES

### CORPORATION TAX

Small companies rate	21%
Full rate	28%
Small rate ends at:	£300,000
Full rate starts at:	£1,500,000
Marginal fraction – between small and full	7/400

### CORPORATE INCOME TAX – USA

<b>Taxable profits (\$)</b>	<b>Tax payable</b>
0 – 50,000	15%
50,001 – 75,000	\$7,500 + 25% of excess amount
75,001 – 100,000	\$13,750 + 34% of excess amount
100,001 – 335,000	\$22,250 + 39% of excess amount
335,001 – 10,000,000	\$113,900 + 34% of excess amount
10,000,001 – 15,000,000	\$3,400,000 + 35% of excess amount
15,000,001 – 18,333,333	\$5,150,000 + 38% of excess amount
18,333,334 and above	35%

### STAMP TAXES - UK

**Stamp Duty** 0.5%

#### Stamp Duty Land Tax

	<b>Residential</b>	<b>Non-residential</b>
£0 - £125,000	0%	n/a
£0 - £150,000	n/a	0%
£125,001 - £250,000	1%	n/a
£150,001 - £250,000	n/a	1%
£250,001 - £500,000	3%	3%
Over £500,000	4%	4%

## **Suggested Solutions for October 2011**

**The solution covers all the points that the examiner expects to see in answers to the examination paper. As such, the solution includes more than would be expected from an individual candidate in the time available to answer the question under exam conditions.**

**Although comprehensive, the solution is not intended to be exhaustive.**

### **QUESTION 1**

In the UK it is now compulsory for employers to submit their year-end payroll returns electronically.

For income tax self-assessment in the UK, electronic filing has been available for many years but is not mandatory. To encourage taxpayers to file returns online, they are given an additional three months to file their return and an automatic calculation of any tax payable is made when the return is submitted.

From 2011, UK corporation tax returns and supporting documents will have to be made electronically. Online payment of corporation tax has been available for many years, but other methods of payment are acceptable eg sending a cheque in the post to the relevant HMRC office.

Most corporate income tax returns in the US can now be filed online, although this is not yet mandatory for all companies. It is however mandatory for most companies in the US to pay their tax liabilities via an online system called the Electronic Federal Tax Payment System.

For VAT, HMRC are trying to encourage the electronic filing of VAT returns and electronic payment and this is compulsory for VAT returns after April 2010 for businesses whose turnover exceeds £100,000. Mandatory online filing for all other businesses is likely to be introduced by April 2012.

## QUESTION 2

Viera Ltd  
Corporation tax computation  
Year ended 31 January 2011

	Working	£
Trading income	1	1,564,400
Chargeable gains	3	<u>69,050</u>
Taxable profits		<u>1,633,450</u>

Taxable profits are in excess of £1,500,000, therefore the corporation tax rate will be 28%:

		£
Taxable profit @ 28%		457,366

### Working 1 – trading adjustments:

		£
Draft trading income		1,920,000
Add: Depreciation		46,000
Client entertaining		8,000
Increase in stock prov'n		5,000
VAT penalty		1,000
Deduct: Profit on sale of building		(250,000)
Dividend received		(20,000)
Capital allowances (W2)		<u>(145,600)</u>
Final trading income		<u>1,564,400</u>

### Working 2 – plant and machinery allowances:

	AIA	WDA
	£	£
B/F	0	220,000
Additions	<u>100,000</u>	<u>8,000</u>
Qualifying exp	100,000	228,000
AIA @ 100%	(100,000)	
WDA @ 20%	—	<u>(45,600)</u>
C/F	<u>—</u>	<u>182,400</u>

Total allowances = £100,000 + £45,600 = £145,600.

### Working 3 – sale of property:

		£
Sale proceeds		600,000
Less: cost		<u>(350,000)</u>
Unindexed gain		250,000
Less: IA 0.517 x £350,000		<u>(180,950)</u>
Gain		<u>69,050</u>

Indexation factor =  $(227.0 - 149.6) / 149.6 = 0.517$

### QUESTION 3

A 16-month accounting period will need to be split into two separate chargeable accounting periods (CAPs). CAP 1 will be the first 12 months and CAP 2 will be the remaining four months:

CAP 1 – 12 months to 31 December 2010

CAP 2 – 4 months to 30 April 2011

Payments on account are due when the company pays corporation tax at the full rate of 28% ie its taxable profits are at least £1.5m for a 12-month CAP without any associates.

For a 12-month CAP, there are four equal instalments of 25% of the current CAPs total taxation payable.

Dates of POA:

	<b>CAP 1</b>	<b>CAP2</b>
	14 July 2010	14 July 2011
	14 October 2010	14 August 2011
	14 January 2011	
	14 April 2011	

Taxable profits (pro-rata):	£3,600,000	£1,200,000
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The first payment in each CAP is made 6½ months after the start of the CAP, and the final payment in each CAP is made 3½ months after the end of the CAP. As many payments as possible are then made between these dates, always leaving 3 months before the next payment.

*[Detail not required – provided as learning point]*

CT payable at 28%:	£1,008,000	£336,000
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Payment amounts:

CAP 1 – on each of the four POA dates, 25% of £1,008,000 ie £252,000 will be payable.

CAP 2 – on 14 July 2011,  $\frac{3}{4}$  (ie 3/n) of the period's tax will be payable ie £252,000 with the balance of £84,000 payable on 14 August 2011.

#### QUESTION 4

US taxation payable = \$5,150,000 + (38% x \$1,000,000 (ie the excess over \$15m) = \$5,530,000.

As the company has taxable profit in excess of \$1m in the previous few years, the favoured treatment is that the payments on account will be based on the current period's tax liability under method 1.

The instalment amounts will each be 25% of \$5,530,000 ie \$1,382,500 and will be payable on 15 April 2010, 15 June 2010, 15 September 2010 and 15 December 2010.

There is a 5% penalty for each month in which the return is late up to a maximum penalty of 25%. The penalty is based on the income tax that is unpaid. If the tax return is over 60 days, there is a minimum penalty of \$135.

#### QUESTION 5

The conditions for eligibility for VAT grouping in the UK are:

- two or more *bodies corporate* controlled by the same person, or one controls the other; and
- both are established, or have a fixed establishment, in the UK.

Companies can *choose* to register as a VAT group, or not, as they please. It is possible to group register some of those eligible and not others, or even to have more than one VAT group in the same corporate group. It is not possible to be a member of more than one VAT group at once, because the members of the VAT group are treated as a single taxable person.

It is not possible to create a VAT group in the UK which includes businesses which are not resident in the UK.

#### Advantages and disadvantages

The main advantages of being treated as a group are as follows:

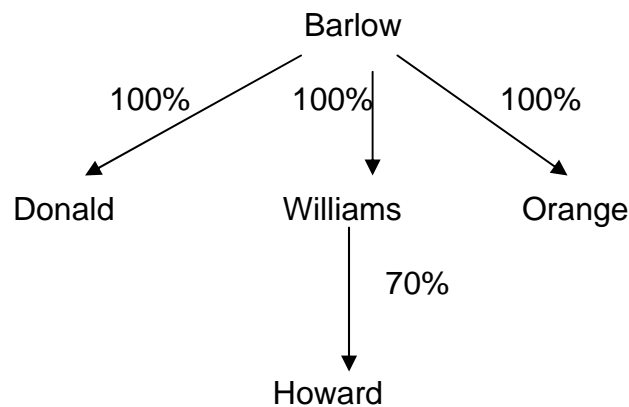
- It *may* be simpler to prepare one VAT return instead of many (but see also the disadvantages). It is likely to be simpler to deal with only one set of compliance responsibilities.
- It is definitely simpler to ignore supplies between group members – it is not possible to get the VAT liability or time of supply wrong.
- It avoids the need to charge VAT on intra-group supplies to exempt companies which could not recover it.
- Including a relatively small wholly exempt company in the group may enable its input tax to be recovered as *de minimis*.
- It enables the holding company to take greater central control of the VAT affairs of the group.

There are also possible disadvantages to grouping:

- It may be difficult to collect all the information required to make a single VAT return by the deadline unless a centralised accounting system is in place.
- There can be advantages to charging VAT on intra-group supplies – for example, if one member of the group is a repayment trader, it can recover input tax earlier (monthly) than the other companies have to pay it to HMRC (quarterly).
- Bringing an exempt company within the group may lead to a restriction of input tax for the group as a whole.
- Every company in the group becomes jointly and severally liable for the whole of the group's VAT; if one company becomes insolvent, the rest of the group will still have to pay its share of the overall VAT liability.
- Larger figures on the VAT return could lead to higher default surcharges if the group is late making payments.

## QUESTION 6

a)



As there is greater than a 50% relationship between all five companies, they will all be treated as associated with each other. The result of which is that the corporation tax limits will be divided by five:

21%	£0 - £60,000
28% - MR (29.75%)	£60,001 - £299,999
28%	£300,000+

For the group relief group, there must be a direct and indirect ownership of at least 75% between the companies. There is a direct relationship of at least 75% between all of the companies except between Williams and Howard and therefore Howard is not included in the group relief group, but all of the other four companies are.

b) In the absence of loss relief, the profitable companies are paying tax at the following marginal rates:

	Barlow £	Williams £	Donald £
Taxable profit	3,000,000	100,000	50,000
Marginal tax rate	28%	29.75%	21%

The loss of £60,000 within Howard must remain within Howard as it does not form part of the group relief group. As a result, the only options available for the loss within Howard are to either carry it back to the previous period (against total profits) or carry it forward against the first available trading profits of the same trade.

The loss of £80,000 within Orange could be retained by this company and either carried back or forward as detailed above with Howard. We have no information in the question regarding the rates of corporation tax that would be saved under these options and therefore we shall assume that the loss will be surrendered to the remainder of the group in the current year.

This £80,000 loss can be surrendered to the other companies in the group relief group ie Barlow, Williams and Donald but not to Howard (not part of the group and also is loss making). The aim of the surrender of the loss is to save the highest marginal rate of corporation tax.

The highest marginal rate of corporation is currently been incurred by Williams but only on the £40,000 of profits that are in the marginal band ie above £60,000. It is therefore most tax efficient to give Williams £40,000 of the loss to save tax at 29.75%. The next highest rate of tax is payable by Barlow (28%) and therefore the remaining £40,000 should be surrendered to Barlow rather than to Donald where the tax rate is only 21%.

## QUESTION 7

a) Conditions to be included within a French tax group:

- There must be a 95% ownership between the companies;
- The companies must have been operating for at least 5 years;
- The companies must have the same year end;
- Not all eligible companies need to be included within the group.

b) The capital duty exemption covers:

- Formation of companies;
- Increase in capital and share issues.

## **Examiner's Report**

### **Certificate in Financial Fundamentals for Business**

#### **Corporate Tax October 2011**

##### **General**

This was the second paper drawn up under the new exam material/approach. The paper was 1 hour long, with a total of 50 marks and a pass mark of 25 out of 50. All seven questions in the paper were compulsory.

No issues were brought to the attention of the CT exam team prior to marking.

- 101 candidates sat this paper.
- The pass rate after moderation was 68%
- The pass rate in April 2011 was 75%.
- The average mark was 26.6 out of 50 (53.2%, compared to 56% in April 2011).
- No issues were identified with the paper during the marking or moderation process, but questions 1 and 7 were very poorly handled.

##### **Moderation**

The moderator reviewed the scripts provided by the marker. All scripts in the double marking range of 22.5 to 25.5 (following double marking) were reviewed and moderated in accordance with the guidelines agreed by ACT's Examination Board.

##### **Spread of marks / detail of marks**

The final marks were spread as shown in the following table, indicating that most candidates scored between 25 and 35 out of 50. The number with very low marks was perhaps slightly less than in recent years, and there were very few scoring over 80%.

The detailed marks show that, as in prior diets, the purely theoretical, narrative questions (Questions 1 and 7) were the ones most often not attempted, presumably through lack of knowledge. It was very disappointing to note that a number of candidates had not read the questions properly to relate their answer to the actual question set.

<b>Range (/50)</b>	<b>No. of candidates</b>	<b>% of candidates</b>
0 – 10	2	2.0%
10.5 - 15	8	7.9%
15.5 - 20	9	8.9%
20.5 - 25	13	12.9%
25.5 - 30	35	34.7%
30.5 - 35	23	22.8%
35.5 - 40	10	9.9%
40.5 - 45	1	1.0%
45.5 - 50	0	0%

Details of the marks are as follows:

	<b>Q1 (5)</b>	<b>Q2 (10)</b>	<b>Q3 (7)</b>	<b>Q4 (5)</b>	<b>Q5 (7)</b>	<b>Q6 (10)</b>	<b>Q7 (6)</b>	<b>Tot (50)</b>
<b>Ave mark</b>	0.74	7.60	4.41	2.60	3.61	6.35	1.33	26.63
<b>Ave %</b>	14.8	76.0	62.9	52.0	51.6	63.5	22.1	53.3
<b>No Passes</b>	3	91	77	68	64	78	23	69
<b>% Pass</b>	2.97%	90.10%	76.24%	67.33%	63.37%	77.23%	22.77%	68.3%
<b>Median</b>	0.5	8	4.5	3	4	6.5	1	27
<b>Max</b>	3.5	10	7	5	6.5	10	5	40.5
<b>Std Dev</b>	0.8	2.2	1.8	1.2	1.9	2.0	1.3	7.3

Question 1 was very poorly handled – this asked candidates to “Outline the various online filing requirements (including years when applicable) for taxation returns in both the UK and US” and was looking for candidates to discuss the types of returns that must be filed online, and any rules relating to these, eg additional time allowed to file compared to paper returns. The majority of candidates did not even mention online returns and focussed only on writing anything they knew about filing dates. The information for the answer to this question comes from Part 3.1.1 Section 5 of the manual, albeit the terminology used here is “electronic filing” in the heading, but the term “online filing” is used throughout. Candidates may have viewed this information as background information and not learnt any specific facts relating to it.

Question 7 was also poorly handled although some candidates were able to score highly on this. The question asked about the conditions for companies to join a French tax group, and transactions that are covered by the EU’s exemption from capital duties. The answers for this question come from Part 3.2.2 Section 3 and Part 3.2.3 Section 3.