

**THE INSTITUTE OF INDIRECT TAXATION
ASSOCIATE EXAMINATION**

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

27 APRIL 2010

**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

Cragside Limited

Mr Adamson is the managing director and major shareholder of a building company, Cragside Limited. Due to the recession, business has been very bad for some time and the company is now financially struggling with several creditors threatening to sue. Cragside Limited has debenture holders and a variety of shareholders.

Mr Adamson has asked you to write him a letter which will provide him with a summary of potential outcomes for the company if it cannot pay back its creditors.

20 Marks

Question 2

Negligence

1. If a court action were to be brought against you for negligence would this be a criminal action or a civil action? **1 Mark**
and what is the difference between the two? **3 Marks**
2. If those court proceedings alleged that you had caused harm valued at £25,000 which court would the case be heard in : the Crown Court, the County Court, the Magistrates Court or the High Court? **1 Mark**
3. What is the standard of proof required by the Courts to prove a case of negligence? **1 Mark**
4. What is a tort? **1 Mark**
Give one example of a tort. **1 Mark**
5. Three factors determine whether someone is liable in negligence. What are they? **3 Marks**
6. What animal was at the centre of the row in the case of *Donoghue v Stevenson*? **1 Mark**
7. Forgetting about the animal, what was important about the judgment of the House of Lords in that case? **2 Marks**

8. A workman went to hospital complaining of stomach pains and the doctor on duty refused to see him and sent him home. That night the workman died from arsenic poisoning. The Court found that the doctor was not liable for negligence. Why might the Court have reached that decision? **2 Marks**
9. What is the most common defence used in actions for negligence? **1 Mark**
10. What is it called when a person is held liable for the negligent acts of another? **1 Mark**
11. In what circumstances might you be held liable for the negligent act of a person with whom you work? **2 Marks**

Question 3

Contract

Dave is the promoter of a popular choir. He sees an advert placed by the Council in the local newspaper which states that the Civic Hall can be booked for the 'deal of a lifetime' rate of £500 per night. Dave rings up the Council, which sends him a copy of its 'standard' contract to sign and return, together with payment. Dave signs the contract and books four nights, but includes a covering letter saying that his booking is on the basis of a £400 per night booking fee only. Dave therefore encloses a cheque for £1600, and finishes the letter by stating that "unless I hear from you within the next couple of weeks, I'll assume that you agree to my £400 per night rate rather than £500". Dave does not receive any reply from the Council.

Dave also enters into a contract with the operator of the Doncaster Morning News Arena (DMN Arena) to put on four 'grand concerts' for £500 per night. Unfortunately, after entering into the contract (but before the first day on which a concert was to be put on) the DMN Arena is destroyed by fire. The contract makes no mention of what happens in this kind of disaster, which was not the fault of either party. The operator of the DMN Arena considers that Dave must nevertheless pay them the £2000 in respect of the booking.

Dave has a brother called Melvin. Melvin has recently discovered that Dave is looking to book venues for the choir, and has offered Dave the use of his extensive landscaped garden for a performance. Dave accepted the offer by telephone ("nice one bruv, it's in the diary now...") but Melvin and Dave have subsequently fallen out. Melvin tells Dave a day before the performance that the choir cannot now use his garden. Incidentally, Dave (2 months' ago) gave Melvin a golden disc which one of his 'acts' was awarded as a gift.

1. List and briefly describe the basic requirements which must exist for there to be a legally binding contract. **8 Marks**
2. When Dave posted the booking form and covering letter back to the Council, do you consider that this created a legally binding contract? **2 Marks**
3. Giving your reasons, do you consider that Dave is contractually obliged to pay the £2000 to the operator of the DMN Arena? **3 Marks**
4. Would it make a difference to your answer to question 3 if Dave, having fallen into a downward spiral of depression, had set fire to the DMN deliberately? **1 Mark**
5. Do you consider that Dave and Melvin have a legally enforceable contract? **3 Marks**
6. Would it make any difference to question 5 if Dave had promised to give Melvin the golden disc in return for Melvin agreeing to make his garden available for the performance? **3 Marks**

Section B – BUSINESS

Attempt two questions from this Section

Question 4

A. Solo

S Holmes Esquire is a private investigator and druggist who commences to trade as a sole trader in February 2010. His transactions for the month of February 2010 are as follows:

1. 15 February - S Holmes Esquire provides £7,000 from his private means.
2. 15 February - To ensure that sufficient cash is available during his first few months of trading, he borrows £5,000 from his brother, Mycroft, for six months.
3. 16 February - This £5,000 is used to put a deposit on premises.
4. 16 February - The total cost of the premises is £50,000. The balance is paid using the proceeds of a loan received from Lestrade Finance Company.
5. 17 February - £6,750 cash is used to purchase a stock of goods for resale, from Baker Street Irregular Suppliers Ltd (i.e. purchases).
6. 19 February - The whole stock of goods was sold on credit to Moriarty and Sons for £9,000.
7. 23 February - A further stock of goods amounting to £8,000 is purchased on credit from Baker Street Suppliers Ltd.
8. 24 February - The rates on the premises £50 for the initial period to 28 February, are paid.
9. 25 February - Interest on the loans, £200 for the month of February, is paid in cash.
10. 26 February - Moriarty and Sons pay for the goods they purchased on 19th February.
11. 28 February - The value of goods in stock at the end of the month is £8,000

His bookkeeper has set up the following Nominal Ledger accounts:

- Cash Account
- S Holmes Esquire Capital Account
- Mycroft - Loan Account
- Premises Account
- Lestrade Finance Company
- Purchases Account
- Sales Ledger Control Account (Moriarty and Sons – Debtor Account)
- Sales Account
- Purchase ledger Control Account (Baker Street Irregular Suppliers Ltd – Creditor Account)
- Business Rates Account
- Interest payable on Loans Account
- Stock Account
- Profit & Loss Account

Style of Journal

	DR	CR
1. DR <i>Account name</i>	xxx	
CR <i>Account name</i>		xxx

Brief narrative

Style of T-account

Nominal Ledger Account						
Date	Narrative	Dr £		Date	Narrative	Cr £
1.3	Balance b/d	<u>zzzzzzz</u> yyyyyy		28.2	Balance c/d	yyyyyy <u>zzzzzzz</u>

You are required to:

1. Draft the **eleven** double entry journals **in the style shown above** to post to the above Nominal Ledger accounts. **4 Marks**
2. Post the journals to the above Nominal Ledger T-accounts (including the Profit and loss T-account) **in the style shown above.** **7 Marks**
3. Produce a draft Profit & Loss Account for S Holmes Esquire for February 2010 **2 Marks**
4. Produce a draft Balance Sheet for S Holmes Esquire as at 28 February 2010. **2 Marks**

B. Dynamic Duo

Dr J Watson is a single man who commences working for S Holmes Esquire on 1 March 2010. His annual salary is £12,000.

S Homes Esquire's bookkeeper has helpfully set up the three additional necessary Nominal Ledger accounts:

Salaries (Profit and Loss account)

Salaries Control account – Dr J Watson Creditor Account (Balance Sheet)

HMRC Control Account (Balance Sheet)

Assume the following effective tax rates apply to this income

Employees NIC	11.0%
Employers NIC	12.8%

PAYE

Annual Tax Free Amount £7200

Basic Tax Rate 20%

You are required to:

1. Calculate for March 2010:
 - i) Gross salary/pay
 - ii) PAYE
 - iii) Employee's national insurance
 - iv) Employer's national insurance
 - v) Net salary/pay **2.5 Marks**

2. Show the four double entry journals (**in the same style as in part A**) for posting to the Nominal Ledger in March of these transactions, assuming that Dr J Watson is to be paid on 31 March but that HMRC will not be paid until 18 April 2010. **2 Marks**

3. State the HMRC creditor to be paid on 18 April 2010. **0.5 Mark**

Question 5

Neshama Construction Limited

Trading and Profit and Loss Account for the Year Ended 31 December 2009

	£	£
Sales		4,852,235
Other Income		
Bank Interest Received	4,325	
Compensation Received	<u>21,463</u>	25,788
Cost of Sales		
Opening Stock	253,352	
Materials Purchase	2,586,989	
Sub contractors	<u>1,487,632</u>	
	4,327,973	
Less Closing Stock	<u>(210,346)</u>	<u>4,117,627</u>
Gross Profit		760,396
<u>Less: Administrative Expenses</u>		
Freight and Carriage	167,235	
Storage and Warehousing	24,540	
Insurance	23,450	
Wages and Salaries	235,985	
Rent and Rates	55,650	
Repairs and maintenance	4,650	
Loan Interest payable	10,152	
Travel and Subsistence	84,025	
Accountancy and Bookkeeping	25,500	
Legal and Professional	18,500	
Printing, Postage and Stationery	3,520	
Advertising and Promotion	4,500	
Sundry Expenses	8,750	
Bad Debts	11,500	
Depreciation Fixtures and Fittings	<u>2,350</u>	
		<u>680,307</u>
Net Profit		<u>80,089</u>

Neshama Properties Limited

Trading and Profit and Loss Account for the Year Ended 31 December 2009

Fixed Assets

	Cost £	Depreciation to Date £	Net Book Value £
Head Office Premises	950,000	0	950,000
Fixtures and Fittings	47,852	24,385	23,467
Motor Cars	124,200	65,000	59,200
Computers	<u>59,000</u>	<u>7,375</u>	<u>51,625</u>
	<u>231,052</u>	<u>96,760</u>	<u>1,084,292</u>

Current Assets

Debtors	366,550	
Cash at bank and in hand	197,523	
Prepayments	18,500	
Closing Stock	<u>210,346</u>	792,919

Current Liabilities

Directors Loan Account	125,750	
Bank Loan	95,748	
Accruals	26,000	
VAT Liability	100,680	
Corporation Tax Liability	99,000	
PAYE/NIC Liability	11,255	
Purchase Ledger Creditors	<u>52,850</u>	<u>511,283</u>

Net Current Assets 281,636

Total Assets Less Current Liabilities 1,365,928

Capital and Reserves

Called Up Share Capital	20,000
Revaluation Reserve	235,000
Profit and Loss Account	<u>1,110,928</u>

Shareholders Funds 1,365,928

During the audit of the accounts, various issues have come to light. These are:

- A) During the year end stock audit, some of the stock was found to be damaged and obsolete and a decision has been made to write off £16,700 of materials.
- B) The public liability insurance of £4,950 was paid in October 2009 for the year 1 October 2009 to 30 September 2010 and the whole charge was posted to the P & L.
- C) During analytical review of the P & L, there was an entry of £3,750 in travel and subsistence which upon enquiry turned out to be the managing director's annual golf trip to Florida. The payment for the trip came from the company's bank account but the private trip had nothing to do with the business.
- D) The company imports building materials from a supplier in the Middle East. The freight company informs HMRC at the port that Neshama Construction Limited is the importer and gives HMRC Neshama's VAT registration number.

The freight company pays the import VAT and duty on Neshama's behalf so the goods can be cleared through Customs and then invoices the company for their freight charges and reimbursement of the import VAT.

It has transpired that a junior bookkeeper has been processing all of these invoices (including import VAT) as a freight charge. The C79s have been received but just filed away and not acted on.

During this financial year there is £35,000 of import VAT posted to the P & L.

- E) After the year end one of the companies' customers who owed £25,000 has gone into receivership. A provision of £10,000 has already been made in the accounts but the directors have decided to provide for the balance to be treated as a bad debt.
- F) Because of the recession, a decision was made to have the head office premises valued by a surveyor. The surveyor valued the office at £875,000 and the directors wish the current value to be shown in the year end accounts.
- G) Purchase invoices from two suppliers totalling £12,799 (net of VAT) dated in December 2009 were found not to have been posted to the purchase ledger. These need to be accrued for the annual accounts.
- H) Depreciation needs to be put in this year's annual accounts for motor cars and computers. The depreciation policy is 15% reducing balance for motor cars and 25% straight line for computers.

All of the computers were purchased during the middle of 2008.

- I) The bank loan interest charge for y/e Dec 2009 of £2,768 has not been accounted for in the draft accounts.

- J) Due to the hard work during the year by all employees, the directors want to pay a bonus of 5% of wages and salaries. A provision needs to be made in the annual accounts for this.

You are required to prepare for Neshama Properties Limited the following (all calculations should be rounded up to nearest £):

- 1) The Journal adjustments required to correct the accounts. Write out the debit and credit entries with the appropriate explanations and calculation **12 Marks**
- 2) Recalculate the trading and profit and loss account to reflect the journal **4 Marks**
- 3) Recalculate the balance sheet to reflect the journals **4 Marks**

Question 6

Accounting ratios

At 31st March 2009 George Michael, a sole trader, had the following ratios and figures

Year end	2009
Acid test ratio	1.4:1
Current ratio	2.0:1
Gross profit : sales	35%
Net profit : Sales	10%
Debtor settlement period	1 month
Creditors at year end	£32,000
Net profit: opening capital	12%
Drawings as a % of net profit	80%
Sales	£450,000
Fixed assets at book value	£352,000

You are required to:

- a. As far as possible construct summary accounts (abbreviated P & L, balance sheet) for the year. **15 Marks**

A year later at 31st March 2010 his accounts showed the following figures:

Trading Profit and Loss account

	£	£
Sales		600,000
Less cost of sales		
Open stock	19,200	
Purchases	<u>440,800</u>	
	460,000	
Closing stock	<u>40,000</u>	<u>420,000</u>
Gross profit		180,000
Less expenses		<u>132,000</u>
Net profit		48,000

Balance sheet as at 31st March 2010

	£	£	£
Fixed assets at book value			370,000
Current assets			
Stock	40,000		
Debtors	<u>75,000</u>	115,000	
Less			
Creditors	36,733		
Bank overdraft	<u>48,267</u>	<u>85,000</u>	<u>30,000</u>
			400,000
Opening Capital			384,000
Add profit			<u>48,000</u>
			432,000
Less drawings			<u>32,000</u>
			400,000

b. Give a brief report on George Michael's progress in the year ended 31st March 2010

5 Marks

Show all workings.

Section C – PROFESSIONAL ETHICS

Attempt **the one** question in this Section

Question 7

Ethics

- (a) It is sometimes said that :- "There is no morality in a tax statute".
- (i) What do you consider the above quote really means? **2 Marks**
 - (ii) Give arguments or reasons in support of the above quote. **4 Marks**
 - (iii) Give arguments or reasons against the above quote. **4 Marks**
- (b) You are in business as a tax adviser and a potential new client, an accountant, approaches you for advice to help with the tax affairs of a limited company the accountant represents. Focusing just on the money laundering requirements what ought you to do? **10 Marks**