

J03

Diploma in Financial Planning

Unit J03 – The tax and legal aspects of business

October 2014 examination

SPECIAL NOTICES

All questions in this paper are based on English law and practice applicable in the tax year 2014/2015, unless stated otherwise in the question, and should be answered accordingly.

It should be assumed that all individuals are domiciled and resident in the UK unless otherwise stated.

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. Arko Ltd has two directors who are both 50% shareholders.

State the tax treatment for both the business and the directors should they withdraw profits from the company in the following ways:
 - (a) by paying themselves a dividend; (3)
 - (b) by making contributions to a registered pension scheme. (3)

2. (a) State **three** ways in which the creation of a partnership can be made 'expressly'. (3)

(b) Explain briefly the rules regarding interest payments to a partner on a loan they have made to the partnership as stated in the Partnership Act 1890. (3)

3. James, Victoria and Anam are creating a partnership. They would like their partnership agreement to include some restrictions on the ability of each partner to dissolve the partnership, but also retain the ability for a partner to retire.

James will be the senior partner but intends to retire in approximately three years and the remaining partners will want the partnership to continue in this circumstance.
 - (a) Describe **three** ways in which a partnership agreement could restrict a partner's right to dissolve a partnership and the suitability of each method for the proposed partnership above. (9)
 - (b) State the order of priority that is applied to partnership property when repaying a firm's debts and liabilities in the event of dissolution in the absence of any formal agreement. (5)

4. List **five** of the statutory general duties of directors as contained within the Companies Act 2006. (5)

5. Drapers Ltd intends to raise capital to invest in the company. They are considering two options; a bank loan or a share issue.
- (a) Describe **two** advantages and **two** disadvantages to **the company** of raising money via a bank loan as opposed to issuing share capital. (4)
- (b) List the rights of minority shareholders should they opt for a share issue. (5)

6. The following table contains information from the most recent accounts of two companies:

| | Company A (£) | Company B (£) |
|--------------------|------------------|------------------|
| Sales | 1,500,700 | 2,700,550 |
| Debtors | 162,000 | 394,000 |
| Long-term loans | 100,000 | 200,000 |
| £1 ordinary shares | 90,000 | 120,000 |
| Retained profits | 200,000 | 220,000 |

- (a) (i) Calculate, **showing all your workings**, the gearing ratio [long-term loans/(ordinary shares + retained profits) x 100%] for each company. (2)
- (ii) Explain briefly which company appears the more secure to invest in. (3)
- (b) (i) Calculate, **showing all your workings**, the debtors ratio [debtors/sales x 365] for each company. (2)
- (ii) Explain briefly the **disadvantage** of a poor debtors ratio to a business and state **one** way in which it could be improved. (3)
7. List the principal information required in a directors' report that must be disclosed by small companies. (5)

QUESTIONS CONTINUE OVER THE PAGE

8. Claire, aged 45, has acted as guarantor on a loan for her friend Bob, a sole trader, to invest in his business. Bob has defaulted on the loan and Claire has been forced to repay it on his behalf. The amount of the guarantee is £6,000. In the tax year 2014/2015 Claire has a taxable income of £46,500 and personal capital gains of £16,500 with no other losses.
- (a) Explain the conditions that must be met for Claire to be able to claim tax relief on the guarantee amount. (4)
- (b) Calculate, **showing all your workings**, any tax relief Claire may be able to claim on the guaranteed sum should these conditions be met. (7)
9. (a) State the basic criteria for expenditure to be classed as an allowable business expense. (2)
- (b) List **six** items that would be classed as an allowable business expense. (6)
10. Partridge Ltd is considering implementing an Enterprise Management Incentive (EMI) scheme.
- (a) Outline, to the company, the rules regarding setting up an EMI scheme. (6)
- (b) Describe the taxation treatment both at the time of granting and exercising the option. (6)
11. Asham is an employee of GJ Logistics Ltd. His gross annual salary is £33,600 and he has a company car with a P11D value of £6,750 per annum.
- Calculate, **showing all your workings**, the Class 1 National Insurance contributions payable by Asham and his employer on his remuneration package. *Express your figures on an annual basis.* (5)

12. (a) Explain the procedures both preceding and following the making of a bankruptcy order. (8)
- (b) Explain briefly the purpose of a bankruptcy restriction order (BRO) and the possible consequences of such an order being imposed. (3)
- (c) List **three** types of conduct that may cause a BRO to be put in place. (3)
13. Normally, claims for unfair dismissal will automatically fail when an employee has less than two years' continuous service.
- List **six** exceptions to this rule. (6)
14. Calculus Property Maintenance Ltd would like to take out key person cover on the life of an employee. Their gross profit for the last year is £427,000.
- The employee has a gross salary of £83,500. The company anticipates that it will take eighteen months to train a replacement to the same standard. The company's total salary bill is £653,000 per annum.
- (a) Calculate, **showing all your workings**, the level of cover required for this key person policy, using the 'proportion of profits' formula. (3)
- (b) State **two** advantages of using gross profit instead of net profit in this calculation. (2)
- (c) State the conditions that must apply for the company to claim a tax deduction for the premiums paid for a key person life policy. (4)
15. The directors of Leisure World UK Ltd have set up a small self-administered pension scheme (SSAS). The directors of the company are thinking of investing pension funds from the SSAS into a residential property.
- (a) Explain why this investment would not be advisable and state the implications of proceeding with this course of action. (4)
- (b) List the requirements that must be followed for the SSAS to grant a loan to the company. (6)

The tax tables can be found on pages 9 - 15

INCOME TAX

| RATES OF TAX | 2013/2014 | 2014/2015 |
|---|-----------|-----------|
| Starting rate for savings* | 10% | 10% |
| Basic rate | 20% | 20% |
| Higher rate | 40% | 40% |
| Additional rate | 45% | 45% |
| Starting-rate limit | £2,790* | £2,880* |
| Threshold of taxable income above which higher rate applies | £32,010 | £31,865 |
| 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 | £50,000 | £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 if born after 5 April 1948) § | £9,440 | £10,000 |
| Personal Allowance (if born between 6 April 1938 and 5 April 1948) § | £10,500 | £10,500 |
| Personal Allowance (if born before 6 April 1938) § | £10,660 | £10,660 |
| Married/civil partners (minimum) (if born before 6 April 1935) at 10% † | £3,040 | £3,140 |
| Married/civil partners (if born before 6 April 1935) at 10% † | £7,915 | £8,165 |
| Income limit for age-related allowances | £26,100 | £27,000 |
| Blind Person's Allowance | £2,160 | £2,230 |
| Enterprise Investment Scheme relief limit on £1,000,000 max | 30% | 30% |
| Seed Enterprise Investment relief limit on £100,000 | 50% | 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 (under the income threshold).

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

| | | |
|---|---------|---------|
| Child Tax Credit (CTC) | | |
| - Child element per child (maximum) | £2,720 | £2,750 |
| - family element | £545 | £545 |
| Threshold for tapered withdrawal of CTC | £15,910 | £16,010 |

NATIONAL INSURANCE CONTRIBUTIONS

| Class 1 Employee | Weekly | Monthly | Yearly |
|----------------------------|--------|---------|---------|
| Lower Earnings Limit (LEL) | £111 | £481 | £5,772 |
| Primary threshold | £153 | £663 | £7,956 |
| Upper Accrual Point | £770 | £3,337 | £40,040 |
| Upper Earnings Limit (UEL) | £805 | £3,489 | £41,865 |

| Total earnings £ per week | CLASS 1 EMPLOYEE CONTRIBUTIONS | |
|---------------------------|--------------------------------|------------------------------------|
| | Contracted-in rate | Contracted-out rate (final salary) |
| Up to 153.00* | Nil | Nil |
| 153.01 – 770.00 | 12% | 10.6% |
| 770.01 – 805.00 | 12% | 12% |
| Above 805.00 | 2% | 2% |

**This is the primary threshold below which no NI contributions are payable. However, the lower earnings limit is £111 per week. This £111 to £153 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 153.00** | Nil | Nil | Nil |
| 153.01 – 770.00 | 13.8% | 10.4% | 13.8% |
| 770.01 – 805.00 | 13.8% | 13.8% | 13.8% |
| Excess over 805.00 | 13.8% | 13.8% | 13.8% |

*** Secondary earnings threshold.*

| | |
|--------------------------------|--|
| Class 2 (self-employed) | Flat rate per week £2.75 where earnings exceed £5,885 per annum. |
| Class 3 (voluntary) | Flat rate per week £13.90. |
| Class 4 (self-employed) | 9% on profits between £7,956 - £41,865 2% on profits above £41,865. |

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 |
| 2013/2014 | £1,500,000 | £50,000 |
| 2014/2015 | £1,250,000 | £40,000 |

ANNUAL ALLOWANCE CHARGE

20% - 45% 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.

CAPITAL GAINS TAX

| EXEMPTIONS | 2013/2014 | 2014/2015 |
|---|-------------|-------------|
| Individuals, estates etc | £10,900 | £11,000 |
| Trusts generally | £5,450 | £5,500 |
| 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.*

INHERITANCE TAX

RATES OF TAX ON DEATH TRANSFERS 2013/2014 2014/2015

Transfers made after 5 April 2014

| | | |
|---|-----|-----|
| - 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 2014, 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) | £325,000 | £325,000 |
| - 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 (CO₂) emissions. There is no reduction for high business mileage users.

For 2014/2015:

- Cars that cannot emit CO₂ have a 0% charge.
- The percentage charge is 5% of the car's list price for CO₂ emissions of 75g/km or less.
- For cars with CO₂ emissions of 76g/km to 94g/km the percentage is 11%.
- For cars with CO₂ emissions of 95g/km to 99g/km the percentage is 12%.
- Cars with CO₂ emissions of 100g/km have a percentage charge of 13% and thereafter the charge increases by 1% for every complete 5g/km to a maximum of 35% (emissions of 210g/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 (£21,700 for 2014/2015) e.g. car emission 100g/km = 13% on car benefit scale. 13% of £21,700 = £2,821.

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

| | 2013/2014 Rates | 2014/2015 Rates |
|--|-----------------|-----------------|
| Cars | | |
| 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 |
| Motor Cycles | 24p per mile | 24p per mile |
| Bicycles | 20p per mile | 20p per mile |

MAIN CAPITAL AND OTHER ALLOWANCES

2013/2014 2014/2015

| | | |
|---|----------|----------|
| Plant & machinery (excluding cars) 100% annual investment allowance (first year) | £250,000 | £500,000 |
| Plant & machinery (reducing balance) per annum | 18% | 18% |
| Patent rights & know-how (reducing balance) per annum | 25% | 25% |
| Certain long-life assets, integral features of buildings (reducing balance) per annum | 8% | 8% |
| Energy & water-efficient equipment | 100% | 100% |
| Zero emission goods vehicles (new) | 100% | 100% |
| Qualifying flat conversions, business premises & renovations | 100% | 100% |

Motor cars: Expenditure on or after 01 April 2014 (Corporation Tax) or 06 April 2014 (Income Tax)

| | | | |
|------------------------------------|-------------|------------------|------------------|
| CO ₂ emissions of g/km: | 95 or less* | 96-130 | 131 or more |
| Capital allowance: | 100% | 18% | 8% |
| | first year | reducing balance | reducing balance |

*If new

CORPORATION TAX

2013/2014 2014/2015

| | | |
|-------------------------|------------|------------|
| Full rate | 23% | 21% |
| Small companies rate | 20% | 20% |
| Small companies limit | £300,000 | £300,000 |
| Effective marginal rate | 23.75% | 21.25% |
| Upper marginal limit | £1,500,000 | £1,500,000 |

VALUE ADDED TAX

2013/2014 2014/2015

| | | |
|-------------------------------|---------|---------|
| Standard rate | 20% | 20% |
| Annual registration threshold | £79,000 | £81,000 |
| Deregistration threshold | £77,000 | £79,000 |

MAIN SOCIAL SECURITY BENEFITS

| | | 2013/2014 | 2014/2015 |
|---|---|--------------|--------------|
| | | £ | £ |
| Child Benefit | First child | 20.30 | 20.50 |
| | Subsequent children | 13.40 | 13.55 |
| | Guardian's allowance | 15.90 | 16.35 |
| Employment and Support Allowance | Assessment Phase | | |
| | Age 16 – 24 | Up to 56.80 | Up to 57.35 |
| | Aged 25 or over | Up to 71.70 | Up to 72.40 |
| | Main Phase | | |
| | Work Related Activity Group | Up to 100.15 | Up to 101.15 |
| | Support Group | Up to 106.50 | Up to 108.15 |
| Attendance Allowance | Lower rate | 53.00 | 54.45 |
| | Higher rate | 79.15 | 81.30 |
| Retirement Pension | Single | 110.15 | 113.10 |
| | Married | 176.15 | 180.90 |
| Pension Credit | Single person standard minimum guarantee | 145.40 | 148.35 |
| | Married couple standard minimum guarantee | 222.05 | 226.50 |
| | 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 | | 108.30 | 111.20 |
| Jobseekers Allowance | Age 16 - 24 | 56.80 | 57.35 |
| | Age 25 or over | 71.70 | 72.40 |
| Statutory Maternity, Paternity and Adoption Pay | | 136.78 | 138.18 |

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