

J03

Diploma in Financial Planning

Unit J03 – The tax and legal aspects of business

October 2011 examination

SPECIAL NOTICES

All questions in this paper are based on English law and practice applicable in the tax year 2011/2012, unless stated otherwise in the question, and should be answered accordingly.

Assume all individuals are domiciled, resident and ordinarily resident in the UK unless stated otherwise.

Instructions

- Two hours are allowed for this paper.
- **Do not begin writing until the invigilator instructs you to.**
- **Read the instructions on page 3 carefully before answering any questions.**
- Provide the information requested on the answer book and form B.
- You are allowed to write on the inside pages of this question paper, but you must **NOT** write your name, candidate number, PIN or any other identification anywhere on this question paper.
- The answer book and this question paper must **both be handed in personally by you** to the invigilator before you leave the examination room. **Failure to comply with this regulation will result in your paper not being marked and you may be prevented from entering this examination in the future.**

Unit J03 – The tax and legal aspects of business

Instructions to candidates

Read the instructions below before answering any questions

- **Two hours** are allowed for this paper which consists of 15 short answer questions and carries a total of 130 marks.
- You are strongly advised to attempt **all** questions to gain maximum possible marks. The number of marks allocated to each question part is given next to the question and you should spend your time in accordance with that allocation.
- Read carefully all questions and information provided before starting to answer. Your answer will be marked strictly in accordance with the question set.
- You may find it helpful in some places to make rough notes in the answer booklet. If you do this, you should cross through these notes before you hand in the booklet.
- It is important to show all steps in a calculation, even if you have used a calculator.
- If you bring a calculator into the examination room, it must be a silent battery or solar-powered non-programmable calculator. The use of electronic equipment capable of being programmed to hold alphabetic or numerical data and/or formulae is prohibited. You may use a financial or scientific calculator, provided it meets these requirements.
- Tax tables are provided at the back of this question paper.
- Answer each question on a new page and leave six lines blank after each question part.

Subject to providing sufficient detail you are advised to be as brief and concise as possible, using note format and short sentences on separate lines wherever possible.

Attempt ALL questions

Time: 2 hours

1. Aimee and Craig are web designers who have been collaborating recently on a contract for which they will share the liabilities and profits. Currently they are both sole traders but are considering setting up an ordinary partnership.
 - (a) State the definition of a partnership and comment on how this relates to Aimee and Craig's current collaboration. (4)
 - (b) As partners they would have a duty of good faith to each other. Explain briefly how this would change their responsibilities to each other compared with continuing to trade as sole traders. (5)

2. Sally, Jason and Ivan are business partners and Ivan is retiring at the end of the year.
 - (a) Explain to Ivan how his liability for partnership debts will be treated under the Partnership Act 1890 when he retires. *Ignore the consequences to the partnership itself.* (2)
 - (b) Explain how Ivan's personal liability will be treated if the partners have a partnership agreement which includes an indemnity. *Ignore the consequences to the partnership itself.* (4)

3. Describe the personal taxation that would apply to a member of a limited liability partnership compared to a director shareholder of a limited company, in respect of any drawings from the business, salary and bonus and their share of business profits. (8)

4.
 - (a) List the **three** principal documents that should be presented to Companies House in order to incorporate a private limited company. (3)
 - (b) Explain briefly the main purpose of each of the documents listed in your answer to part (a) above. (6)

5. Budgets for small businesses are normally drawn up and measured on a profit and loss account basis using the accruals approach.
 - (a) Describe briefly the accruals basis for drawing up accounts. (4)
 - (b) Describe the limitations of relying on the profit and loss account in isolation for budgeting and outline steps to address this issue. (3)

6. Smith Manufacturing Ltd is considering the option of borrowing from the company small self-administered scheme (SSAS).

Describe the rules the scheme should adhere to if Smith Manufacturing Ltd decide to borrow from the company SSAS. (11)

7. Jacob, aged 40, is the sole shareholder in Nosta Ltd and his only income is an annual salary from the company of £15,000. He has not made any pension contributions and has a normal personal allowance. The taxable profits of Nosta Ltd for the trading year ending 31 March 2012 are budgeted at £20,000.
- (a) Calculate, **showing all your workings**, the net cash amount that would be received by Jacob if the total £20,000 profits were withdrawn from the company by way of a bonus. *The calculation should be based on the bonus amount only.* (5)
- (b) (i) State **two** other options Jacob would have for withdrawing the profit from the business. (2)
- (ii) State **one** immediate benefit and **one** immediate drawback for Jacob in relation to the net amount he would receive for each of the options identified in (b)(i) above, compared with taking the profits as a bonus. (4)
8. CHG Ltd will prepare accounts for the 18 month period ending 31 December 2011.
- (a) Calculate, **showing all your workings**, how the profits of £200,000 will be apportioned for Corporation Tax purposes in terms of chargeable periods and financial years. (5)
- (b) Calculate, **showing all your workings**, the Corporation Tax liability. (3)
9. Natalie trades as an online business designing and selling jewellery. She spent a lump sum of £5,000 on IT equipment for the business in September 2011, and pays £150 per month for the hosting and maintenance of her company website.
- Explain to Natalie how each of these expenses would be treated when drawing up her accounts. (8)
10. Sylvan, a self-employed furniture maker, has decided to transfer his sole trader business into a newly incorporated private limited company of which he is the sole shareholding director.
- (a) Explain to Sylvan the Capital Gains Tax treatment of this transaction. Include in your answer the application of incorporation relief, where relevant. (9)
- (b) Sylvan is worried that he will lose any benefit from his unabsorbed losses from the sole trader business on incorporation. Explain how these can be dealt with after incorporation. (3)
11. Kieran, aged 29, has worked for his current employer continuously for the last five years and has just found out that he is at risk of being made redundant.
- (a) State the criteria Kieran needs to meet in order to qualify for the statutory minimum amount of redundancy pay. (3)
- (b) Explain to Kieran how his statutory minimum redundancy pay would be calculated. (3)

Questions continue over the page

12. State the conditions that need to be met to qualify for Statutory Maternity Pay and the amount and duration of the pay. (5)
13. The Jackson Partnership is considering setting up separate Life and Critical Illness policies on the lives of all the partners. The objective is to provide cash to the surviving partners and ensure an Inheritance Tax efficient transfer of business assets. The senior partner, Peter, is concerned about how the arrangements would work in the event of serious illness.
- (a) Explain to Peter the potential taxation implications he may face if he is forced to sell his share of the business should he become seriously ill. (3)
- (b) Describe how the policies and associated arrangements could be set up to facilitate the surviving partners' requirements on the death of a partner. (6)
- (c) State the additional provisions that should be put into the arrangement to address Peter's concerns in the event of serious illness. (3)
14. You are meeting with the financial director of Tegan Ltd to discuss the need for key person assurance for their sales manager who accounts for 50% of sales. You have requested copies of the accounts for the last three to five years.
- (a) Describe how you would use the information in the:
- (i) balance sheet; (2)
- (ii) profit and loss account. (3)
- (b) Explain why you would ask to see the accounts over several years. (3)
15. Richard, John and Louise are shareholding directors in a small manufacturing firm. They are keen to put a shareholder protection arrangement in place.
- (a) Describe to the directors **two** options for payment of premiums on any life policies and the tax implications of each option identified. *Your answer should refer only to the payment of premiums.* (6)
- (b) State **four** key considerations to include in an agreement on how an individual's shares will be valued after death. (4)

The Tax Tables can be found on pages 8 - 12

INCOME TAX

RATES OF TAX	2010/2011	2011/2012
Starting rate for savings*	10%	10%
Basic rate	20%	20%
Higher rate	40%	40%
Additional rate	50%	50%
Starting-rate limit	£2,440*	£2,560*
Threshold of taxable income above which higher rate applies	£37,400	£35,000
Threshold of taxable income above which additional rate applies	£150,000	£150,000

*restricted to savings income only and not available if taxable non-savings income exceeds starting rate band.

MAIN PERSONAL ALLOWANCES AND RELIEFS

Income limit for Personal Allowance §	£100,000	£100,000
Personal Allowance (basic) §	£6,475	£7,475
Personal Allowance (age 65-74) §	£9,490	£9,940
Personal Allowance (aged 75 and over) §	£9,640	£10,090
Married/civil partners (minimum) at 10% †	£2,670	£2,800
Married/civil partners (age 75 and over) at 10%	£6,965	£7,295
Income limit for age-related allowances	£22,900	£24,000
Blind Person's Allowance	£1,890	£1,980
Enterprise Investment Scheme relief limit on £500,000 max	20%	30%
Venture Capital Trust relief limit on £200,000 max	30%	30%

§ the Personal Allowance reduces by £1 for every £2 of income above the income limit irrespective of age.

† where at least one spouse/civil partner was born before 6 April 1935.

Child Tax Credit (CTC)		
- family element	£545	£545
- family element baby addition	£545	Withdrawn
CTC usually reduced by 41% of joint income (6.67% for 2010/2011) over	£50,000	£40,000

NATIONAL INSURANCE CONTRIBUTIONS

Class 1 Employee	Weekly	Monthly	Yearly
Lower Earnings Limit (LEL)	£102	£442	£5,304
Primary threshold	£139	£602	£7,225
Upper Accrual Point	£770	£3,337	£40,040
Upper Earnings Limit (UEL)	£817	£3,540	£42,475

Total earnings £ per week	CLASS 1 EMPLOYEE CONTRIBUTIONS	
	Contracted-in rate	Contracted-out rate
Up to 139.00*	Nil	Nil
139.01 – 770.00	12%	10.4%
770.01 – 817.00	12%	12%
Above 817.00	2%	2%

* This is the primary threshold below which no NI contributions are payable. However, the lower earnings limit is £102 per week. This £102 to £139 band is a zero rate band introduced in order to protect lower earners' rights to contributory State benefits e.g. Basic State Pension.

Total earnings £ per week	CLASS 1 EMPLOYER CONTRIBUTIONS		
	Contracted-in rate	Contracted-out rate	
		Final salary	Money purchase
Below 136.00**	Nil	Nil	Nil
136.01 – 770.00	13.8%	10.1%	12.4%
770.01 – 817.00	13.8%	13.8%	13.8%
Excess over 817.00	13.8%	13.8%	13.8%

** Secondary earnings threshold.

Class 2 (self-employed)	Flat rate per week £2.50 where earnings exceed £5,315 per annum.
Class 3 (voluntary)	Flat rate per week £12.60.
Class 4 (self-employed)	9% on profits between £7,225 - £42,475 plus 2% on profits above £42,475.

PENSIONS

TAX YEAR	LIFETIME ALLOWANCE	ANNUAL ALLOWANCE
2006/2007	£1,500,000	£215,000
2007/2008	£1,600,000	£225,000
2008/2009	£1,650,000	£235,000
2009/2010	£1,750,000	£245,000
2010/2011	£1,800,000	£255,000
2011/2012	£1,800,000	£50,000

ANNUAL ALLOWANCE CHARGE

20% - 50% member's tax charge on the amount of total pension input in excess of the annual allowance.

LIFETIME ALLOWANCE CHARGE

55% of excess over lifetime allowance if taken as a lump sum.

25% of excess over lifetime allowance if taken in the form of income, which is subsequently taxed under PAYE.

INHERITANCE TAX

RATES OF TAX ON DEATH TRANSFERS	2010/2011	2011/2012			
Transfers made after 5 April 2011					
- Up to £325,000	Nil	Nil			
- Excess over £325,000	40%	40%			
- Lifetime transfers to and from certain trusts	20%	20%			
MAIN EXEMPTIONS					
Transfers to					
- UK-domiciled spouse/civil partner	No limit	No limit			
- non-UK-domiciled spouse/civil partner (from UK-domiciled spouse)	£55,000	£55,000			
- UK-registered charities	No limit	No limit			
Lifetime transfers					
- Annual exemption per donor	£3,000	£3,000			
- Small gifts exemption per donor	£250	£250			
Wedding/civil partnership gifts by					
- parent	£5,000	£5,000			
- grandparent	£2,500	£2,500			
- other person	£1,000	£1,000			
100% relief: businesses, unlisted/AIM companies, certain farmland/building					
50% relief: certain other business assets					
Reduced tax charge on gifts within 7 years of death:					
- Years before death	0-3	3-4	4-5	5-6	6-7
- Inheritance Tax payable	100%	80%	60%	40%	20%

CAR BENEFIT FOR EMPLOYEES

The charge for company car benefits is based on the carbon dioxide (CO₂) emissions. There is no reduction for high business mileage users.

For 2011/2012:

The percentage charge is 15% of the car's list price for CO₂ emissions at or below the qualifying level of 125g/km.

- Cars with CO₂ emissions of less than 75g/km have an appropriate percentage of 5%.
- Cars with CO₂ emissions of 76g/km to 120g/km have an appropriate percentage of 10% and thereafter the rate is 15% increasing by 1% for every 5g/km to the current maximum of 35% (emissions of 225g/km and above).

There is an additional 3% supplement for diesel cars not meeting Euro IV emission standards. However, the maximum charge remains 35% of the car's list price.

Car fuel The benefit is calculated as the CO₂ emissions % relevant to the car and that % applied to a set figure (£18,800 for 2011/2012) e.g. car emission 155g/km = 21% on car benefit scale.
21% of £18,800 = £3,948

1. **Accessories** are, in most cases, included in the list price on which the benefit is calculated.
2. **List price** is reduced for capital contributions made by the employee up to £5,000.
3. **Car benefit** is reduced by the amount of employee's contributions towards running costs.
4. **Fuel scale** is reduced only if the employee makes good **all** the fuel used for private journeys.
5. **All car and fuel benefits** are subject to employers National Insurance Contributions (Class 1A) of 13.8%.

PRIVATE VEHICLES USED FOR WORK

2011/2012 Rates

Cars	
On the first 10,000 business miles in tax year	45p per mile
Each business mile above 10,000 business miles	25p per mile
Motor Cycles	24p per mile
Bicycles	20p per mile

MAIN CAPITAL AND OTHER ALLOWANCES

2011/2012

Plant & machinery (excluding cars) 100% annual investment allowance (first year)	£100,000
Plant & machinery (reducing balance) per annum	20%
Patent rights & know-how (reducing balance) per annum	25%
Certain long-life assets, integral features of buildings (reducing balance) per annum	10%
Energy & water-efficient equipment	100%
Zero emission goods vehicles (new)	100%
Qualifying flat conversions, business premises & renovations	100%

Motor cars: Expenditure on or after 01/04/09 (Corporation Tax) or 06/04/09 (Income Tax)

CO ₂ emissions of g/km:	110 or less *	111-160	161 or more
Capital allowance:	100%	20%	10%
	first year	reducing balance	reducing balance

* If new

Research & Development:	Capital expenditure	100%
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MAIN SOCIAL SECURITY BENEFITS

2010/2011 2011/2012

		£	£
Child Benefit	first child	20.30	20.30
	subsequent children	13.40	13.40
Employment and Support Allowance	Assessment Phase		
	Age 16 – 24	N/A	Up to 53.45
	Aged 25 or over	N/A	Up to 67.50
	Main Phase		
	Work Related Activity Group	N/A	Up to 94.25
	Support Group	N/A	Up to 99.85
Attendance Allowance	lower rate	47.80	49.30
	higher rate	71.40	73.60
Retirement Pension	single	97.65	102.15
	married	156.15	163.35
Pension Credit	single person standard minimum guarantee	132.60	137.35
	married couple standard minimum guarantee	202.40	209.70
	maximum savings ignored in calculating income	10,000.00	10,000.00
Bereavement Payment (lump sum)		2,000.00	2,000.00
Widowed Parent's allowance		97.65	100.70
Jobseekers Allowance	Age 16 - 24		53.45
	Age 25 or over	65.45	67.50

CAPITAL GAINS TAX

EXEMPTIONS	2010/2011	2011/2012
Individuals, estates etc	£10,100	£10,600
Trusts generally	£5,050	£5,300
Chattels proceeds (restricted to five thirds of proceeds exceeding limit)	£6,000	£6,000

TAX RATES

Individuals:		
Up to basic rate limit	18%	18%
Above basic rate limit	18%/28%*	28%
Trustees and Personal Representatives	18%/28%*	28%
Entrepreneurs' Relief – Gains taxed at:	10%	10%
Lifetime limit	£5,000,000 / £2,000,000**	£10,000,000

For trading businesses and companies (minimum 5% employee or director shareholding) held for at least one year.

* 18% rate applies to disposals on or before 22/06/10. 28% thereafter.

** For disposals 06/04/10 to 22/06/10: £2,000,000. £5,000,000 until 05/04/11

CORPORATION TAX

	2010/2011	2011/2012
Full rate	28%	26%
Small companies rate	21%	20%
Small companies limit	£300,000	£300,000
Effective marginal rate	29.75%	27.5%
Upper marginal limit	£1,500,000	£1,500,000

VALUE ADDED TAX

	2011/2012
Standard rate	20%
Annual Registration limit	£73,000

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