

# Examiner's report

P6 Advanced Taxation (UK)

December 2014



## General Comments

The overall standard in the December 2014 exam was not as good as one would have hoped.

The exam was in its standard format; section A consisting of the compulsory questions 1 and 2, worth 35 marks and 25 marks respectively, and section B where candidates were required to answer two out of the three questions worth 20 marks each. Question 3 was the most popular optional question in section B.

In general terms, those candidates who did not perform as well as they could were not sufficiently strong in the following areas:

- They did not do sufficiently well in questions 1 and/or 2 indicating a lack of practise of Section A style questions and, often, a lack of knowledge of the unincorporated trader and income tax.
- They did not spend sufficient time thinking before they started writing. This meant that they did not give themselves the chance to identify the issues that needed to be addressed and they were therefore unable to earn sufficient marks.
- They wasted time providing information that had not been asked for.
- They did not attempt every part of four questions.
- They did not have sufficient, precise knowledge of the tax rules required by the syllabus.

Candidates should pay particular attention to the following advice in order to maximise their chances of success in the exam in the future.

1. Know your stuff
  - Successful candidates are able to demonstrate sufficient, precise knowledge of the UK tax system.
  - This knowledge must be up-to-date. Candidates must familiarise themselves with the changes introduced by the recent Finance Acts as summarised in the Finance Act articles published on the ACCA website.
2. Practise questions from past exams with the aim of adopting the style of the model answers. In particular, candidates should practise the often more intellectually demanding Section A style questions.
3. Address the requirement
  - Read the requirement carefully – in the Section A questions the detailed tasks that you are to perform will be set out in one of the documents. It may be helpful to tick off the tasks as you address them. Marks are awarded for satisfying the requirements and not for other information even if it is technically correct.
  - The requirements of each question are carefully worded in order to provide you with guidance as regards the style and content of your answers. You should note the verbs used (calculate, explain etc), any matters which are not to be covered, and the precise issues you have been asked to address.
  - You should also note any guidance given in the question or in any notes following the requirement regarding the approach you should take when answering the question.
  - Pay attention to the number of marks available – this provides you with a clear indication of the amount of time you should spend on each question part.
4. Don't provide general explanations or long introductions.
  - If you are asked to calculate, there is no need to explain what you are going to do before you do it; just get on with it – only provide explanations when you are asked to.
  - Think before you write. Then write whatever is necessary to satisfy the requirement.
  - Apply your knowledge to the facts by reference to the requirement.
5. Think before you start and manage your time
  - Ensure that you allow the correct amount of time for each question.



- Before you start writing, think about the issues and identify all of the points you intend to address and/or any strategy you intend to adopt to satisfy the requirement.

If you are preparing to resit the exam, think about the number of additional marks you need to obtain and identify a strategy to earn them. For example:

- Identify those areas of the syllabus where you are weakest and work to improve your knowledge in those areas.
- Practise past exam questions in order to familiarise yourself with the style of questions with which you will have to deal.
- Ask yourself whether you could improve the way you manage your time in the exam and whether you address all of the parts of all four questions or whether you waste time addressing issues which have not been asked to consider.
- Make sure that you earn the professional skills marks and that you are prepared to address the ethical issues that may be examined.

#### **Marks available in respect of professional skills**

Marks were available for professional skills in question 1. In order to earn these marks candidates had to demonstrate a professionally acceptable standard of layout and presentation, provide explanations and calculations that were clear and logical and a sensible comparison of the loss strategies. On the whole, the performance of candidates in this area was reasonably satisfactory with the majority of candidates producing a document in a style that was easy to follow.

#### **Specific Comments**

##### **Question One**

Question 1 concerned various aspects of personal taxation and VAT in relation to an unincorporated trader and was in four main parts.

Part (a) concerned the individual's capital transaction and was in two parts. Both parts were answered reasonably well but it felt as though many candidates spent too much time on them. This may have been because it was the first question and thus time may not have appeared to be such a pressing issue. However, of course, any overruns on this part would still have caused candidates to run out of time later on in the exam.

Part (a) was only worth 8 marks in total and so should have been completed in less than 15 minutes, but some candidates found the time to explain the meaning of potentially exempt transfers, the manner in which they are taxed and the other exemptions that may be available rather than simply addressing the requirements of this particular question part.

Candidates will always benefit from answering the specific requirements of the question and from not digressing into other, irrelevant, areas.

Part (i) related to inheritance tax and concerned the small gifts exemption and potentially exempt transfers. Candidates' knowledge in this area was satisfactory. The only common error was the failure to identify the fall in value of the donor's estate as a result of the gift.

Part (ii) related to capital gains tax and concerned the disposal of a piece of land in two stages. The key issue here was the A/A+B calculation of the cost in respect of the first disposal. The majority of candidates knew that such a calculation was necessary but many did not know exactly how to perform it. In addition, a minority of candidates failed to recognise that the base cost of the whole of the land was its value at the time of the uncle's death.

Part (b) concerned the relief available in respect of the trading loss incurred and the payment of tax under self-assessment. It was in two parts.

Part (i) related to the trading loss and required candidates to calculate the tax which would be saved in respect of the offset of the trading loss depending on how the loss was relieved. This part of the question was not tackled particularly well. Many candidates did not know the rules for the offset of trading losses well enough and were unable to determine an approach to answer the question efficiently. As always, it was necessary to think first and decide how to approach the question in order to prepare the required answer.

With trading losses there are two main things that candidates need to know; 1) what the losses can be offset against and 2) when. Many candidates did not possess this precise knowledge and others treated the individual taxpayer as a company or made other fundamental errors.

Many candidates also failed to make use of the information in the question. In particular, the tax liability for the tax year 2013/14 was given in the question but many candidates calculated it themselves, thus wasting time. A final problem was that some candidates were unwilling to commit themselves to an answer, such that they described some of the issues but did not prepare calculations. This made it difficult for them to score particularly well.

Part (ii) concerned payments on account under self-assessment and was not done well. The question required candidates to have a precise knowledge of the manner in which payments of tax under self-assessment are determined and to be able to apply those rules in a chronological manner to the facts of the question and the three tax years concerned.

Many candidates had an awareness of the rules but their knowledge was somewhat vague and confused, such that they were unable to apply it to the facts. Some candidates tried to describe the system but this did not satisfy the requirement. Other candidates presented their answers in confusing ways without explaining which tax year and/or which payments they were referring to.

For a candidate who knew the rules, this part of the question was not particularly challenging, although it did require thought and care. Unfortunately, very few candidates had sufficient precise knowledge to produce an acceptable answer.

Part (c) concerned the ethical issues relating to the non-reporting of chargeable gains by a client. This part was answered well by the majority of candidates. However, the problem here was that many candidates wrote far too much. There were only four marks available, so four decent sentences were sufficient, yet many candidates wrote the best part of a page. Candidates should think before they write and decide on the points they intend to make. They should then make each point concisely, and they should make it only once.

Part (d) concerned VAT registration and the recovery of pre-registration input tax. Answers to this part of the question were generally satisfactory .

Candidates' knowledge of the rules regarding VAT registration was generally sound, although some candidates displayed a tendency to write generally rather than to address the specifics of the question. In addition, candidates need to take care to be precise in their use of language and terminology. The historic test relates to supplies in the 'previous 12 months', and not the sales of 'the trading period', and HMRC must be notified 'within 30 days' as opposed to 'within a month'.

Candidates' knowledge of the rules regarding the recovery of pre-registration input tax was not as strong as that relating to registration but was still generally of an acceptable standard.

## Question Two

Question 2 concerned a group of companies and included various aspects of capital allowances, loss relief, rollover relief and the patent box regime together with the VAT capital goods scheme. The question was in three parts.

Part (a) required candidates to calculate the corporation tax liability of a company for a six-month accounting period and to include notes on various aspects of the computation.

Almost all candidates identified that they were dealing with a six-month accounting period, but many of them did not recognise all of the areas where this point was relevant, ie the annual investment allowance, the rate of writing down allowance, and the corporation tax limits. Other than that, the corporation tax computation was done well with the exception of a minority of candidates who, having identified that the company's profits in their computation was between the limits, calculated corporation tax at the rate of 23.75% (the marginal rate) rather than at the main rate with a deduction for marginal relief. The marginal rate of tax only applies to those profits between the limits.

It was stated in the question that the required notes represented approximately two thirds of the marks available and it was pleasing that most candidates picked up on this guidance and addressed all three areas on which notes were required in various levels of detail.

The capital allowances were handled reasonably well with most candidates recognising the mistake the client had made. However, many candidates did not recognise that the expenditure that did not qualify for the additional investment allowance would qualify for writing down allowances. Of those that did, many forgot to reduce the rate of the writing down allowance by 6/12 to reflect the length of the accounting period.

The use of the company's brought forward trading losses required candidates to consider two matters. First, had the company changed its trade? If it had, the losses brought forward could not be used in the future. Secondly, because there had been a change in ownership of the company, it was necessary to consider if there had been a major change in the nature or conduct of the trade. The company's trade continued to be the baking and selling of bread and baked products. However, the changes made to its products and customers were likely to represent a major change in the nature or conduct of the trade, such that the losses could not be carried forward beyond the date of the change of ownership of the company.

The third area of explanatory notes concerned rollover relief. In order to score well here, candidates had to first be aware of the meaning of a qualifying business asset for the purposes of rollover relief and the qualifying period for reinvestment. Qualifying business assets include land and buildings and **fixed** plant and machinery used in the business. Most candidates were not sufficiently clear on these rules. The qualifying time period was identified by the majority of candidates.

Candidates then had to consider the chargeable gains group aspects of rollover relief. A sizable minority of candidates did not consider this aspect and, of those who did, a minority thought that Madison Ltd, a 65% subsidiary, was a member of the gains group because the holding was more than 50%. However, the direct holding between each company in the group has to be at least 75%; it is any indirect holding between the principal company and a non-directly held subsidiary that has to be more than 50%.

Finally, candidates had to point out that only part of the gain can be rolled over if only part of the sales proceeds are reinvested in qualifying replacement assets. Although many candidates were aware of this point, not all of them were able to calculate the amount of gain that could be rolled over given a specific level of reinvestment in the question.



Part (b) required candidates to write briefly about the patent box regime. This regime was introduced in Finance Act 2013 and so is fairly new. This aspect of the question was mainly knowledge-based.

A minority of candidates were not aware of the regime and consequently did not score well. Those who knew about the regime scored well provided they took care to address the requirement and made separately identifiable points rather than repeating themselves. As always, time spent identifying relevant points before putting pen to paper was time well-spent.

Part (c) concerned the VAT capital goods scheme. Despite this being examined regularly, it was not tackled particularly well. Many candidates thought, incorrectly, that the scheme applies to plant and machinery generally. The way in which the scheme operates was also misunderstood by many candidates who were unable to explain the adjustments that would be made in future years. This aspect of VAT is not part of the Paper F6 (UK) syllabus and thus is new knowledge at P6 (UK). It should be regarded as an area that is likely to continue to be examined regularly in future Paper P6 (UK) exams.

### **Question Three**

This question concerned capital gains tax and inheritance tax planning in respect of an individual who had died. It was in four main parts.

Part (a) required candidates to explain the inheritance tax advantages that would have arisen if the deceased had made additional lifetime gifts.

The first thing to note here was that this part of the question concerned inheritance tax and not capital gains tax. The question also stated that candidates should not consider lifetime exemptions, for example the annual exemption. Many candidates did not identify these important points and thus wrote about both of these areas rather than focussing on the question requirements.

In addition, many candidates wrote at length about business property relief. This was not relevant because business property relief is available in respect of both lifetime gifts and the death estate and thus additional lifetime gifts by the deceased would not have resulted in additional relief. Other candidates were of the opinion that lifetime gifts will reduce the value of the death estate (true) and therefore reduce the inheritance tax due on death (not necessarily true). These candidates had failed to recognise the inheritance tax due in respect of potentially exempt transfers in the seven years prior to death (which these transfers inevitably would be due to the facts of the question).

Most candidates would have benefited from reading the question more carefully (and, for example, ignoring the annual exemption) and thinking more (thus recognising that business property relief was not relevant) and then writing a shorter answer that may very well have scored more marks.

Having said that, the majority of candidates correctly identified taper relief as an advantage of lifetime gifts and many explained the concept of value freezing. However, very few candidates were able to explain fall in value relief correctly.

Part (b) required candidates to calculate the increase in the legacy to charity that would be necessary for the reduced rate of inheritance tax to apply. Candidates appeared to be well-prepared for a question on this area of the syllabus and this part was answered particularly well with the exception of a very small minority who were simply not aware of the new rules regarding the 36% rate of tax.



Part (c) concerned the inheritance and capital gains tax advantages of varying the terms of the taxpayer's will and the procedures necessary to achieve a valid variation.

The tax advantages are not obscure, but they do require some thought and they are not particularly easy to explain. Candidates would have benefited from slowing down and thinking about how best to express what they wanted to say rather than writing in the hope that the necessary words would eventually appear on the page.

As always, candidates had to apply their knowledge to the facts in the question. As far as capital gains tax was concerned, many candidates knew that there was no capital gains tax on death but failed to think about the potentially undesirable implication of the proposed gift of the house and how that implication could be avoided. In respect of inheritance tax, many candidates saw that this was linked to generation skipping but mentioning the term 'generation skipping' was not in itself sufficient. Candidates had to explain that the variation would avoid the need for Raymer to make a potentially exempt transfer and therefore removed the possibility of such a transfer being chargeable to inheritance tax in the event that Raymer died within seven years of making the gift.

The majority of candidates were able to explain the procedures necessary in order to achieve a valid variation of the terms of the will.

Part (d) was slightly more challenging and was, again, based on the specific facts of the question. It concerned capital gains tax and the beneficial actions that could have been taken in respect of the individual's shareholdings.

Many candidates were unsure of the answer to this question despite having sufficient knowledge to deal with it. Unfortunately, instead of calmly thinking about it, they wrote about various aspects of capital gains tax, and inheritance tax, until they ran out of time. In particular, many candidates wrote about using any unused annual exempt amount despite being told in the question that the individual paid capital gains tax every year.

The key issue here was that, because there is no capital gains tax on death, any unrealised losses in respect of shares worth less than cost are lost. Candidates simply had to point out, for example, that the quoted shares that were valued at less than cost at the time of death should have been sold prior to death in order to realise a loss that could then have been offset against chargeable gains.

#### **Question Four**

This question concerned two aspects of income tax: change of accounting date and residency and the remittance basis. It was in two main parts.

Part (a) required candidates to perform calculations in relation to a change of accounting date and to write about the advantages of choosing a particular date. It was in three parts.

The calculations in parts (i) and (ii) would have been straight forward for those candidates who knew the rules and had practised applying them. Unfortunately, most candidates who attempted this question did not know the rules, such that very few scored well on these parts of the question.

Part (iii) required candidates to identify two advantages of using a 30 April year end as opposed to a year end of 28 February. Many candidates were able to identify one advantage but few were able to come up with two. This was disappointing as the choice of year end is a basic aspect of tax planning for the unincorporated trader and one that candidates should be confident of.

Candidates should recognise that change of accounting date is not part of the Paper F6 (UK) syllabus and must therefore be regarded as an area that will be examined regularly in future Paper P6 (UK) exams.



The second part of the question concerned residency and the remittance basis and was in two parts.

Part (i) required candidates to explain certain aspects of an individual's residency position by reference to the facts provided in the question. Candidates' appeared to be well-prepared for a question on this area of the syllabus with good levels of knowledge.

However, it was important for candidates to realise that this was a question that required their knowledge to be applied to the specific facts and that it was not enough to simply set down everything they knew on the topic. For example, candidates should have realised that, depending on the number of days spent in the UK (which was left imprecise in the question) the relevant number of ties was either two or three. Then, it was not sufficient to list the ties, it was necessary to state whether or not they were met by the individual concerned. It was then good exam technique to draw the various aspects of the explanation together into a form of summary or conclusion.

The other common mistake made by candidates when answering this question was to include irrelevant information in their answers. A significant number of candidates explained the automatic UK residency tests despite the wording of the requirement. Such explanations would not have scored any marks as they were irrelevant to the requirement and thus such candidates put themselves under unnecessary time pressure as a result.

Part (ii), the final part of the question, concerned the remittance basis. This was answered well by many candidates. There were only two matters to note here. Firstly, some candidates' knowledge of the rules governing the remittance basis charge was somewhat imprecise. Secondly, a minority of candidates set out the rules but did not apply them to the individual concerned.

### Question Five

This question concerned the filing of corporation tax returns, tax-efficient share schemes and controlled foreign companies. It was in three main parts.

Part (a) concerned a company with a long period of account. Candidates were required to state when any corporation tax returns needed to be filed and explain any penalties for late filing.

The first thing candidates had to point out was the need to split the long period of account into two accounting periods. Unfortunately, many candidates failed to identify this point. Candidates then had to know the filing dates and the penalty rules. However, many candidates wrote about the dates on which corporation tax has to be paid as opposed to the filing dates of the returns, such that they did not answer the requirement set.

Part (b) of the question was more substantial. It required a comparison of two approved share schemes: a share incentive plan and a share option scheme, by reference to certain specified areas.

It was very important to identify clearly the particular areas that needed to be addressed, and to stick to them. Failure to do this could result in irrelevant parts of an answer that would score no marks, despite being technically accurate. Unfortunately many candidates were insufficiently disciplined in their approach and regarded the question as being about the two share schemes generally as opposed to being about *certain aspects* of the two schemes.

Generally, candidates' knowledge of this area was good with many candidates providing satisfactory answers. The candidates who did best were those who structured their answer in a very clear manner so that it was always clear which *aspect* of which *scheme* was being addressed. This clear structure enabled candidates to keep their answers relatively brief whilst addressing all of the precise requirements of the question.



However, a minority of candidates appeared to be making up their answer as they went along, such that they were setting out each thought as it occurred to them. The problem with this approach was that some points were repeated, other points were made which were not relevant and some aspects of the requirement were omitted altogether.

Most candidates knew that under a share incentive plan, shares need to be offered to, broadly, all employees whereas, under a company share option plan, the employer can choose certain employees to join the scheme. Candidates' knowledge of the number or value of shares that could be offered under each scheme was also satisfactory notwithstanding that some candidates confused the two schemes or confused the different categories of shares that can be offered under a share incentive plan.

When it came to the tax implications of acquiring and selling the shares it was important for candidates to stick to the facts of the question. It was clear from the question how long the shares would be held for and when they would be sold. Accordingly, there was no need to address all of the different tax implications that could occur if the shares were sold at other times. Candidates who failed to realise this wasted time writing lengthy answers that were not addressing the requirements of the question.

When explaining the tax implications, stronger candidates were clear as to which scheme they were writing about and which tax (income tax or capital gains tax) they were addressing. The answers of other candidates were more confused and used the general term 'tax' as opposed to the specific tax concerned.

The final part of the question concerned controlled foreign companies and was in two parts.

The first part required candidates to explain whether or not the company concerned was a controlled foreign company and to consider the availability of the low profits exemption. This part was done reasonably well by many candidates.

Candidates had two main problems when answering this first part of the question. First, they confused the definition of a controlled foreign company with the exemptions that are available. Secondly, there was a tendency to write about all of the available exemptions as opposed to the particular one in the question requirement; this resulted in irrelevant parts of answers.

Part (c)(ii) required a calculation of a controlled foreign company charge. Candidates had to remember to exclude the gains from the calculation, bring in only 30% of the trading profits, and deduct an appropriate amount of creditable tax. Answers here were generally not as accurate as might have been hoped.