

**THE INSTITUTE OF INDIRECT TAXATION
ASSOCIATE EXAMINATION**

**PAPER I
GENERAL: LEGAL, BUSINESS &
PROFESSIONAL ETHICS**

28 APRIL 2009

**TIME ALLOWED - 15 MINUTES READING TIME
3 HOURS WRITING TIME**

Candidates must answer **5 QUESTIONS** - two questions from Section A; two questions from Section B and the one question in Section C

Each question carries 20 marks

Start each answer in a fresh book

All workings should be shown and (unless stated otherwise) made to the nearest month and pound.

Marks are specifically allocated for good presentation and references to relevant legislation

Section A - LEGAL

Attempt **two questions** from this Section.

Question 1

Basics of Business

1. What is the difference between a *contract of service* and a *contract for services*? **4 marks**
2. The Courts have adopted a variety of tests to determine whether someone is an employee or an independent contractor. Name 4 of them. **4 marks**
3. With respect to land, what is the difference between a *lease* and a *licence*? **4 marks**
4. Where a trustee holds land on trust for a beneficiary who is under 18 what interests in land does each hold? **2 marks**
5. Where the trustees of a trust have the power to accumulate income, for how long may they do so? **2 marks**
6. Are trustees entitled to be paid for their services in administering a trust? If so, has this always been the case? From what sources does a trustee derive the power to charge for his/her services? **4 marks**

Question 2

Forms of Business Entity

Mr Hay and Mr Ryton are about to set up a new manufacturing business together and would like some advice on the different ways to do this. Their intention is to expand relatively quickly, however, they appreciate the market is volatile and that there are therefore financial risks involved. There is also an intention for Mr Hay's younger two brothers to join the business once it is up and running. Mr Ryton currently operates a hardware shop as a sole trader.

You are required to:

Draft a letter to them explaining the main forms of business entity and benefits and risks of each; offering your initial thoughts (subject to the more detailed information you would obtain from contact with clients in the future). **20 marks**

Question 3

Legislation

- (a) List the stages for creating an Act of Parliament? **9 marks**
- (b) What is the role of the House of Lords in passing a money Bill? **2 marks**
- (c) Explain what is secondary, also called delegated, legislation? **2 marks**
- (d) How is secondary legislation passed into law? **2 marks**
- (e) Give examples of the advantages and disadvantages of secondary legislation. **2 marks**
- (f) What is tertiary legislation? **2 marks**
- (g) Give an example of tertiary legislation? **1 mark**

Section B – BUSINESS

Attempt two questions from this Section

Question 4

SlumCat Limited

An opportunity has arisen to purchase the leasehold premises, stock and goodwill of a well sited film merchandise discount store and SlumCat Ltd has been formed to run the business. The owners of SlumCat Ltd, Millionaire Ltd have bought and paid for the business and SlumCat Ltd is only concerned with the running of the business. The previous owners have taken on the responsibility of collecting all debtors due before the sale of the business to Millionaire Ltd and will pay all creditors at the date of sale. SlumCat Ltd therefore starts with a "clean sheet" taking on only the stock, ongoing obligations to the landlord under the lease, and other ongoing expenses as set out below.

Details of the Business purchased are as follows:

1. The lease has 5 years to run from the date of purchase (1 January 2009). It can then be renewed for 5 years at the same rent if all of the 5 years' rent is paid up front ie £700,000. Rent is paid on the usual English Quarter Days, 25 March, 24 June, 29 September and 25 December.
2. The stock is in good condition and can all be used in the business. Its current replacement cost is £1,300,000.
3. The expected sales/turnover for the year from 1 January 2009 is £12,000,000, provided that a stock quantity to satisfy two months sales is carried throughout the year, beginning 1 January 2009.
4. Suppliers give two months credit for stock bought.
5. The average profit/markup on all stock is 20% of sales value.
6. Most sales are for cash, but one tenth in value are on one month's credit. Both cash and credit sales arise evenly over the year.
7. Fixed expenses (excluding rent) are estimated at £1,800,000 a year, representing a cash outlay spread evenly over twelve months.

You are required to: prepare a month-by-month operating CASH FLOW FORECAST for SlumCat Ltd for the year ended 31 December 2009 in the following tabular format: **20 marks**

SLUMCAT LIMITED

OPERATING CASH FLOW FORECAST

YEAR ENDING 31 DECEMBER 2009

Month	Rent A	Stock Purchase B	Fixed costs C	Monthly Costs D=A+B+C	Cash Sales E	Credit sales F	Total Sales G=E+F	Cash Generated H=G-D
2009	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Jan								
Feb								
Mar								
etc								
etc								
Totals £	£		£	£	£	£	£	£

Question 5

Virgil

Virgil is a sole trader. His draft accounts for the year ended 31st December 2008 are shown below.

Sales		273,827
<u>Cost of sales</u>		
Opening stock	31,215	
Purchases	<u>127,844</u>	
	159,059	
Less – closing stock (ESTIMATED)	<u>(30,000)</u>	
		<u>129,059</u>
Gross Profit		144,768
<u>Less Overhead expenses:</u>		
Payroll costs	42,081	
Rent & rates	32,875	
Repairs	3,502	
Loan interest payable	2,625	
Transport costs	9,942	
Accountancy (as accrued)	2,000	
Insurance	2,390	
Bad debt provision	2,524	
Depreciation	-	
General expenses	<u>3,326</u>	
		<u>101,265</u>
NET PROFIT		<u>£ 43,503</u>
Balance Sheet		
Fixed assets		12,024
<u>Current assets</u>		
Stock (ESTIMATED)	30,000	
Debtors	45,638	
Cash at bank	10,824	
Petty cash	<u>750</u>	
	<u>87,212</u>	
<u>Liabilities</u>		
Trade creditors	22,824	
Accruals (for accountancy fees)	2,000	
Loan	<u>50,000</u>	
	<u>74,824</u>	
Net current assets		<u>12,388</u>
NET ASSETS		<u>£ 24,412</u>
Representing:		
Opening Proprietor's capital		26,802
Profit for the year		43,503
Drawings		<u>(43,893)</u>
Closing Proprietor's Capital		<u>£ 26,412</u>

You notice immediately that the balance sheet does not balance, that the closing stock figure is estimated and that there is no depreciation charge. After further review you find:

- a) Just before Christmas Virgil took £250 from the petty cash box to buy presents for his family. This was not recorded in the petty cash book or indeed in the nominal ledger.
- b) A payment of £2,000 to a supplier has been duly recorded in the cash book but the corresponding entry has not been made in the creditors' ledger.
- c) Virgil holds three lines of stock. A count of the stock at the year end showed the following

<u>Stock Line</u>	<u>Units counted</u>	<u>Unit cost</u>
Alphas	12,108	£ 1.25
Betas	8,320	£ 1.35
Gammas	7,536	£ 1.60

Unfortunately the gammas have become obsolete. In February 2009 Virgil managed to sell 2,000 of the units for a knockdown price of 25p each and scrapped the rest.

- d) The long-term loan of £50,000 has been outstanding for several years. No capital repayments have been made but Virgil pays interest at 7% per annum in quarterly instalments in arrears.
- e) The bad debt provision has been made in respect of two customers. Terence (a comedian and an undischarged bankrupt) owes £1,603. Sallust (a poet) had owed £921 for many months but eventually paid up last week.
- f) The payroll costs include £10,000 to Virgil himself. He maintains that the charge is justified as it represents the salary he could obtain if he was not self-employed.
- g) The rent is £30,000 per annum payable quarterly in advance. Virgil's landlord's administration broke down with the result that the rent for the quarter to 31st December 2008 was not paid until January 2009.
- h) Fixed assets are depreciated at 25% per annum on the reducing balance basis. The figure in the draft balance sheet reflects the net book value as at 31st December 2007 (£13,524) less £1,500 proceeds of sale for a piece of plant which had originally been purchased for £4,000 at the start of 2006.
- i) The charge for transport costs includes £2,380 for the purchase of a second hand truck.
- j) On 1st December Virgil invoiced a customer for £1,710 for goods delivered on the same day. The customer has since complained that the goods were substandard. Virgil had to agree that the complaint was justified and on 2nd February 2009 he issued a credit note for 40% of the invoice value.
- k) Virgil is contractually obliged to pay a staff bonus equivalent to 5% of gross profit.

You are required to: prepare the following for Virgil in respect of the year ended 31 December 2008

- i) The journal adjustments required to correct the accounts. The journals should be supported by the appropriate explanations and calculations. **12 marks**
- ii) A schedule reconciling the profit as shown in the draft accounts with the final result. **4 marks**
- iii) A revised balance sheet. **4 marks**

Question 6

George Sands

George Sands has been in business for some years as a sole trader. The following figures have been taken from his year end accounts for the last four years.

Year end 31 st March	2006	2007	2008	2009
	£'000	£'000	£'000	£'000
Sales	120	138	166	207
Gross Profit	30	34.5	33.1	41.4
Depreciation	9.25	8	11	10
Net Profit	12	15	10	14
Fixed assets at cost	74	74	98	110
Fixed assets net of depreciation	52	44	57	59
Stock	7.5	8.6	16.6	27.6
Debtors	10	13.8	20.7	34.5
Bank	8	14.2		
Bank overdraft			10.4	16.6
Creditors	7.5	8.6	19.9	34.5
Owners capital (Note 1)	70	72	64	70

Note 1. The owners' capital is the figure on the closing balance sheet. i.e. opening capital plus profit less drawings. The owner accounts for tax as a personal liability so it does not show in these accounts.

You are required to:

- For each of the four years a calculation to one decimal place of the following ratios:
 - Net Profit : Sales expressed as a percentage
 - End Year stock : Cost of sales expressed as a percentage
 - Average credit given to debtors (End year debtors /sales * 365) answer in days
 - Current Ratio expressed as x:1
 - Acid Test Ratio expressed as x:1 **12 marks**
- A note of four points you would make to George Sands about the progress of his business. **8 marks**

Section C – PROFESSIONAL ETHICS

Attempt **the one** question in this Section

Question 7

1. Money laundering

“Money laundering” is defined by HMRC as “the process by which criminally obtained money or other assets (criminal property) are exchanged for “clean” money or other assets with no obvious link to their criminal origins”.

- (a) What UK legislation can affect tax practitioners as far as money laundering is concerned and where is the primary HMRC guidance to be found? **2 marks**
- (b) Give a brief description of (other than actual money laundering) the offences a person in the regulated sector, which includes tax advisers, might commit in the context of money laundering? **1 mark**
- (c) As far as money laundering is concerned with what sort of proceeds is the legislation formally concerned? **1 mark**
- (d) The applicable regulations require businesses affected by them to take a risk-based approach to customer due diligence. Briefly summarise the meaning of this. **1 mark**
- (e) What is the minimum level of client information necessary to satisfy the regulations on customer due diligence? **2 marks**
- (f) Once you have entered into a business relationship with a client for whom you have carried out proper customer due diligence, when might you wish to repeat that process? **3 marks**

2. Legal professional privilege

Please provide a summary of the concept of legal professional privilege covering, in particular, how the rule operates, **with specific reference** to the case of Morgan Grenfell & Co Ltd -v- Special Commissioners of Income Tax [2002] STC 786. To whom and to what does the rule apply and not apply and how is its application affected where litigation is involved? **10 marks**