

Examiner's report

P6 Advanced Taxation (UK)

March 2016

The ACCA logo consists of the letters 'ACCA' in a white, bold, sans-serif font, centered within a solid black square.

General Comments

The overall standard in the March 2016 exam was fairly satisfactory.

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.

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

- They did not spend sufficient time carefully reading the question and thinking before they started writing. This meant that they failed to address the question from the required angle, produced an unstructured answer which tended to lead to unnecessary repetition, or omitted part of the requirements.
- They did not attempt every part of four questions.
- They did not have sufficient, precise knowledge of the tax rules within the syllabus, particularly some of the more fundamental rules brought forward from the F6 (UK) syllabus.

It was particularly noted that a considerable number of candidates wasted time providing information that had not been asked for. In particular, providing detailed explanations where none were required, or (to a lesser degree), providing calculations when explanations were asked for.

Candidates should pay particular attention to the following 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 includes knowledge brought forward from the F6 syllabus, which remains very important.
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
 - 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 pay particular attention to the command words (calculate, explain etc), any matters which are not to be covered, and the precise issues you have been asked to address.**
 - 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.
 - 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/provide calculations, without any mention in the requirement of supporting explanations, inclusion of such explanations will not gain marks, but will probably waste time— 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. Remember that at P6 you will be asked to apply your knowledge, rather than just reproduce information you have learned.
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 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. This should include any technical areas brought forward from F6 where necessary.
- Practise past exam questions in order to familiarise yourself with the style of questions that you will have to deal with.
- 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 for.
- 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 style and presentation, provide calculations and explanations that were clear and logical and demonstrate effective communication skills. 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 and appropriately written.

Specific Comments

Question 1

Question 1 concerned the acquisition of overseas businesses as, alternatively, branches or subsidiaries. There was also a requirement to consider the value added tax (VAT) treatment of purchasing goods and services from overseas suppliers, and to explain the tax implications of a transfer of trade and assets between members of a 75% group.

Part (a), which was in two parts, related to the acquisition of two overseas businesses. The first of these parts required candidates to calculate the UK company's corporation tax liability for an accounting period under the alternative assumptions that an election to exempt overseas permanent establishments was, or wasn't made. Most candidates made a reasonable attempt at this, but a very significant proportion also included detailed explanations to accompany these calculations, despite these clearly not being required. Accordingly these candidates wasted time, which could have beneficially been spent elsewhere. Candidates would be advised to double check what is required by each question before making a start. There were a good number of easy marks here for producing corporation tax computations, which most candidates achieved, but

again, a significant number wasted time in identifying that the company was entitled to marginal relief in calculating its corporation tax liability, despite being told in the question that the company paid tax at the main rate. If a question states that a company pays tax at a certain rate, candidates should accept that the conditions must be satisfied, and not waste time considering them. Most candidates were able to state the factors to be considered by the UK company in deciding whether or not to make the election, which was clearly a question they were prepared for.

The second part of part (a) concerned the operation of the overseas businesses as subsidiaries of the UK company, and consideration of the potential application of the controlled foreign company (CFC) legislation. Performance on this part of the question was mixed. Very few candidates questioned the residence status of the overseas located subsidiaries, although this was deliberately left open to question. A high number of candidates thought that any dividends received from a subsidiary overseas would be taxable, or included in franked investment income, neither of which is true. Although many candidates were aware of the consequences of a company being a CFC, only a minority were able to actually provide the reasons required as to why the profits of these companies were unlikely to be subject to the legislation, and so failed to address the specific question set.

Part (b) of this question related to the value added tax (VAT) implications of UK VAT registered companies obtaining goods and services from overseas VAT registered suppliers. The requirements for payment of and accounting for output VAT were different in each case due to the fact that the supplier of goods was situated in a non-European Union (EU) country, but the supplier of services was situated in a EU country. Very few candidates demonstrated accurate knowledge here. Several candidates appeared to confuse output and input VAT, which are fundamental terms which must be learned and applied correctly. A number of candidates considered that one or both types of import would be exempt or outside the scope of VAT due to the fact that the supplier is located overseas. Overseas aspects of VAT are very important at P6, as are overseas aspects of all taxes which are included in the P6 syllabus.

Part (c) of this question concerned the transfer of trade and assets between two UK resident 75% subsidiaries of a UK resident parent company. Candidates' performance on this part of the question was not satisfactory with many candidates making only a very brief attempt at it, despite the fact that it was worth 8 marks. The transfer comprised a number of commonly tested assets, such as goodwill, a building, and equipment. The transfer of such assets between companies has been tested many times in the past. The majority of candidates recognised the group relationship between the two companies, and the fact that chargeable assets would be transferred at no gain, no loss, but didn't appear to be aware of the consequences for the transfer of goodwill or for assets subject to capital allowances or stamp duty land tax. The small minority of candidates who performed well on this part had a good knowledge of the subject, adopted a sensible, logical approach and addressed each of the issues briefly in turn.

Group aspects of corporation tax are a key area at P6 and candidates should endeavour to practise a wide range of questions on these to ensure that they are confident in dealing with different aspects of this area.

Question 2

Question 2 required the correction of a number of errors relating to the income tax, capital gains tax and inheritance tax liabilities for a married couple. There was also a requirement to briefly discuss the factors HM Revenue and Customs (HMRC) will take into account in determining any penalties due in respect of these errors, and finally to summarise the information required and action to be taken before becoming tax advisers to the couple.

Part (a)(i) of this question required candidates to calculate the effect of correcting four errors which had been identified in relation to the information provided on a married couple's tax returns. It was pleasing to see that the majority of candidates were able to identify the error in most of the four cases and to calculate the impact on the relevant individual's tax liability as a result. However, as in question 1, a good number of candidates provided unnecessary explanations, ignoring the instruction to include explanations in respect of error 3 and error 4 only, and providing detailed explanations of the first two errors as well, once again wasting valuable exam time. It is very important for candidates to fully read through the requirements before starting to write, to try and avoid this issue.

The two most common errors in this part of the question were:

- (i) Failure to recognise that income from a jointly owned asset is split 50:50 between spouses, unless it is beneficial for them to make an election for it to be split according to their actual interest in the asset, which was not the case here.
- (ii) Failure to identify the possibility of offsetting a capital loss on the disposal of unquoted trading company shares against general income, as well as capital gains.

Overall, the majority of candidates performed well on this part of the question.

In part (a)(ii) candidates were required to explain the factors which HMRC will take into account in determining any penalties due in respect of the incorrect returns. The majority of candidates were able to identify that the taxpayers' behaviour was relevant – whether the errors were made carelessly, deliberately etc – but then went on to give examples of the different level of penalty in each case, rather than stating additional factors such as disclosure by the taxpayer and whether this is prompted or unprompted. This part was only worth 3 marks, and it was pleasing to see that most candidates produced a suitably brief answer.

Part (b) required candidates to summarise the information required and action to be taken before agreeing to become tax advisers to the couple. This is a frequently tested area of ethics, but it wasn't answered as well as might have been expected in many cases. Many candidates appeared to have been put off, perhaps, by the focus in the previous parts of the question on the earlier problems with these potential clients. While this was relevant to the scenario, the majority of the marks were available for discussing routine procedures which the firm would be expected to undertake before taking on any new client. Candidates must expect that ethical issues will be tested in a wide variety of different scenarios in this paper.

Question 3

This question concerned the capital gains tax implications of two disposals, the inheritance reliefs available on a taxpayer's death and the application of the personal service company (IR35) legislation).

Part (a) required candidates to calculate the after-tax proceeds from two capital gains tax disposals.

Questions at P6 frequently ask for a calculation of after-tax proceeds – here, the amount of proceeds remaining after the payment of capital gains tax. Candidates need to think more carefully about the starting point for this type of calculation. Failure to identify the correct starting point is a common error, with many candidates in this case deducting the tax from the taxable gain, rather than the sale proceeds, which they have used at the start of the computation.

Very few candidates proved able to calculate the capital gain arising on receipt of insurance proceeds for a damaged asset where no repair was undertaken. Similarly, many missed the implications of the previous gift relief claim when calculating the gain on disposal of quoted company shares. Candidates should expect to have to deal with some of the trickier aspects of the calculation of individual gains at this level, and should therefore ensure that they practise a sufficient number of these.

The requirements for part (b)(i) stated the inheritance tax reliefs to be considered in respect of the assets in the taxpayer's estate on death. Candidates demonstrated good knowledge of the availability and operation of agricultural property relief. Business property relief, despite being examined far more frequently, was handled less well, with many candidates omitting to consider it in relation to the farmland, and believing that it is available to a minority shareholder in a quoted company. Many candidates were able to identify the ability to take quick succession relief in the given scenario, but very few were able to provide the formula for calculating it. Precise knowledge of these reliefs, when they are available, and how they are calculated is essential at P6.

Part (b)(ii) required an explanation, with supporting calculations, of the impact on the inheritance tax arising on the taxpayer's death estate if his death occurred four months later than originally assumed. An ability to recognise the relevance of the timing of events or transactions in respect of all taxes is an important skill at P6. The key point here was that the lifetime gift would no longer be accumulated as it was made more than seven years prior to death, thereby leaving the full nil rate band for use against the death estate. It was pleasing to see that many candidates recognised this point, providing concise explanations to score the full 3 marks. However, a significant number provided comprehensive calculations of the death estate, often with no explanation at all, making it difficult to demonstrate understanding of the requirement and consequently to score marks. Once again this highlights the need to read the wording of the requirement very carefully to ensure that the correct approach is taken.

Part (c) was concerned with the application of the personal service company (IR35) legislation. It was generally not well attempted by many candidates, despite having been examined in a similar way on previous occasions. It remains an important topic within the P6 syllabus.

Question 4

This question was concerned with the tax treatment for an individual shareholder of the sale of some shares back to the company, and the corporation tax and VAT implications for the company of acquiring the business of an unconnected partnership.

Part (a)(i) of this question focused on the requirement for the sale of shares by an individual shareholder to the company to result in a 'substantial reduction' in their shareholding in order to receive capital treatment on the disposal. Unfortunately it would appear that this is an aspect of a

company purchasing its own shares which many candidates are not comfortable with. A small number of candidates just reproduced the conditions to be satisfied in order to obtain capital treatment, which was not required and so scored no marks. Of those candidates who did try to answer this part of the question, the most common mistake was to forget that when a company repurchases shares from a shareholder, the shares are cancelled so that the total issued share capital of the company is reduced as a consequence.

Part (a)(ii) of this question required the calculation of after-tax proceeds on the disposal of two alternative numbers of shares from a shareholding, one of which did qualify for capital treatment and one of which didn't. This information was given in the requirements. In spite of this, a lack of technical knowledge or inadequate reading of the question meant that a significant number of candidates did not apply this and treated both disposals as giving rise to chargeable gains, rather than correctly treating one of them as a distribution. Additionally, many candidates failed to recognise that the disposal which attracted capital treatment would also qualify for entrepreneurs' relief. In any question regarding the disposal of shares by an individual, candidates should automatically consider the application of entrepreneurs' relief. This is an area where it is very important to know the precise conditions, to be able to state definitively whether or not the relief applies, and the reasons why, or why not. Candidates who went on to calculate the after-tax proceeds generally identified the correct starting point on this occasion, which was pleasing.

Part (b)(i) concerned the tax deductions available to a company on the acquisition of an intangible asset. There were very few good answers to this part of the question. Intangible assets are examined frequently at P6, so candidates need to be aware of their tax treatment as trading assets, rather than capital assets, for companies, and the consequential tax treatment of these for corporation tax purposes.

Part (b)(ii) required candidates to explain how the company could get tax relief for a loss incurred by a recently acquired trade. Several candidates incorrectly discussed group relief here. This was not the acquisition of shares in a company, which would have created a group, but the acquisition of trade and assets from a partnership. The two situations are completely different, and candidates must take care to ensure that they read and interpret the facts in this type of question correctly. It appeared that many candidates would have benefited from pausing and thinking more before they started to write. It is important in any question dealing with relief for losses that a well-considered and logical approach is taken. Well-prepared candidates were able to identify that at least part of the trading loss would have to be carried forward, relief for which would be restricted to profits from the same trade, and discussed the relevance of proposed changes to the trade in this context.

Part (c) required an explanation of the VAT implications of the acquisition of the business and additional information needed to fully clarify the VAT position in relation to a building. The majority of candidates were able to identify that the transaction would not be liable to VAT as it concerned the transfer of a going concern. Candidates who performed less well on this part, however, then went on to explain why the going concern rules applied, stating all the conditions, but reasons **why** a particular treatment applies aren't required in a discussion of the VAT implications of that treatment. The VAT rules relating to property are very frequently tested at P6 and it was good to see that the majority of candidates were aware of the main facts here in relation to the age of the building and the existence, or otherwise of an option to tax.

Question 5

This question concerned various aspects of one individual joining with another in a business partnership, and also a calculation of the individual's income tax liability for a tax year, including a comprehensive redundancy package.

Part (a)(i) required an explanation of the tax deductions available in respect of interest on two loans; The new partner took out a personal loan, which qualified for income tax relief in her personal tax computation, and she used this to make a loan to the partnership, which qualified for tax relief in the computation of the partnership's taxable trading profit. A good number of candidates produced rather muddled answers to this part, not making it clear which of the loans they were referring to in their explanations or supporting calculations, and therefore potentially not attracting as many marks as they could have done. The adoption of a logical approach in this sort of question requiring a discussion of two very similar issues can save considerable confusion and avoid wasting time. Candidates should pause and think before they start writing. Dealing fully with the implications of one of the loans first, and then the other, tended to provide a much clearer answer than those who adopted something of a random approach, apparently writing points as they occurred to them, without making it clear which loan they were dealing with, and leading to confusion for the reader.

In part (a)(ii) candidates were required to calculate the taxable trading profit for the first accounting period for the partnership and show the allocation between the partners. The majority of candidates correctly identified the deductions available for loan interest and capital allowances, and allocated the profit between the two partners in the profit sharing ratio. The most common error was a failure to deal correctly with the salary paid to one of the partners, treating this as an allowable deduction from the partnership profit, rather than as part of the profit allocation.

Part (a)(iii) required candidates to go on and calculate one partner's taxable trading income for all relevant tax years. It was good to see that most candidates were able to correctly identify the relevant tax years, but only a small minority correctly identified the actual basis periods for all three relevant years. Unincorporated businesses are tested in every paper, and questions frequently demand identification of basis periods – particularly in the opening years (as here) or closing years of a business. This is fundamental knowledge from F6 which candidates must bring forward and be able to apply to given scenarios at P6.

Part (b) required explanation of the tax treatment of various items within a redundancy package, and calculation of the taxpayer's income tax liability for the year in which this was received. In the main, this was done well, with the majority of candidates appearing to be very comfortable with this topic.