

Examiner's report

P6 Advanced Taxation (IRL)

June 2014

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General Comments

The examination consisted of two sections. Section A contained two compulsory questions, question 1 for 35 marks and question 2 for 25 marks. Section B comprised three further questions of 20 marks each, and candidates were required to answer any two of these.

The vast majority of candidates attempted four questions, and there was little evidence of time pressure. However, (as mentioned in a previous examiner's report) some unnecessary calculations were performed which wasted time. For example in question 3 (a)(i) only the additional taxes payable were required but many candidates still performed full income tax, PRSI and USC computations.

Where sections of questions were left unanswered by candidates, this appeared to be due to a lack of knowledge or poor exam technique, as opposed to time pressure.

Candidates performed well on question 4 (CAT). Otherwise the general standard of answers was not satisfactory. Many basic errors were made, including:

- Illegible handwriting and poor layout of answers.
- Allowing the CGT annual exemption against CAT.
- Allowing PAYE credit in the case of a sole trader.
- Giving relief at 52% where it is only available against income tax. (EIS and FED)
- Allowing the small gifts exemption against CAT on an inheritance.
- Overlooking the fact that directors' salaries are subject to income tax, PRSI and USC.

Specific Comments

Question One

This 35-mark question was based on the purchase of a business by Jane, aged 32, who had €1million to invest in a dress-shop business. The issues to be considered included: latent gains and then whether the shares or the assets of the business should be bought; the allowability of losses; the allowability of loan interest; and ultimately advising Jane on the most beneficial option.

Many candidates were not sufficiently prepared for this question.

Part (a)

Part (i) for 9 marks required candidates to explain the tax issues associated with option 1, buying the shares of Style Dublin Ltd.

Most candidates recognised that stamp duty applied at 1% and that VAT did not apply to the sale of shares. However, insufficient detail was given in relation to the anti-avoidance rules in relation to loss buying.

Many candidates recognised the latent gains in the company, but a significant number incorrectly suggested that CGT became payable immediately and was payable by Jane. Most candidates recognised the clawback of group relief issue. Some candidates (perhaps prompted by the information in the scenario that Jane had inherited money) performed unnecessary CAT computations, which were not asked for in the requirement.



Part (ii) for 6 marks required an explanation (with supporting calculations) of the tax issues associated with option 2; Jane buying the assets of Style Dublin Ltd and operating the business as a sole trader.

Stamp duty was generally well dealt with, but the option to transfer certain assets by delivery was overlooked by many. Most candidates recognised that the properties were “old” and that VAT would consequently not apply. Few candidates referred to the “transfer of an undertaking” exemption.

The effect on latent gains of purchasing the asset (i.e. purchaser gets full base cost in the assets) was generally overlooked by candidates. The seven year CGT relief was generally not referred to either.

Part (iii) for 2 marks required candidates to comment on the treatment of loan interest for income tax purposes under both options 1 and 2. In general, this was well-answered.

Part (iv) required a recommendation on whether option 1 or option 2 should be pursued. The standard of answer here followed the standard in earlier parts, although few candidates referred to non-tax issues (due- diligence etc.)

Four professional marks were available. Candidates generally used the correct letter format. However, there were many instances of unsatisfactory presentation (e.g. poor writing and “crooked lines” in calculations) which resulted in these marks not being optimised.

Part (b)

Eleven marks were available for proposing a tax efficient structure whereby a company under Jane’s control would buy the assets of Style Dublin Ltd. The general standard of answers here was not satisfactory.

Most candidates mentioned the double charge to CGT on holding assets in a company and also recommended that the premises be held personally. Pension planning was also mentioned by most candidates.

However, many candidates gave details of incorporation relief (which was irrelevant) and/or retirement relief (not relevant to Jane aged 32). The holding company exemption and the seven year CGT exemption were overlooked by most candidates.

Question Two

This question dealt with a revenue audit for a business in the takeaway food sector. The main issues addressed in the question (cash wages paid from the till and under-declaration of sales) are common issues in the audit of “cash” businesses.

Part (a) for 2 marks required candidates to list the books and records that are required to be kept by a business and the required period of retention. Most candidates correctly mentioned the six year retention period but omitted to mention certain records, in particular the linking documents.

Part (b) for 5 marks required candidates to state their strategy for minimising penalties and explain the requirements of the strategy and its benefits. Most candidates mentioned a prompted qualifying disclosure. However, the importance of cooperation was omitted from many answers.

Part (c) required candidates to calculate the under-declaration of sales. Many candidates calculated the correct sales using the industry average, but did not calculate the VAT under-declared. With regards to Mary’s lifestyle, most candidates compared €66,000 of expenditure with drawings of €26,000 but did not consider the implications of Tim’s wages and the proceeds from the sale of shares.

Part (d) for 14 marks required a calculation of the tax underpayments and penalties arising together with an explanation of the penalty categories.

As explained above, many candidates did not consider the VAT underpayment arising on sales. In general the net wages paid to Tim were not re-grossed as required and in many cases the employer's PRSI was also omitted.

The VAT overclaimed on electricity was generally well dealt with.

The CGT computation was generally not well dealt with and candidates did not treat the bonus shares correctly.

The income tax implications of the under-declared sales was not well dealt with and most candidates did not recognise the effect of additional wages and VAT overclaimed.

There were many mistakes made in calculating the quantum of penalty, often in relation to the correct percentage of the penalty. In addition, some candidates calculated the penalty as a percentage of the income itself rather than on the tax due on the income. Many candidates incorrectly applied 20% penalties to the underdeclaration of sales and the payroll offence, both of which were clearly deliberate behaviour.

Question Three

Part (a) of the question was for a total of 12 marks and required candidates to prepare calculations for veterinary surgeon comparing the taxes payable as a sole trader to that of a company, in a scenario where profits were rising. Issues arising included pension planning and the close company surcharge. This question was the least popular choice for candidates.

As mentioned above, despite being told that full income tax computations were not required, many candidates wasted time in preparing full computations rather simply taxing the additional income based on the information provided.

In part (i), common errors included failure to recognise that capital allowances are deducted in arriving at net relevant earnings and also failure to recognise that pensions do not relieve PRSI or USC.

In part (ii) many candidates omitted the close company surcharge when calculating the company's position.

In part (iii) the company pension aspects were generally well dealt with.

In part (iv) the summary and recommendations were generally well dealt with.

Part (b) of the question was for a total of 8 marks and required candidates to list the required conditions of EIS relief and to apply the relief to a specific scenario. This was generally well answered. However, some common mistakes included:

- Not recognising EIS as a specified relief and
- Not recognising that EIS relief only applies to income tax and not PRSI and USC.

Question Four

This 20-mark question was generally well answered and it was clear that candidates had worked hard in this area.

In part (a), most candidates performed the agricultural relief calculations correctly. However, in many cases the non-business assets were not correctly dealt with in the calculation of business property relief. Some errors were made in relation to the investment property and the use of the relevant age factor, and candidates are referred to

the published solution in this regard.

In part (b), most candidates identified the clawback of business property relief in relation to the sale of shares by Eva. However, the potential CGT exposures were not referred to.

In part (c), the clawback of agricultural relief in relation to farmhouse was generally dealt with correctly. However, many candidates suggested that all agricultural relief should be clawed back, as Kenneth would not be a farmer at the date of sale, without the farmhouse included in his assets. This is not correct because the beneficiary is only required to pass the 80% test at the valuation date of the gift/inheritance.

Many candidates omitted to mention the income tax implications of the rental income.

Question Five

Part (a) of the question was for 9 marks and required candidates to explain how to implement a group structure to optimise loss relief while availing of share for share reliefs in relation to CGT and stamp duty.

In general the question was answered well. However, often details were omitted in relation to the conditions for the relevant reliefs (e.g. the 90% shareholding requirement for the stamp duty relief, and the requirement to have a 75% shareholding relationship to avail of group relief on losses).

Part (b) of the question was for 5 marks and related to VAT. Candidates generally referred to the s56 relief, but many did not adequately explain the issues involved in forming a VAT group.

Part (c) of the question related to the foreign earnings deduction (FED) and was generally well answered. However, common errors included not recognising that the FED did not relieve PRSI and USC and incorrectly including the BIK in the remuneration figure in the formula.