

# Examiners' report

P6 Advanced Taxation (MYS)

June 2008



It is encouraging to see that June 2008 shows a welcome overall improvement. This is only the second sitting under the new syllabus, however I notice that some candidates seem to have taken note of the changes and have adapted well to the new style examination under P6. Nevertheless, there is a perceptible difference between the achievements of different candidates with the more successful ones attaining much higher marks than the majority. This seems to suggest that some re-sitters are not putting as much effort into their studies as they might.

What is also noticeable is that many candidates achieved their best results on the questions which have a computational element. For candidates who still have to sit, there is no room for complacency. It will be difficult for candidates to obtain a pass in this paper unless they have developed their skills in answering discursive-type questions. It is suggested that all students would benefit from studying carefully past examination questions and answers which have required the application of mature analytical skills and the provision of coherent and well-presented discursive answers. These are to be found not only in paper P6MYS but also in other optional papers.

One thing that candidates should be clear about is that both of the compulsory questions are likely to require the answer to be presented by way of a report or letter. This requires the application of professional skills for which marks are specifically available. No questions are entirely computational. Calculations or computations may be required to support or supplement a narrative answer given by way of a report or letter. In that case, they must be placed in an appendix and a summary of the results given in the report or letter. The techniques required in answering such questions must be studied and mastered to avoid the loss of marks. Students might find it worthwhile to read the article 'effective report writing' by Mustafa Muchhala which is available on the ACCA website.

## General comments

Section A of the paper has two compulsory questions which may attract 50-70 marks. This time, the two compulsory questions had 38 marks and 32 marks respectively. Section B consisted of three optional questions, each for 15 marks, of which two must be answered. Questions are mostly scenario-based with Section A questions requiring answers by way of a letter or report involving professional marks.

Although every effort is made in drafting the questions to ensure that only relevant information is included and that the information and the requirement are stated succinctly and unambiguously, it is noticeable that candidates often misunderstand the question or overlook an important piece of information. There is now an allocation of fifteen minutes for reading before beginning to tackle the paper. Candidates should remember that time spent reading a question thoroughly and gaining a proper understanding of it is not time wasted. There is no rule that says you have to start writing as soon as the 15 minutes has expired.

Only candidates who are well prepared for the exam can expect to succeed. Some questions were answered very well but many were not. The reasons for poor answers were the same as usual:

- Inadequate fundamental knowledge
- Inadequate advanced knowledge
- Poor application of knowledge
- Difficulty in expressing reasoned conclusions in narrative form.
- Lack of technique in putting together a complete and comprehensive answer to a question

Paper P6 builds on fundamental knowledge and candidates should ensure that the basic knowledge they acquired earlier is not lost while striving to acquire advanced knowledge at professional level. All sources of information and knowledge should be used, including the recommended text books, the student accountant magazine and the ACCA website which often contains helpful articles. Technical articles written by the examiner

are a valuable resource for candidates. One relevant article published recently in 'student accountant' as well as on the ACCA website is 'export-related exemptions'. Students need not confine their studies to a single text book. The reading list contained in the study guide gives a list of books of different types, some technical, some comprehensive and some more simplified books for easy reading.

For many candidates, English is not their first language and although they struggle valiantly to make sense of a question something is lost on the way. If a candidate does not fully understand the question he will now know exactly what the examiner requires and will be unable to apply his knowledge appropriately. The problem is then confounded because the candidate is unable to express himself clearly so as to convey the full meaning of his conclusions to the examiner. As such, candidates will be at a disadvantage if their proficiency in English is below a certain level. However, candidates will find it useful to read relevant articles written in English and to work through as many exam questions as possible, writing the answer out fully in the time available. This will assist with their exam technique too.

### **Question 1**

This question, for 38 marks, had three different themes. In part (a), candidates were invited to identify and discuss the reasons why it is often preferable for rents to be assessed as business income rather than as investment income. Parts (b) and (c) dealt with reinvestment allowance and control transfers respectively.

Many candidates produced meritable answers to part (a), identifying the reasons for the preference and describing the salient features of each. However, some candidates over-answered the question as a result of not seeing the importance of the words '**the two most significant reasons**' in the requirement. Whilst there might be other valid reasons for having a preference, the two given in the model answer are, without doubt, the two most significant. With only 6 marks available, there were none for discussing less significant reasons.

Part (b) comprised a very specific test of knowledge about the qualifying conditions for reinvestment allowance. It was often well answered but typical mistakes included:

- Not correctly applying the condition requiring a company to have been in operation for at least 12 months before any expenditure can qualify (which ruled out the expenditure on 30 November 2006).
- Not stating that, in relation to the expenditure on 1 January 2007, that the reason why it qualified was not only that the twelve months initial period had expired by then, but also that it was for a qualifying purpose (automation.)
- Not stating that the 15-year qualifying period started on the first day of the basis period for the year of assessment in which the first qualifying expenditure took place (in other words not just 'the year of assessment 2007' but '1 December 2006').
- Not identifying correctly the year of assessment that would mark the end of the 15-year qualifying period (the year of assessment 2021) and not stating the last day of its basis period (30 November 2021, assuming that the company had not changed its basis period in the meantime.)

Part (c) dealt with capital allowances and reinvestment allowance in the context of control transfers. It had to be answered by preparing a letter to the client. A total of 25 marks were available. Although a compulsory question, it seemed to be a popular one due perhaps to its substantial computational content. Many candidates achieved very good marks for it.

It was disappointing to see so many candidates not gaining marks due to poor presentation. Few placed their calculations in an appendix with the results summarised in the letter itself. The following errors also contributed to poor presentation:

- Not 'setting the scene' or concluding the letter appropriately.
- Topics not dealt with in the order required by the question.
- Topics not given suitable headings.

- Excessive explanations.

As there were only six marks available for explanations (3 each in requirements (i) and (iii)) candidates should have realised that they were not expected to go into detailed explanations of the control transfer provisions or the entitlement to reinvestment allowance. It could be concluded from the way the question was worded that in this case the control transfer provisions applied and there was an entitlement to reinvestment allowance. The requirement was to explain how the capital allowances and reinvestment allowance would apply to the two assets concerned given that they were both the subject of a control transfer.

Some of the mistakes made were:

- Not distinguishing between the tax consequences for the two assets due to the fact that, in one case, the expenditure had been incurred in the transferor's final period and in the other case it had not.
- Failure to describe all of the tax consequences fully and succinctly.
- Not showing all necessary workings in the computations.
- Not applying the 70% limitation on set off correctly.

Residual values were often calculated in part (ii) although they were not strictly necessary until part (iv). Appropriate marks were given accordingly but many candidates fell into the error of applying the clawback of capital allowances for assets owned less than two years. Paragraph 71, under which the clawback is permitted, is an anti-avoidance provision. The study guide for paper P6MYS expressly excludes detailed knowledge of anti-avoidance provisions not referred to in the study guide so there was no justification for invoking it in this situation.

## **Question 2**

This 32 mark question was set in the context of the proposed transfer of a partnership business to a new company and candidates were asked to prepare a report dealing with the income tax implications of transferring certain specified assets. In each case, the candidate was asked to recommend the value at which the asset should be transferred to the new company and marks were available for this. All of the topics have been examined before and they should be familiar to candidates. Many answers were good in part but in most cases the overall result was disappointing.

In this case, the answer had to be provided in the form of a report and students should note the difference in format and presentation of a report compared with a letter. However, many of the same principles apply such as the setting out of the topics in a logical order and under suitable headings. Where topics are listed in the question, they should appear in the same order in the answer. Many answers were unsatisfactory due to poor organisation of topics.

Another problem deserving comment is the tendency to digress. Readers will notice that the model answer is contained in just over one typed A4 page. It is not uncommon for candidates to have spread the answer to this question over 5 or 6 pages, the reason being that they have not organised their thoughts before starting to write with the result that many of their words cover what is not relevant and few cover what is relevant, which wastes time and effort.

To deal with the specific topics:

### **Trading stocks**

In this case, the relevant point was the application of section 35(5) under which any value used as the transfer price is acceptable provided that the trading stocks are to be used in the business of the new company. Many candidates seemed to know this but were often unable or unwilling to make the assumption that normal consequences would ensue and to make a positive statement. When it is given in the question that the partners run an electrical business and that they propose to transfer the business and assets to a new company, it can be

assumed in the absence of any other information that they intend to continue to run the business as a business of the new company.

#### **Trade debtors**

This part was well answered by most candidates.

#### **Short life assets**

Many candidates thought that this applied to small value assets which qualify for capital allowances (even if they have a life of more than two years). It does not. What it does apply to is assets which are dealt with on the replacement basis. Even when candidates recognised this and explained how the basis applies, they often did not see the possible pitfalls in transferring the assets at value and therefore came to the wrong conclusion about the value at which they should be transferred.

#### **Commercial vehicles**

This should have been straightforward but candidates often missed many of the seven marks available. Errors included:

- (i) Taking this to be a control transfer merely because the three partners were siblings. It is not and those who got this wrong were likely to get the rest of it wrong.
- (ii) Not saying that, by law, the disposal of an asset on which capital allowances have been claimed must be taken at the higher of the sale proceeds and the market value.
- (iii) Not stating that, whatever value was used to transfer assets on which capital allowances had been or could have been claimed, assets acquired by the partnership after the end of the previous basis period should be transferred at cost to avoid any loss of relief.

In too many cases, candidates also referred to the clawback of capital allowances on assets owned for less than two years. For the reason given under question 1(c) above this is not appropriate. In any case the application of the clawback is at the discretion of the Director General of Inland Revenue and it has been confirmed by the Inland Revenue Board (IRB) (in a dialogue with the professional bodies on 15 April 2002) that the clawback will only be applied to the disposal of luxury assets. Commercial vehicles are not luxury assets.

#### **Motor cars for the use of partners**

Much of what applies to the commercial vehicles also applies to these vehicles. Bearing in mind that this part accounted for eight marks, candidates were expected to refer to or repeat the common aspects such as the control transfer implications but often they did not. One difference is the restriction on qualifying capital expenditure for private motor cars and almost all candidates referred correctly to this. However many did not refer to the other crucial point, the fact that the expenses and capital allowances attributable to partners' private use of cars would cease to be restricted and instead the individuals as directors of a company would be assessed on a benefit in kind (usually) at scale rates.

#### **Freehold shop premises.**

There are no direct income tax implications and candidates were expected to say that. They were also expected to see a possible commercial or tax advantage in transferring this asset for a cash consideration left on loan rather than in exchange for shares. Instead many candidates, talked about real property gain tax and stamp duty neither of which are relevant because the requirement of the question was confined to the income tax implications.

#### **Question 3**

This was a straightforward question in two parts. Part (a) was about the derivation of business income and part (b) about the Malaysian transfer pricing guidelines. It was not the most popular of the optional questions.

Part (a) concerned Section 12 of the Act which covers the principles governing the derivation of business income. This section is of considerable importance, as are the other provisions dealing with derivation of income. They set out the ground rules which apply under Malaysia's own law in order to determine whether income is deemed to be derived from Malaysia or not. They should be known and understood by every student before considering the application of double tax agreements and transfer pricing rules. Unfortunately, this part was not well answered as most candidates are not familiar with these principles. Errors included:

- Discouraging on permanent establishment and whether any income was taxable in Malaysia. This was not necessary as the question specified that the company carried on a manufacturing operation in Malaysia.
- Talking about transfer pricing when it was obvious that this could not be relevant in relation to actual sales which were said to be made to 'non-related' customers.
- Dealing with the export of components to the branch overseas as a sale rather than as an export without sale

Part (b) was a simple test of candidates' knowledge of the basics of transfer pricing. Although some candidates were able to provide satisfactory answers, most answers were inadequate.

#### **Question 4**

This question, in two parts, was wholly on the topic of the exemption for MITCs (Malaysian International Trading Companies). It was without doubt the most popular optional question. It was also the one that most candidates got substantially, if not fully, correct. Part (b) was entirely computational.

Common mistakes were:

- Incorrectly or incompletely stating the conditions to be fulfilled by a company in order to qualify for the exemption or the items excluded from the meaning of export sales.
- Incorrectly applying the percentage determining the qualifying amount or the percentage limitation on deduction by reference to the amount of statutory income.
- Wrongly treating the whole of the qualifying amount (RM5,000) as relief to be given in the year of assessment 2007.

#### **Question 5**

Although not the most popular of the optional questions, this one was attempted by a good number of candidates. However, few provided satisfactory answers.

Part (a) tested candidates' knowledge of the penal provisions for non-disclosure of income. Those who attempted it often seemed to know the provisions but few were able to describe them fully and coherently. The question was broader than a mere test of knowledge. It required candidates to exercise their judgment in advising one of two brothers on the right course of action to take when the non-disclosure also involved his brother who had stated his intention to continue with the non-disclosure. Very few candidates rose to the challenge posed by this moral dilemma.

In part (b) candidates were asked to describe the extended meaning of 'Malaysia' which is relevant for determining the scope of income tax and petroleum income tax. It is obvious that few candidates know this statutory definition which is contained in section 2 of the Income Tax Act 1967. This question was set by way of introduction to the topic of petroleum income tax which is relatively new to the syllabus.

Part (c) was also set by way of introduction to a new topic, this time advance rulings of the Director General of Inland Revenue. Most answers relied more on guesswork than on real knowledge.