CPA IRELAND | CERTIFIED PUBLIC ACCOUNTANTS

TAXATION

FORMATION 2 EXAMINATION - APRIL 2015

NOTES:
Section A - You are required to answer Questions 1, 2 and 3.
Section B - You are required to answer any **two** out of Questions 4, 5 and 6.
(If you provide answers to all of Questions 4 to 6, you must draw a clearly distinguishable line through the answer not to be marked. Otherwise, only the first two answers to hand for these three questions will be marked.)

TAXATION TABLES ARE PROVIDED

TIME ALLOWED:
3 hours, plus 10 minutes to read the paper.

INSTRUCTIONS:
During the reading time you may write notes on the examination paper but you may not commence writing in your answer book. **Please read each Question carefully.**

Marks for each question are shown. The pass mark required is 50% in total over the whole paper.

Start your answer to each question on a new page.

You are reminded to pay particular attention to your communication skills and care must be taken regarding the format and literacy of your solutions. The marking system will take into account the content of your answers and the extent to which answers are supported with relevant legislation, case law or examples where appropriate.

List on the cover of each answer booklet, in the space provided, the number of each question attempted.

NB: PLEASE ENSURE TO ENCLOSE YOUR ANSWER SHEET TO QUESTION 3 IN THE ENVELOPE PROVIDED.

THE INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS IN IRELAND

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Time Allowed: 3 hours, plus 10 minutes to read the paper.

SECTION A

Answer Question 1, 2 and 3 in this Section.
(**ALL** are Compulsory)

1. Dribbs Ltd. is an Irish resident company. The Company's Income Statement account for the year ended 31 December 2014 shows the following:

	Notes	**€**	**€**
Gross profit from trading			700,000
Other income			
Profit on sale of delivery van	(i)	4,800	
Investment income	(ii)	16,000	
			20,800
			720,800
Less expenses			
Depreciation		14,400	
Loss on disposal of site	(iii)	64,000	
Legal and professional fees	(iv)	48,800	
Bank interest	(v)	20,000	
Rates and service charges		16,800	
Light and heat		25,600	
Salaries and wages	(vi)	464,000	
Motor expenses	(vii)	24,800	
Finance lease charges	(viii)	1,680	680,080
Net profit			40,720

Notes:

(i) In June 2014, Dribbs Ltd. sold a delivery van for €9,600. The van had been bought in December 2010 for €24,000 and had a net book value at the date of sale of €4,800.

(ii) Investment income comprised the following:

	€
Dividends from a UK quoted trading company	9,600
Irish deposit interest, received gross	6,400
	16,000

(iii) Dribbs Ltd. had acquired a site in October 2003 for €142,000. At the time of acquisition it had been the intention of the company to expand its operations. The current use value of the site at the time of acquisition was €72,000. In May 2006, the company spent €90,000 carrying out work to improve the site. Due to trading difficulties the site was sold in March 2014 for €168,000, at this time the current use value of the site was €56,000. The site had never been used for trade purposes by the business.

(iv) Legal and professional fees comprise:

	€
Legal fees on the disposal of the site	12,000
Trade consultancy reports	9,600
Audit and accountancy fees	17,400
Legal fees for debt collection	9,800
	48,800

(v) Bank interest comprises:

	€
Interest on bank overdraft	8,000
Interest on loan to purchase shares in UK quoted company	12,000
	20,000

(vi) Salaries and wages include an accrual for a pension contribution of €32,000 for the directors. There was no opening accrual or prepayment in respect of the pension. A pension is not provided for all employees.

(vii) Motor expenses comprise:

	€
Running expenses of cars/vans owned by the company	12,000
Car lease expense for the managing director's car	8,800
Running expenses of the managing director's car (The car is used 20% for business purposes)	4,000
	24,800

The managing director's car was leased new on 1 July 2011, the car would have cost €32,000 if bought for cash. The car is a category E car.

(viii) The finance lease charges relate to equipment leases in 2009, the cost of which is capitalised in the company's accounts. The lease agreement states that the burden of wear and tear is transferred to the lessee. Total repayments made during the year ended 31 December 2014 were €11,200. This figure comprised capital repayments of €9,520 and finance charges of €1,680.

(ix) Other information relating to fixed assets:

Additions during the year at cost were	€
Category C car, for the marketing manager	28,000
Category A car, for general use by staff	16,800

The only disposal during the year is detailed in Note (i) on Page 1.

Capital allowances for 2014 on business assets other than those acquired or disposed of during the year are €16,000.

REQUIREMENT:

Compute the corporation tax liability of Dribbs Ltd. for the tax year 2014. **[Total: 20 marks]**

2. Jack Riordan (43) is married to Sally (39). They are both Irish resident and domiciled. Jack used to own a leisure centre. He found it difficult being self-employed and decided to cease to trade as and from 30 September 2014.

Details of Jack's results are as follows:

Adjusted Case I Income

	€
Year end 31 May 2013	86,000
Year end 31 May 2014	78,000
Period end 30 September 2014	60,000

Jack has since found employment as the gym manager for a chain of hotels in the region. His commencement date in this new position was 1 November 2014. Further details relating of Jack's employment package follow:

- His annual salary is €60,000 and is paid monthly.
- Jack has been given a company car. The car was bought second hand for €22,000, it's list price when new was €38,000. He drove 6,000 km for business purposes during November and December 2014.
- He will be able to eat his meals in the company's own cafe docks. All employees are entitled to do this and the annual benefit is deemed to be €1,800.
- In December, he received a holiday break at one of the chain's hotels free of charge. The value of the break was €800.
- Jack has accumulated various loans totalling €30,000 over the past three years. In order for him to consolidate these into one loan, his new employer agreed to give him a favourable loan of €30,000, from the date of commencement of his new job. The interest rate on this favourable loan is 4% per annum.

Other information:

Jack and Sally have been married since June 2006. They do not have any children.

Sally receives Irish dividend income of €8,000, net of dividend withholding tax and €7,300 net bank deposit interest from AIB. She also earns rental income, the equivalent of €15,000 from a property in the UK. Both the shares and property were inherited from her father, on his death in 2003.

Jack paid income tax of €1,870 under the PAYE system in 2014, and €27,000 preliminary tax.

REQUIREMENT:

(a) Compute the total Case I income which will be assessed for Jack's trade for the last 2 years of assessment, giving brief explanations for any revisions made.

(5 marks)

(b) Compute the income tax payable by (refundable to) Jack and Sally for the tax year 2014, on the basis that they have opted for joint assessment.

(15 marks)

[Total: 20 marks]

3.

(a) List FOUR items of expenditure in respect of which a registered trader cannot claim back VAT. (2 marks)

(b) A private business college intends to purchase €70,000 worth of computers from Germany. The college is exempt from VAT. Outline its VAT obligations, if any, for the above transaction. (4 marks)

(c) Briefly explain the terms: 'Residence', 'Ordinary Residence' and 'Domicile'. (4 marks)

(d) Explain the term 'Bed & Breakfast' transactions and how they are treated for capital gains tax. (4 marks)

(e) Taxpayers chargeable under Schedule D are obliged to retain records which will enable true returns to be made of profits or gains.

(i) What records are required to be retained? (2 marks)

(ii) How long must the records be retained? (1 mark)

(f) For the accounting period ends listed below for ABC Limited, state the return filing dates:

(i) Year ended 30 November 2014 (1 mark)

(ii) 8 month period ended 30 June 2014 (1 mark)

(iii) 15 month period ended 30 September 2014. (1 mark)

[Total: 20 marks]

SECTION B

Answer **ANY TWO** of the three questions in this Section.

4. Roy Bean has the following share transactions in a company called Keano Limited in 2014:

- On 11 April, Roy sold 2,760 shares in the company for €19 each. He incurred transaction costs of €2,400.
- On 17 August, the day after his Civil Partnership with Alex, Roy gifted 1,250 shares to his partner Alex. The shares were worth €4.95 at the date of gift.
- On 29 December, Roy sold 3,120 shares in the company for €16 each. He incurred costs of €2,800.

Roy has obtained the shares in Keano Limited as follows:

- He purchased his first shares in the company in September 1989. He paid €10,200 for 4,900 shares.
- On 10 December 1991, the company had a bonus issue of three shares for every two shares in issue.
- The company announced a rights issue in May 1994. Roy did not have sufficient funds to avail of the rights issue so he sold his rights issue for €2,500. The ex rights price of the shares at that time was €3.
- Roy used some of his money from his retirement gratuity to purchase more shares on 10 February 1996. He purchased 2,650 shares at €5.10 per share
- Following a surge in the value of the company, Roy sold 6,500 shares at €6.95 each on 1 March 1996.
- On 1 December 2001, the company had a rights issue of three shares for every two shares in issue. Roy decided to take up his full entitlement and acquired the shares at €3.75 each.

REQUIREMENT:

(a) Calculate Roy's capital gains tax liability (if any) for 2014. (17 Marks)

(b) Outline when the above tax (if any) has to be paid and when Roy has to file his Capital Gains Tax Return to avoid any interest or penalties. (3 Marks)

[Total: 20 marks]

5. Scarth Ltd. distributes beauty products on the home and foreign markets. The following transactions were undertaken by the company during the VAT period November-December 2014:

	€
Sales invoiced to customers within Ireland	170,000
Sales invoiced to customers in the U.S.A.	60,000

The above amounts are stated net of VAT. The VAT rate applicable to the company's sales is 23%. During the same period, purchase invoices were received in respect of the following:

	€
Stock purchased from suppliers in Ireland	190,000
Stock purchased from suppliers in the UK	112,000
Accountant's Fees	9,000
Motor Van Leasing	22,000
Computer	7,000
Accommodation & Food Expenses	18,000

The amounts stated include VAT where appropriate.

REQUIREMENT:

(a) Compute the VAT payable or refundable for November-December 2014 for Scarth Ltd. (8 marks)

(b) Explain the difference between a multiple supply and a composite supply for VAT purposes. Give an example of each.

(6 marks)

(c) Explain the 'Two-Thirds Rule' in the context of Irish VAT and give an example (including figures) to illustrate your answer.

(6 marks)

[Total: 20 marks]

6. Croy Ltd. carried on a retail trade for many years based in Waterford. The company's results for the three years ended 31 December 2012, 2013 & 2014 were as follows:

Year ended 31 December	**2012**	**2013**	**2014**
	€	**€**	**€**
Case I income (loss)	(48,000)	42,000	(58,000)
Case III			18,000
Case V	12,000	9,000	10,800
Case V capital allowance	4,800	12,800	4,800
Trade Charges	8,000		
Capital gains converted	18,000		
Capital gain re development land			80,000

The capital gain arose on the sale of development land on 1 September 2014.

REQUIREMENT:

(a) Compute the tax liabilities, if any, for Croy Ltd. arising on the income/gains for the years ended 31 December 2012, 31 December 2013 and 31 December 2014 respectively, on the basis that any claims for losses/reliefs are made at the earliest possible date.

(17 marks)

(b) Explain the implication of claiming loss relief when a corporation tax return is filed late. (3 marks)

[Total: 20 marks]

END OF PAPER

SUGGESTED SOLUTIONS

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SOLUTION 1

Workings

1. Adjusted profit

	€	€	
Net Profit		40,720	½ mark
Addbacks:			
Depreciation	14,400		½ mark
Legal	12,000		½ mark
Interest	12,000		½ mark
Salaries	32,000		½ mark
Motor Expenses (W2)	5,500		2 marks
Lease Interest	1,680		½ mark
Loss of disposal site	64,000	141,580	½ mark
		182,300	
Deductions:			
Profit on sale of van	4,800		½ mark
Finance Lease payments	11,200		1 mark
Investment Income	16,000		1 mark
		(32,000)	½ mark
		150,300	

2. Motor Expenses

$$€8,800 * \frac{€32,000-€12,000}{€32,000} = €5,500$$

3. Capital Allowances

Van disposal bought in 2010 for €24,000 W&T 24,000 *12/5%

€3,000 for 4 years = €12,000

	€	
TWDV	12,000	1 mark
Proceeds	9,600	
Bal Allow	2,400	1 mark

New Cars

Car Cat C cost €28,000 only €24,000 allowable @ 12.5% = €3,000 — 1½ marks

Car Cat A cost €16,800 allowed €24,000 @ 12.5% = €3,000 — 1½ marks

Capital Allowances = cars €3,000 + €3,000 + balancing allowance €2,400 + Given €16,000 =
Total Capital Allowances €24,400

Corporation Tax Liability for the year ended 31 December 2014

	€	
Adjusted Profit (W1)	150,300	
Capital Allowances (W2)	(24,400)	
Case 1	125,900	½ mark
Case 111	9,600	1 mark
Case 111	6,400	1 mark
Total Income	141,900	
No Gains		
Taxable profits	141,900	

Corporation Tax	€	
€125,900 * 12/5%	15,738	½ mark
€9,600 * 25%	2,400	½ mark
€6,400 * 25%	1,600	½ mark
	19,738	½ mark

CGT on development land is calculated separately, it is a CGT issue. It is not incorporated into the corporation tax computation. The question did not ask for the CGT liability only the corporation tax liability.

2 marks

SOLUTION 2

(a) Last Year 2014, basis of assessment actual

Profits earned during the period 1st January to the last day, so it is 1/1/14 -30/9/14

June to September 2014 = €60,000 +
Jan -30th May 2014 = 5/12 * €78,000 = €32,500
Total Jan – Sept = €92,500 — 2 marks

Second Last Year 2013, CYB
31/05/2013 €86,000 — 1 mark

Revenue may revise to actual
5/12 * €86,000 + 7/12 * €78,000 = €81,333 — 2 marks

Revenue will not revise because higher profits were already assessed

(b) Workings

Salary €60,000/12 * 2= €10,000 — 1 mark

BIK Car

KM = 6,000/2 * 12 = 36,000 KM
36,000 KM =18%
18% * 2/12 =3%.
38,000 * 3% =€1,140. — 2 marks

Meals – exempt — 1 mark

Holiday €800 — 1 mark

Loan €30,000 *(13.5 – 4 = 9.5%) * 2/12 = €475 — 2 marks

Sch E = €10,000 + €1,140 + €800 +€475 =€12,415

Sch F €8,000 *100/80 = €10,000 — 1 mark

Case IV = €7,300 GROSS UP = €12,373, DIRT €5,073 — 1 mark

Income Tax Computation 2014

	€	€	
Case I	92,500		½ mark
Case III	15,000		½ mark
Case IV	12,373		
Schedule E	12,415		
Schedule F	10,000		
Total Income	142,288		
Taxed As Follows			
€65,600 @ 20%	13,120		½ mark
€12,373 @ 41%	5,073		½ mark
€64,315 @ 41%	26,369	44,562	½ mark
Less non refundable tax credits-			
Married	3,300		½ mark
PAYE	1,650		½ mark
DIRT	5,073	(10,023)	½ mark
Less refundable tax credits			
DWHT	2,000		½ mark
Preliminary tax	27,000		½ mark
PAYE	1,870	(30,870)	½ mark
Tax due		3,669	½ mark

SOLUTION 3

(a) Petrol, Cars, Food, Drink, Accommodation, Non-business items. 2 marks

(b) The college will have to register for VAT because it is importing more than €41,000 worth of goods from another EU country. It will supply its VAT number to the company in Germany, who will then not charge any VAT. The college will self-account for the VAT by putting VAT @23% on the €70,000 and returning this to the Irish Revenue.

4 marks

(c) Residence – 183 days in year or 280 days in two tax years 1 mark

Ordinary Residence – 3 years to get and 3 years to lose 1 mark
Domicile – Origin you retain your fathers domicile
Choice you acquire if you permanently leave the country 2 marks

(d) Where shares are sold within 4 weeks of purchase then LIFO not FIFO applies. Where shares are bought within 4 weeks of having sold them, any loss arising on the sale of the original shares can only be offset against future gains in same shares 4 marks

(e)
(i) prime records including invoices, bank statements, cheque books, cash receipts, books of prime entry including computerised records

2 marks

(ii) 6 years 1 marks

(f)
(i) Year ended 30th November 2014 – 23rd August 2015 1 mark

(ii) 8 month period ended 30th June 2014 – 23rd March 2015 1 mark

(iii) 15 month period ended 30th September 2014 – 2 returns

- 23rd March 2015
- 23rd June 2015 1 mark

SOLUTION 4

(i) Roy's share history

		No	Value €	P/S	
1989/90	bought	4,900	10,200	2.08	
1991/92	bonus	7,350	nil		
1989/90		12,250	10,200	.83	1 mark

Sale of rights

$$10{,}200 * \frac{2{,}500}{2{,}500 + 36{,}750} = \quad (650) \qquad \text{1 mark}$$

1989/90	12,250	9,550	.78	½ mark
1995/96	2,650	13,515	5.10	½ mark

Sale of Shares in 1996.

Because this is within 4 weeks of buying shares the shares will be dealt on LIFO — 2 marks

Therefore the 6,500 shares will come from all of the 1995/96 holding and 3850 from 1989/90

Shares remaining after the sale

1989/90	8,400	6,552	.78	½ mark

Rights issue

2001	12,600	47,250	3.75	½ mark

Disposals

11th April	2,760 @€19	52,440	
		(2,400)	
		50,040	1 mark

These shares will have to come from 1989/90 (2) and 2001 (3) pro rata

2,760/5 = 552

1989/90 1,104 shares
2001 1,656 shares

1,104 @ .78		
861 * 1.503	(1,294)	1 mark
1,656 * 3.75		
6,210 * 1.087	(6,750)	1 mark
	41,996	

17th August
This disposal is exempt but we have to account for the shares — 1 mark

1250/5 = 250

1989/90	500 shares	1 mark
2001	750 shares	1 mark

Therefore Roy's current shareholding will be

1989/90	8,400	6,552	.78	½ mark
	(1,104)			
	(500)			
1989/90	6,796	5,301	.78	½ mark

Rights issue

2001	12,600	46,250	3.75	½ mark
	(1,656)			
	(750)			
2001	10,194	38,228	3.75	½ mark

29th December

3,120 @€16	49,920	
	(2,800)	
	47,120	1 mark

These shares will have to come from 1989/90 (2) and 2001 (3) pro rata

3,120/5 = 624

1989/90 1,248 shares
2001 1,872 shares

1,248 @ .78		
973 * 1.503	(1,462)	1 mark
1,872 * 3.75		
7,020 * 1.087	(7,631)	1 mark
	38,027	

41,996
(1,270)
40,726 @ 33% = 13,440

38,027 @ 33% = 12,549

(ii) Disposals from 1st January to 30th November have to be paid by 15th December 2014 — 1 mark

Disposals in December have to be paid by 31st January 2105 — 1 mark
File Return by 31st October 2015 — 1 mark

SOLUTION 5

		€	€	
(a)	Sales	170,000 @23%	39,100	1 mark
		60,000 @ 0%		
	Notional VAT	112,000 @23%	25,760	1 mark
			64,860	
	Purchases	190,000 * 23/123	35,528	1 mark
	Notional VAT	112,000 @ 23%	25,760	1 mark
	Accountant	9,000 *23/123	1,683	1 mark
	Van Lease	22,000 * 23/123	4,114	1 mark
	Computer	7,000 * 23/123	1,309	1 mark
			68,394	
		VAT refund	3,534	1 mark

(b) A composite supply means a supply comprising two or more supplies of goods/services made in conjunction with each other, where one of the supplies is the predominant part of the supply and the other is not physically and economically dissociable from the main supply.

The supply of a TV with an instruction book is an example of a composite supply. 3 marks

A multiple supply means two or more individual supplies made in conjunction with each other but each part is capable of being a supply of goods or services in its own right.

A Christmas hamper would be an example of a multiple supply. 3 marks

(c) The "Two-Thirds Rule" applies where there is a contract for the supply of a service which involves the supply of goods (in order to apply, it is important that the contract be for the supply of a service and not for the supply of goods). An often-quoted example of where the two-thirds rule might apply is the repairing of a washing machine which requires the replacement of parts.

Where the VAT-exclusive cost of the goods in a contract for the supply of a service is less than two-thirds of the total contract price, the rate of VAT applicable to the entire supply is the rate applicable to the supply of the service provided as part of the contract.

Example: A property developer contracts with a plumber to supply and lay pipes for a number of houses which he is building. The plumber quotes a price of €225,000 plus VAT for the job. The pipes and fittings cost the plumber €148,000 plus VAT. He prices his labour at €77,000. As the cost of the materials to the builder does not exceed €150,000 (two thirds of €225,000), the rate applicable to the service, 13.5%, is applied to the entire supply by the plumber. Thus, he will invoice the property developer for €225,000 plus €30,375 VAT.

6 marks

SOLUTION 6
(a)

		2012	2013	2014	
		€	€	€	
Case I			42,000		1 mark
S 396(1) (W2)			(23,600)		2 marks
S.396 A (W3)			(18,400)		2 marks
Case III				18,000	1 mark
Case V	(W1)	7,200	Nil	6,000	
Case V loss c/f				(3,800)	1 mark
Adj Gain		18,000			1 mark
		25,200	NIL	20,200	
Tax @ 12.5%		2,250			
Tax @ 25%		1,800		5,050	
S 243 B (W2)		(1,000)			1 mark
S396B	(W2)	(3,050)	S396B(W3)	(4,950)	4 marks
Final CT		NIL	NIL	100	
CGT on Development Land		€80,000@33% = €26,400			1 mark

Workings

1.

Case V	**2012**	**2013**	**2014**	
	€	€	€	
Income	12,000	9,000	10,800	1½ marks
Capital Allowance	(4,800)	(12,800)	(4,800)	1½ marks
Case V	7,200	Nil	6,000	
Excess Case V Cap Allow		3,800		

This will be carried forward to 2014. Alternatively it could be used in 2012.

2. Loss Memo

2012 Trade Charges €8,000 @12.5% =€1,000

		€
2012	Trade Loss	48,000
	S396 (b)	(24,400)
		23,600
396(1)		(23,600)
		NIL

3. Loss Memo 2014

	€
Trade Loss	58,000
S396(A)	(18,400)
	39,600
S396B	(39,600)
	NIL

(b) Where a company's corporation tax return is submitted after the due date, but is filed within Two months of the due date, there is a 25% restriction on the amount of relief which would otherwise have been available. This restriction is limited to a maximum of €31,740. Where a company's corporation tax return is submitted more than two months late, there is a 50% restriction on the amount of relief which would otherwise have been available. This restriction is limited to a maximum of €158,715.

3 marks