

F2 Tax August 2016

Question 1 (Tax Calculations for a Sole Trader)

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Note: It is strongly recommended that viewers of this presentation have a hard copy of the exam question to hand while viewing.

Mick O'Driscoll runs a sports shop. His Statement of Comprehensive Income for y/e 2015 is set out below

Gross profit			351,050
Other income			
Deposit interest (net)			1,700
Irish rental income	11		26,000
UK Dividends			3,000
			381,750
Less: Expenses			
Salaries and wages	1	110,500	
Pension contributions	2	8,700	
Motor expenses	3	5,500	
Rent, rates and insurance	4	22,200	
Light and heat	5	5,810	
Telephone	5	5,960	
Postage and stationery		900	
Bank interest and charges	6	6,780	
Interest on late payment of VAT		1,900	
Bad debts	7	2,400	
Professional fees	8	6,300	
Depreciation		5,100	
Loss on disposal of shop fixtures		800	
Miscellaneous expenses	9	<u>6,955</u>	<u>-189,805</u>
Net profit			191,945

Gross profit			351,050
Other income			
Deposit interest (net)			1,700
Irish rental income	11		26,000
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Bad debts	7	2,400	
Professional fees	8	6,300	
Depreciation		5,100	
Loss on disposal of shop fixtures		800	
Miscellaneous expenses	9	<u>6,955</u>	
Net profit			<u>-189,805</u> 191,945

The question is:

Calculate Mick & Roz's
Income Tax liability for
2015 (Ignore PRSI and
USC)

Always remember.....

- There are different income streams, which need to be separately identified and taxed accordingly. Different tax rules apply to different streams.
- You are presented with a set of accounts which include the different streams, and a list of expenses. Some expenses relate to some income streams. Some are not allowable – partially or fully.
- The set of accounts must be adjusted to take into account the different streams and allowable expenses.
- This means “deducting” some expense items (increasing taxable income), and adding back others (decreasing taxable income)

Gross profit			351,050
Other income			
Deposit interest (net)			1,700
Irish rental income	11		26,000
UK Dividends			3,000
			381,750
Less: Expenses			
Salaries and wages	1	110,500	
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Motor expenses	3	5,500	
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Bank interest and charges	6	6,780	
Interest on late payment of VAT		1,900	
Bad debts	7	2,400	
Professional fees	8	6,300	
Depreciation		5,100	
Loss on disposal of shop fixtures		800	
Miscellaneous expenses	9	<u>6,955</u>	<u>183,895</u>
Net profit			191,945

Different
Income Streams

Always, always, always.....

- Isolate the Case I (Trading) Income and Expenses first.
- Start with
 - **“Net profit per accounts”**
- In this case
 - Net profit per accounts = €191,945
- Follow the expenses, one by one, and adjust as you go.

Gross profit			351,050
Other income			
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Salaries and wages	1	110,500	
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Depreciation		5,100	
Loss on disposal of shop fixtures		800	
Miscellaneous expenses	9	<u>6,955</u>	<u>-189,805</u>
Net profit			191,945

Salaries & Wages - Note 1

- **Salaries and wages**

• Shop staff	90,500
• Office staff – Roz (Mick’s wife)	14,000
• Employer’s PRSI	<u>6,000</u>
•	110,500

- Wages for shop staff include €55,000 paid to Mick. PAYE of €1,400 was deducted from Roz’s salary.

- *As Mick is a sole trader he may not claim his wages as an expense. Therefore €55,000 has been included in the accounts which must be added back*
- *No adjustment required for €1,400 PAYE*
- *TOTAL ADDBACKS: 55,000*

Effect of Note 1

- Net Profit per accounts: 191,945
- Add:
 - Mick's Wages 55,000

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Other income			
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Irish rental income	11		26,000
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Less: Expenses			
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Net profit			191,945

Pension contributions - Note 2

- Pension contributions for self €8,700
- Pension contributions were paid during the year except for €4,000 which was paid on 1 October 2016
- *Pension contributions on Mick's behalf should be included in his remuneration, and therefore added back. The tax relief on pension contribution will be dealt with later.*
- *The €4,000 paid on October 1 2016 can be "thrown back" to 2015 so no further adjustment necessary.*
- *TOTAL ADDBACKS – 8,700*

Effect of Note 2

- Net Profit per accounts: 191,945
- Add:
 - Mick's Wages 55,000
 - *Mick's pension contribution 8,700*

Gross profit			351,050
Other income			
Deposit interest (net)			1,700
Irish rental income	11		26,000
UK Dividends			3,000
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Less: Expenses			
Salaries and wages	1	110,500	
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Professional fees	8	6,300	
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Miscellaneous expenses	9	<u>6,955</u>	<u>-189,805</u>
Net profit			191,945

Note 3 – Motor Expenses

- Motor Expenses
 - Petrol/tax/insurance 5,000
 - Parking fines 500
- 25% of petrol/tax/insurance is personal.
- *25% of the petrol/tax/insurance is personal and is disallowed. Therefore 25% x 5,000 = €1,250 should be added back.*
- *Fines are never allowable. Therefore the fine of €500 is disallowed and must be added back.*
- *TOTAL ADDBACKS: 1,250 + 500 = 1750*

Effect of Note 3

• Net Profit per accounts: 191,945

• Add:

- Mick's Wages 55,000
- Mick's Pension contributions 8,700
- Motor Expenses 1,750

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Other income			
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UK Dividends			3,000
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Less: Expenses			
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Depreciation		5,100	
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Net profit			191,945

Rents Rates & Insurance - Note 4

• Rent & rates – shop	5,600
• Property Tax – investment property (Dublin)	700*
• Public Liability Insurance	5,900
• Insurance – investment property (Cork)	2,650*
• Home Insurance	800*
• Shop stock insurance	4,900
• Permanent Health Insurance – Mick	1,650*

- *Rent & rates (shop) are allowable (no adjustment).*
- *Property tax (Dublin) – unrelated to shop business – disallow and add back.*
- *Public liability insurance – relates to shop – allowable. (No adjustment)*
- *Insurance – Cork property – disallow and add back*
- *Home insurance – personal expense – disallow and add back*
- *Shop stock insurance – allowable. (No adjustment)*
- *PHI – personal expense – disallow and add back.*
- *TOTAL ADDBACKS – 700+ 2650+800+1650 = 5800*

Effect of Note 4

• Net Profit per accounts:	191,945
• Add:	
• Mick's Wages	55,000
• Mick's pension contribution	8,700
• Motor expenses	1,750
• Rent Rates and Insurance	5,800
•	

Gross profit			351,050
Other income			
Deposit interest (net)			1,700
Irish rental income	11		26,000
UK Dividends			3,000
			381,750
Less: Expenses			
Salaries and wages	1	110,500	
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Motor expenses	3	5,500	
Rent, rates and insurance	4	22,200	
Light and heat	5	5,810	
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Bad debts	7	2,400	
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Net profit			191,945

Light, heat and phone - Note 5

- 30% of costs relate to Mick's home bills
- *Total costs are $5,810 + 5,960 = 11,770$. 30% of this is personal and therefore disallowed and added back.*
- *TOTAL ADDBACKS - $30\% \times 11,770 = \text{€}3,531$*

Effect of Note 5

• Net Profit per accounts:	191,945
• Add:	
• Mick's Wages	55,000
• Mick's pension contribution	8,700
• Motor Expenses	1,750
• Rent Rates and Insurance	5,800
• Light Heat Phone	3,531

Gross profit			351,050
Other income			
Deposit interest (net)			1,700
Irish rental income	11		26,000
UK Dividends			3,000
			381,750
Less: Expenses			
Salaries and wages	1	110,500	
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Rent, rates and insurance	4	22,200	
Light and heat	5	5,810	
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Bad debts	7	2,400	
Professional fees	8	6,300	
Depreciation		5,100	
Loss on disposal of shop fixtures		800	
Miscellaneous expenses	9	<u>6,955</u>	-189,805
Net profit			191,945

Bank Interest & Charges - Note 6

- Interest on Loan to purchase Cork property = €3,750
 - Finance Lease Interest = €1,750
 - Bank Overdraft charges = €1,280
 - New shop fittings acquired under finance lease. CAPEX repayments = €16,000.
-
- *Interest on loan is unrelated to shop business. Therefore disallow and add back.*
 - *Finance lease interest is dealt with later. For now, disallow, and add back. CAPEX repayments dealt with later – no adjustment for now.*
 - *Total Addbacks = 3,750 + 1,750 = 5,500*

Effect of Note 6

• Net Profit per accounts:		191,945
• Add:		
• Mick's Wages	55,000	
• Mick's pension contribution	8,700	
• Motor Expenses	1,750	
• Rent Rates and Insurance	5,800	
• Light Heat Phone	3,531	
• Bank Interest and Charges	5,500	

Gross profit			351,050
Other income			
Deposit interest (net)			1,700
Irish rental income	11		26,000
UK Dividends			3,000
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Less: Expenses			
Salaries and wages	1	110,500	
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Interest on late payment of VAT		1,900	
Bad debts	7	2,400	
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Depreciation		5,100	
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Miscellaneous expenses	9	<u>6,955</u>	<u>-189,805</u>
Net profit			191,945

Interest on late payment of VAT – No note

- Fines, penalties, or interest on late tax payments are never allowable.
- *Total cost is 1,900. Therefore disallow and add back.*
- ***TOTAL ADDBACK = 1900***

Effect of Interest on VAT

• Net Profit per accounts:	191,945
• Add:	
• Mick's Wages	55,000
• Mick's pension contribution	8,700
• Motor Expenses	1,750
• Rent Rates and Insurance	5,800
• Light Heat Phone	3,531
• Bank Interest and Charges	5,500
• Interest on VAT	1,900

Gross profit		351,050
Other income		
Deposit interest (net)		1,700
Irish rental income	11	26,000
UK Dividends		3,000
		381,750
Less: Expenses		
Salaries and wages	1	110,500
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Bad debts	7	2,400
Professional fees	8	6,300
Depreciation		5,100
Loss on disposal of shop fixtures		800
Miscellaneous expenses	9	<u>6,955</u>
Net profit		<u>-189,805</u> 191,945

Bad debts - Note 7

- Increase in general bad debt provision = 800
- Bad debts written off = 1600.
- *Increase in general provisions is not allowable and must be added back.*
- *Bad debts written off are allowable – therefore no adjustment required.*
- *TOTAL ADDBACKS = 800*

Effect of Note 7

- Net Profit per accounts: 191,945
- Add:
 - Mick's Wages 55,000
 - Mick's pension contribution 8,700
 - Motor Expenses 1,750
 - Rent Rates and Insurance 5,800
 - Light Heat Phone 3,531
 - Bank Interest and Charges 5,500
 - Interest on VAT 1,900
 - *Bad debts general provision 800*

Gross profit			351,050
Other income			
Deposit interest (net)			1,700
Irish rental income	11		26,000
UK Dividends			3,000
			381,750
Less: Expenses			
Salaries and wages	1	110,500	
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Motor expenses	3	5,500	
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Interest on late payment of VAT		1,900	
Bad debts	7	2,400	
Professional fees	8	6,300	
Depreciation		5,100	
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Miscellaneous expenses	9	<u>6,955</u>	<u>-189,805</u>
Net profit			191,945

Professional Fees - Note 8

- Accountancy fees = 2,500
- Legal fees re planning permission investment = 2,700
- Legal fees re debt recovery = 1,100

- *Accountancy fees are allowable – no adjustment.*
- *Legal fees re investment property – not allowable – addback 2,700*
- *Legal fees re debt recovery – allowable – no adjustment.*
- *TOTAL ADDBACKS = 2,700*

Effect of Note 8

• Net Profit per accounts:		191,945
• Add:		
• Mick's Wages	55,000	
• Mick's pension contribution	8,700	
• Motor Expenses	1,750	
• Rent Rates and Insurance	5,800	
• Light Heat Phone	3,531	
• Bank Interest and Charges	5,500	
• Interest on VAT	1,900	
• Bad debts general provision	800	
• Legal fees	2,700	

Gross profit			351,050
Other income			
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Irish rental income	11		26,000
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Professional fees	8	6,300	
Depreciation		5,100	
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Miscellaneous expenses	9	<u>6,955</u>	
Net profit			<u>-189,805</u> 191,945

Depreciation

- Depreciation = 5,100
- *Depreciation is never allowable, and must always be added back. (The write off of fixed assets is dealt through capital allowances)*
- *TOTAL ADDBACKS = 5,100*

Effect of Depreciation

- Net Profit per accounts: 191,945
- Add:
 - Mick's Wages 55,000
 - Mick's pension contribution 8,700
 - Motor Expenses 1,750
 - Rent Rates and Insurance 5,800
 - Light Heat Phone 3,531
 - Bank Interest and Charges 5,500
 - Interest on VAT 1,900
 - Bad debts general provision 800
 - Legal fees 2,700
 - Depreciation 5,100

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Other income			
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Interest on late payment of VAT		1,900	
Bad debts	7	2,400	
Professional fees	8	6,300	
Depreciation		5,100	
Loss on disposal of shop fixtures		800	
Miscellaneous expenses	9	<u>6,955</u>	<u>-189,805</u>
Net profit			191,945

Loss on disposal of shop fittings

- Loss = 800
- *The loss is not a trading loss, and is therefore not allowable and addback is required.*
- *TOTAL ADDBACKS = 800*

Effect of Loss on shop fittings

• Net Profit per accounts: 191,945

• Add:

• Mick's Wages	55,000
• Mick's pension contribution	8,700
• Motor Expenses	1,750
• Rent Rates and Insurance	5,800
• Light Heat Phone	3,531
• Bank Interest and Charges	5,500
• Interest on VAT	1,900
• Bad debts general provision	800
• Legal fees	2,700
• Depreciation	5,100
• Loss on shop fittings	800

Gross profit			351,050
Other income			
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Professional fees	8	6,300	
Depreciation		5,100	
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Miscellaneous expenses	9	<u>6,955</u>	<u>-189,805</u>
Net profit			191,945

Miscellaneous - Note 9

Expense	Amount	Comment	ADDBACK
Advertising	490	Allowable – no adjustment	0
Donation to Sporting Body	800	Allowable – no adjustment	0
Political donation	400	Political donations never allowable	400
Trade magazines	165	Allowable – no adjustment	0
Customer entertainment	950	Customer entertainment not allowable	950
Staff Christmas Party	510	Allowable – no adjustment	0
New roof	3,400	Non-revenue expense – not allowable, add back	3400
Other allowable expenses	240	Allowable – no adjustment	0
TOTAL	6,955		4,750

Effect of Miscellaneous

• Net Profit per accounts:	191,945
• Add:	
• Mick's Wages	55,000
• Mick's pension contribution	8,700
• Motor Expenses	1,750
• Rent Rates and Insurance	5,800
• Light Heat Phone	3,531
• Bank Interest and Charges	5,500
• Interest on VAT	1,900
• Bad debts general provision	800
• Legal fees	2,700
• Depreciation	5,100
• Loss on shop fittings	800
• Miscellaneous	4,750

Effect of Miscellaneous

• Net Profit per accounts:		191,945
• Add:		
• Mick's Wages	55,000	
• Mick's pension contribution	8,700	
• Motor Expenses	1,750	
• Rent Rates and Insurance	5,800	
• Light Heat Phone	3,531	
• Bank Interest and Charges	5,500	
• Interest on VAT	1,900	
• Bad debts general provision	800	
• Legal fees	2,700	
• Depreciation	5,100	
• Loss on shop fittings	800	
• Miscellaneous	4,750	
• TOTAL ADDBACKS		96,331

Deductions – Note 6

- | | |
|-------------------------------|---------|
| • The finance lease involves: | |
| • Capital Repayments | €16,000 |
| • Interest payments | € 1,750 |
- *The capital repayments have not been entered in accounts and therefore qualify for a deduction.*
 - *We already wrote back the interest payments, but as allowable as part of the total finance lease payments, they are also included in the deductions.*
- **TOTAL DEDUCTIONS = €17,750**

Summary of Case I taxable income

• Net Profit per accounts:	191,945
• ADDBACKS	96,331
• DEDUCTIONS	(17,750)
• Tax Adjusted Case I profits (before capital allowances)	270,526
• Capital Allowances (re Note 10)	(2,500)
• Case I taxable income	268,026

• *We have now established Mick's Case I taxable income and now we proceed to look at his other sources of income.*

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Professional fees	8	6,300	
Depreciation		5,100	
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Miscellaneous expenses	9	<u>6,955</u>	<u>-189,805</u>
Net profit			191,945

Other income (1) – Deposit Interest Case IV

- Deposit Interest Received (net) 1,700
- Grossed up = $1700 \times 100/59 =$ 2,881
- Therefore 2,881 is entered in Mick's tax return as Case IV income

Other income (2) – Rental Income Case V

	Dublin	Cork	
Rental Income	6,000	20,000	
Insurance		(2,650)	
Loan Interest (x75%)		(2,813)	
Legal fees (planning)	n/a*		
Total	6,000	14,537	
Loss forward	(1,000)		
Taxable	5,000	14,537	19,537

* Deemed a Capital Item

Other income (3) Dividends & (4) Salary

• Case III (Dividends)	3,000
• Sch E (Roz)	14,000

Summary of all taxable Income

• Sch D Case I	237,326
• Sch D Case III	3,000
• Sch D Case IV	2,881
• Sch D Case V	19,537
• Sch E	14,000
• <i>Gross Income</i>	<i>276,744</i>
• <i>Less PHI (note xx)</i>	<i>(1650)</i>
• <i>Less Pension (note xx)</i>	<i>(8700)</i>
• <i>TAXABLE INCOME</i>	<i>266,394</i>

Computation of Tax Liability

• Taxable Income		266,394
• Tax		
• DIRT (2881 x 41%)	1,181	
• Sch E (14,000 x 20%)	2,800	
• 42,800 x 20%	8,560	
• 206,713 x 40%	82,685	
• TOTAL		95,226
• Less Credits		
• Personal Credits (1,650 x 2)	3,300	
• PAYE Tax credit (Roz)	1,650	
• DIRT paid	1,811	(6,131)
• Tax Payable		89,095
• Less PAYE paid		(1,400)
• Net payable		87,695
•		