

# J03

## Diploma in Financial Planning

### Unit J03 – The tax and legal aspects of business

April 2013 examination

#### SPECIAL NOTICES

All questions in this paper are based on English law and practice applicable in the tax year 2012/2013, 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.

Candidates should answer based on the legislative position immediately BEFORE the 2013 budget.

#### 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**

To gain maximum marks for calculations you **must** show **all** your workings and express your answers to **two** decimal places.

1. Peter Morris runs Easy-Street Asset Finance and Leasing Ltd in the local high street. He is aware that James Sanders, a sole trader, has opened Easi-Street Leasing in an adjacent street.
  - (a) Explain why Peter can bring an action in law against James regarding his trading name. (2)
  - (b) State **two** ways in which Peter may prevent James from trading with the name Easi-Street Leasing. (2)
  - (c) If James decides to trade as Small Town Leasing, state how this would be shown on his business stationery. (1)
  
2. Andrew is married with three young children at school. His sole trader business has failed and he is facing bankruptcy.
  - (a) State **six** business reasons why a business may face financial difficulties leading to possible bankruptcy. (6)
  - (b) State why Andrew's main residence might not immediately be sold by the receiver to pay his business debts. (4)
  
3. For each of the following scenarios, state, giving reasons, whether or not a partnership exists.
  - (a) Philip and Stephen have decided to set up a delicatessen and have rented premises to fit out. They will start trading in three months time. (5)
  - (b) Rebecca and Susan have entered into a partnership agreement but have yet to find premises or start any trading activity. (2)
  - (c) James and Katherine, who are not related to each other, own retail commercial property which they rent out and share the revenue equally. (3)
  
4. Mary and John are the joint owners of Willow and Oak Ltd, a family garden centre business. They are retiring and plan to retain their 100% shareholding in the business. They will resign as directors and intend to appoint their two sons as directors to run the business.
  - (a) Explain briefly the main points of the relationship between the shareholders of Willow and Oak Ltd and the Directors. (5)
  - (b) State how a director may become legally prevented from continuing in office. (4)
  - (c) Apart from disqualification, state the main ways in which the directors can be removed from office. (4)

5. Phil, Jacqui and Ben are in partnership as Chartered Accountants. They are concerned as to what would happen to their respective shares in their partnership should one of them die. There is no partnership agreement in place. You recommend that they consider life assurance policies and a cross option agreement.
- Explain how this arrangement would work and its benefits. (12)
6. (a) State the **two** main methods commonly used for calculating the level of cover of key person protection. (2)
- (b) Describe briefly the advantages and drawbacks for each method you have identified in part (a) above. (8)
7. (a) Describe what is meant by the terms 'accruals basis' and 'going concern basis' in relation to a company's accounts. (6)
- (b) Summarise **one** disadvantage for each of the methods in (a) above. (4)
8. The following table contains extracts from a company's accounts:
- | Year | Gross Profit<br>£ | Total Assets<br>£ | Current Assets<br>£ | Liquid Assets<br>(Current Assets<br>less stock) £ | Current Liabilities<br>£ |
|------|-------------------|-------------------|---------------------|---------------------------------------------------|--------------------------|
| 2011 | 45,000            | 60,000            | 40,000              | 30,000                                            | 20,000                   |
| 2010 | 40,000            | 40,000            | 45,000              | 20,000                                            | 15,000                   |
| 2009 | 30,000            | 20,000            | 20,000              | 15,000                                            | 5,000                    |
- (a) Calculate, **showing all your workings**, the quick ratio for the company for the year 2011. (2)
- (b) Calculate, **showing all your workings**, the working capital ratio for the three financial years and briefly comment on the results. (7)
9. Totron Manufacturing Ltd is a medium sized private company and the directors are seeking funding, either from a bank or from private investors to expand the business.
- (a) State **two** reasons why raising finance from private investors may be better than borrowing from a bank. (2)
- (b) The company wishes to raise finance by issuing debentures. Explain briefly the term debenture. (4)

Questions continue over the page

10. The directors of Trew Ltd each have personal borrowings that are not treated as qualifying loans by H M Revenue and Customs. Trew Ltd's accounts show that the directors are owed money by the company in their directors' loan accounts.
- State the precise steps that need to be followed in order for the directors to replace their non-qualifying loans with loans that will qualify for tax relief on the interest they pay. (5)
11. Joan has been baking and selling cakes at a farmers' market for the past six months. She has decided to give up her full time job and dedicate her time to expanding her bakery business.
- As the activity was not on a regular basis, she assumed it would not be treated as a business and has not declared any of this activity to HM Revenue & Customs. She realises, however, that as she will be concentrating on this full time she must now formalise her business.
- (a) State why Joan must declare her income for the past six months. (1)
- (b) Outline to Joan the tax reporting and record keeping requirements HM Revenue & Customs expects of a sole trader. (4)
- (c) Joan will be working from her home and renting a stand at each market. Explain what expenses Joan can offset from income for tax purposes. (4)
12. Elia Care Homes Ltd (ECH Ltd) have just had their most successful year of trading and want to reward the employees who have been with them through their first three years of existence with shares in the business.
- (a) List the main types of employee share option schemes available to ECH Ltd. (5)
- (b) ECH Ltd has decided to implement a savings-related scheme to reward the employees who remain with them for the next three years. Explain how this scheme will meet this objective. (3)
13. Kesrea Ltd is a small company with two directors and three employees. The directors pay the employees monthly but pay themselves irregularly.
- (a) State how employee and employer National Insurance contributions are treated when assessing an employee's Income Tax and employer's Corporation Tax. (2)
- (b) State the conditions that would give rise to a liability for employees to pay class 1 National Insurance contributions and employers to pay class 1A National Insurance contributions. (6)
- (c) State how H M Revenue and Customs expect directors who are paid irregularly to be treated, so that they are liable to National Insurance contributions. (2)

14. Village Pots Ltd has just submitted their accounts for the year ending 31 March 2013 and has made a profit of £276,000 during the accounting period.

Their associated company, Village Tractors Ltd, has also submitted their accounts for the same period and made a profit of £147,000.

The two companies have three directors in common who control 75% of the first company and 60% of the second.

- (a) Explain how the rate of Corporation Tax to be applied for each company is identified. *(No calculations are required).* (6)
- (b) State when the Corporation Tax is due for payment for both these companies. (1)

15. Datessi Ltd, a small company that manufactures chemicals, has seven employees. One employee is currently four months pregnant and another employee has recently had an accident at work.

- (a) State the information that should be recorded in the accident register in respect of the accident. (3)
- (b) In compliance with Health & Safety Regulations, state under what conditions the company must suspend the pregnant employee and how she should be treated. (3)

The Tax Tables can be found on pages 9 – 13



## INCOME TAX

RATES OF TAX	2011/2012	2012/2013
Starting rate for savings*	10%	10%
Basic rate	20%	20%
Higher rate	40%	40%
Additional rate	50%	50%
Starting-rate limit	£2,560*	£2,710*
Threshold of taxable income above which higher rate applies	£35,000	£34,370
Threshold of taxable income above which additional rate applies	£150,000	£150,000
Child benefit charge from 7 January 2013: 1% of benefit for every £100 of income over	N/A	£50,000

\*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) §	£7,475	£8,105
Personal Allowance (age 65-74) §	£9,940	£10,500
Personal Allowance (aged 75 and over) §	£10,090	£10,660
Married/civil partners (minimum) at 10% †	£2,800	£2,960
Married/civil partners (age 75 and over) at 10%	£7,295	£7,705
Income limit for age-related allowances	£24,000	£25,400
Blind Person's Allowance	£1,980	£2,100
Enterprise Investment Scheme relief limit on £1,000,000 max (£500,000 in 2011/2012)	30%	30%
Seed Enterprise Investment relief limit on £100,000	N/A	50%
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)		
- Child element per child (maximum)	N/A	£2,690
- family element	£545	£545
Threshold for tapered withdrawal of CTC	N/A	£15,860

## NATIONAL INSURANCE CONTRIBUTIONS

Class 1 Employee	Weekly	Monthly	Yearly
Lower Earnings Limit (LEL)	£107	£464	£5,564
Primary threshold	£146	£634	£7,605
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 (money purchase)	Contracted-out rate (final salary)
Up to 146.00*	Nil	Nil
146.01 – 770.00	12%	10.6%
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 £107 per week. This £107 to £146 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 144.00**	Nil	Nil	Nil
144.01 – 770.00	13.8%	10.4%	13.8%
770.01 – 817.00	13.8%	13.8%	13.8%
Excess over 817.00	13.8%	13.8%	13.8%

*\*\* Secondary earnings threshold.*

<b>Class 2 (self-employed)</b>	Flat rate per week £2.65 where earnings exceed £5,595 per annum.
<b>Class 3 (voluntary)</b>	Flat rate per week £13.25.
<b>Class 4 (self-employed)</b>	9% on profits between £7,605 - £42,475 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
2012/2013	£1,500,000	£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

**2011/2012    2012/2013**

Transfers made after 5 April 2012

- Up to £325,000	Nil	Nil
- Excess over £325,000	40%	40%
- Lifetime transfers to and from certain trusts	20%	20%

*\*For deaths after 5 April 2012, a lower rate of 36% applies where at least 10% of deceased's net estate is left to charity.*

### 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	£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 (CO<sub>2</sub>) emissions. There is no reduction for high business mileage users.

**For 2012/2013:**

- Cars that cannot emit CO<sub>2</sub> have a 0% charge.
- The percentage charge is 5% of the car's list price for CO<sub>2</sub> emissions of 75g/km or less.
- For cars with CO<sub>2</sub> emissions of 76g/km to 99g/km the percentage is 10%.
- Cars with CO<sub>2</sub> emissions of 100g/km have a percentage charge of 11% and thereafter the charge increases by 1% for every complete 5g/km to a maximum of 35% (emissions of 220g/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 CO<sub>2</sub> emissions % relevant to the car and that % applied to a set figure (£20,200 for 2012/2013) e.g. car emission 100g/km = 11% on car benefit scale. 11% of £20,200 = £2,222.

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	2012/2013 Rates
<b>Cars</b>		
On the first 10,000 business miles in tax year	45p per mile	45p per mile
Each business mile above 10,000 business miles	25p per mile	25p per mile
<b>Motor Cycles</b>	24p per mile	24p per mile
<b>Bicycles</b>	20p per mile	20p per mile

## MAIN CAPITAL AND OTHER ALLOWANCES

	2011/2012	2012/2013	
Plant & machinery (excluding cars) 100% annual investment allowance (first year)	£100,000	£25,000	
Plant & machinery (reducing balance) per annum	20%	18%	
Patent rights & know-how (reducing balance) per annum	25%	25%	
Certain long-life assets, integral features of buildings (reducing balance) per annum	10%	8%	
Energy & water-efficient equipment	100%	100%	
Zero emission goods vehicles (new)	100%	100%	
Qualifying flat conversions, business premises & renovations	100%	100%	
<b>Motor cars:</b> Expenditure on or after 01/04/09 (Corporation Tax) or 06/04/09 (Income Tax)			
CO <sub>2</sub> emissions of g/km:	110 or less*	111-160	161 or more
Capital allowance:	100%	18%	8%
	first year	reducing balance	reducing balance
*If new			
Research & Development:	Capital expenditure	100%	

## MAIN SOCIAL SECURITY BENEFITS

	2011/2012	2012/2013	
	£	£	
Child Benefit	First child	20.30	20.30
	Subsequent children	13.40	13.40
	Guardian's allowance		15.55
Employment and Support Allowance	Assessment Phase		
	Age 16 – 24	Up to 53.45	Up to 56.25
	Aged 25 or over	Up to 67.50	Up to 71.00
	Main Phase		
	Work Related Activity Group	Up to 94.25	Up to 99.15
	Support Group	Up to 99.85	Up to 105.05
Attendance Allowance	Lower rate	49.30	51.85
	Higher rate	73.60	77.45
Retirement Pension	Single	102.15	107.45
	Married	163.35	171.85
Pension Credit	Single person standard minimum guarantee	137.35	142.70
	Married couple standard minimum guarantee	209.70	217.90
	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	100.70	105.95	
Jobseekers Allowance	Age 16 - 24	53.45	56.25
	Age 25 or over	67.50	71.00
Statutory Maternity, Paternity and Adoption Pay	128.73	135.45	

## CAPITAL GAINS TAX

EXEMPTIONS	2011/2012	2012/2013
Individuals, estates etc	£10,600	£10,600
Trusts generally	£5,300	£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	28%	28%
Trustees and Personal Representatives	28%	28%
Entrepreneurs' Relief* – Gains taxed at:	10%	10%
Lifetime limit	£10,000,000	£10,000,000

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

## CORPORATION TAX

	2011/2012	2012/2013
Full rate	26%	24%
Small companies rate	20%	20%
Small companies limit	£300,000	£300,000
Effective marginal rate	27.5%	25.0%
Upper marginal limit	£1,500,000	£1,500,000

## VALUE ADDED TAX

	2011/2012	2012/2013
Standard rate	20%	20%
Annual Registration limit	£73,000	£77,000

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