

# Examiner's report

## P6 Advanced Taxation (UK)

June 2010



### General Comments

There were many very good scripts and it is pleasing to note that the vast majority of candidates attempted all of the parts of four questions. In addition, the majority of answers were brief and to the point. The most significant issue for weaker candidates was a failure to identify all of the tasks within each question such that they failed to address all of the available marks. Many candidates would benefit from thinking more and writing less.

The exam was divided into section A and section B. Section A consisted of two compulsory questions worth a total of 68 marks. In section B candidates were required to answer two of the three questions worth 16 marks each.

In section B, questions 4 and 5 were equally popular; question 3 was the most popular question.

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. For example, it was clear that many weaker candidates did not know the conditions that needed to be satisfied in order for entrepreneurs' relief and/or gift relief to be available.
  - This knowledge must be up to date. Candidates sitting the exam in December 2010 must familiarise themselves with the changes introduced by the recent Finance Acts as summarised in the Finance Act articles published in Student Accountant magazine and on the website.
2. Practise questions from past exams with the aim of adopting the style of the model answers.
3. Address the requirement
  - Read the requirement carefully – in the Section A questions you will need to identify the various tasks from the documents provided; instructions may be provided by both the 'client' and the 'manager'. It may be helpful to list them out and tick them off 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 command words (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 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.
  - Think about the issues before you start and identify a strategy to solve the problem set.



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.
- 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 questions 1 and 2. In order to earn these marks candidates first had to satisfy the requirement in relation to the format of the document requested. Further marks were then available for providing clear explanations, coherent calculations and the ease with which the meeting notes in question 2 could have been used in a meeting.

On the whole, the performance of candidates in this area was good with the majority of candidates producing well structured documents in a style that was easy to follow.

### **Specific Comments**

#### **Question One**

This question concerned a number of issues relating to a group of companies. Candidates were required to prepare corporation tax computations and to provide detailed explanations of the rules regarding controlled foreign companies and the capital goods scheme.

Part (i) concerned the corporation tax liabilities of the three subsidiary companies and required knowledge of the rules in relation to research and development and the annual investment allowance.

The corporation tax computations were the straightforward marks in this part of the question and were prepared well. However, many candidates let themselves down by failing to satisfy the precise details of the requirement. The question asked for a calculation of the total of the liabilities of the three subsidiaries before taking account of the additional expenditure set out in the e-mail from the client, together with an explanation of the effects of that expenditure on the total of the liabilities. Unfortunately, many candidates simply calculated three corporation tax liabilities.

The manager's instructions required candidates to 'take advantage of any opportunities available to reduce the total corporation tax liability'. One of the companies, Truffle Ltd, had a chargeable gain. Candidates were expected to propose that some of that gain should be transferred to Fondant Ltd to take advantage of that company's capital loss. The remainder of the gain should also be transferred (to Ganache Ltd or Fondant Ltd) in order to take advantage of lower tax rates. Many candidates did not spot these opportunities and would perhaps have benefited from pausing for a moment in order to give themselves a chance to think about the situation presented to them.

Candidates demonstrated an excellent knowledge of the relief available in respect of expenditure on research and development and the rules concerning the annual investment allowance.

The second part of the question required a 'detailed analysis' of whether or not a proposed acquisition would be a controlled foreign company together with the implications of it being such a company. This was a chance for candidates to present detailed knowledge of this area in a structured manner and many answers were very good. Candidates who did not score well either did not know this area of the syllabus well enough or did not pick up on the instructions to provide a 'detailed analysis' such that their answers were too brief and superficial. Many



candidates would have benefited from pausing and thinking before they started writing in order to ensure that they approached the question in a logical manner and thus identified more of the points that needed to be made. Candidates need to ensure that they identify all of the elements of the requirements in each question. In part (ii) of this question the client questioned the tax treatment of the arrangement fees and interest relating to the loan taken out to purchase the overseas subsidiary. This was not a difficult point but it was not addressed by many candidates.

The final part of the question concerned a partially exempt company considering the purchase of a building and the workings of the capital good scheme. This was reasonably straightforward and was done reasonably well. A small minority of candidates wasted time by providing detailed descriptions of partial exemption and other aspects of VAT and many candidates were confused about who was going to be charging VAT to whom. However, having said that, a good proportion of candidates understood the operation of the capital goods scheme and explained it well. Only a minority of candidates addressed the possible advantages of using the company's partial exemption percentage for the previous year.

#### **Question Two**

Question 2 was a substantial question in four parts. Although some of the question parts could be seen as easier or harder than others, all of the parts had some easily accessible marks and candidates benefited from attempting all parts rather than only attempting those that appeared to be straightforward.

Part (i) concerned the implications of a change to an employee's location of work. On the whole this part of the question was done reasonably well. However, in order to score a high mark for this part it was necessary to focus on the client's financial position and calculate how much better or worse off he was going to be as a result of the change. This required candidates to think in terms of income and costs (with tax as a cost) and to recognise that costs that are not tax deductible are still costs and are therefore still relevant. This aspect of the question was not handled particularly well.

The calculation of the benefit in respect of the flat provided by the company was done well. However, the majority of candidates failed to recognise that the mileage allowance related to travel to and from work and was therefore taxable in full.

It was pleasing to note that fewer candidates than in the past provided lengthy explanations of what they were going to do before getting on and doing it. However, the question asked for an explanation of the tax treatment of two particular points; the receipt of the mileage allowance and the receipt of the rent. Many candidates failed to provide these explanations. As noted above, in respect of question 1, candidates must identify and carry out all of the tasks in the question in order to maximise their marks.

Part (ii) concerned the new rules introduced in the Finance Act 2009 in relation to senior accounting officers. These rules were a significant development in the personal responsibility of individuals for the behaviour of their employing companies and were covered in great detail in the financial press at the time. However, the majority of candidates were not aware of them and, consequently, found it difficult to score well on this part of the question. Having said that, there were also marks available for pointing out that the client's error needed to be communicated to HMRC and for identifying the action necessary if the client was unwilling to make such disclosure. Accordingly, it was possible to score reasonably well in this part of the question without any knowledge of the new rules.

Part (iii) of the question concerned inheritance tax and the advantages of lifetime giving. At first sight it was a daunting question requiring the consideration of three possible property values, two dates of death and a lifetime gift or gift via will; a total of 12 possible situations. However, there was guidance from the 'manager' as to where to start together with the reassurance that 'you should find that the calculations do not take too long'.



It was very pleasing to find that the majority of candidates had no problem with this part of the question and that their knowledge of the basic mechanics of inheritance tax was sound. Candidates benefited from thinking rather than writing such that they were then able to realise that, for example, with a lifetime gift, the only difference between the two possible dates of death was the availability of taper relief. The best answers were admirably short and to the point.

The one area where candidates could have done better was in identifying the possible gift with reservation. The failure by many candidates to do this indicates, yet again, that some candidates do not take enough care in identifying all that has been asked of them.

The final part of the question concerned the tax treatment of income received from a trust. This was a test of knowledge, as opposed to application of knowledge, and candidates should have scored well. However, the marks for this part were not as high as expected because candidates were not sufficiently careful in their approach. As always, the advice here is to stop and think. The question made it clear that the nature of the trust was not known and therefore candidates were expected to consider the income tax position of receipts from both an interest in possession trust and a discretionary trust. There was also the need to be specific and precise, as regards grossing up fractions and tax rates, rather than superficial and general in order to maximise the marks obtained.

### **Question Three**

This question concerned the choice of business vehicle for a new business that was anticipating initial trading losses and the implications of registering voluntarily for VAT. It was in three parts.

Part (a) (i) required candidates to calculate the taxable trading profit or allowable trading loss depending on whether the business vehicle was a company or an unincorporated business. The majority of candidates scored high marks here although some had difficulty calculating the figure for the second tax year of an unincorporated business based on the first 12 months of trading. Those who did not do so well simply did not know the basic mechanical rules and either missed out this part of the question or tried to make it up. The opening and closing years rules for unincorporated traders are examined regularly and candidates preparing for future sittings are likely to benefit from being able to handle them.

Part (a) (ii) required candidates to provide a 'thorough and detailed explanation' of the manner in which the losses could be used depending on the choice of business vehicle. This part of the question was done well by almost all of the candidates who attempted it. In order to maximise marks here it was necessary to be precise in terms of language used. For example, it was not sufficient to state that losses can be carried forward against future profits. Instead, candidates needed to state that losses could be carried forward for offset against future profits of *the same trade*.

There was also a requirement to state which business structure would best satisfy the client's objectives. The mark available for this was missed by those candidates who had stopped thinking and were simply writing down everything they knew about loss relief.

The other difficulty which candidates had with this part of the question was a failure to recognise that not all possible loss reliefs were available due to the particular facts of the question. Candidates should ensure that they do not write at length about matters which are irrelevant.

The final part of the question concerned the 'financial' advantages and disadvantages of registering voluntarily for VAT. Many candidates let themselves down by not reading the question carefully such that they simply listed all the advantages and disadvantages they could think of without focusing on the word financial or the particular facts surrounding the client. This meant that they missed the possibility of recovering pre-registration VAT, which was often the difference between an OK mark and a good mark.



#### **Question Four**

This question required candidates to provide advice on pensions, the enterprise management incentive scheme and the tax implications of the funding of school fees by a grandparent. The question was in two parts.

The pension scheme element of part (a) was not done particularly well. Candidates struggled in an attempt to produce detailed calculations when a few well chosen sentences would have been much more efficient. Many candidates failed to consider national insurance contributions and there was particular confusion in relation to the employer's contributions to the pension scheme with many candidates deducting the contributions from the employee's salary.

The main problem here was an inability to set down a clear explanation of the rules. Before starting to write an answer, candidates should be willing to stop and think in order to plan what they want to say. Also, as part of their preparation for the exam, candidates should practise explaining the tax implications of transactions in writing in order to improve their ability to get to the point in a clear and precise manner.

A small minority of candidates failed to address the three additional questions raised by the client in respect of pension scheme benefits. This was a shame as there were some relatively straightforward marks available here. The enterprise management incentive scheme element of part (a) again required candidates to address particular points as opposed to writing generally. Although many candidates were aware that there was a maximum value to the options granted under such a scheme, not all of them applied the rule to the facts of the question in terms of the restriction on the number of share options granted by the company. A significant number of candidates confused the enterprise management incentive scheme with the enterprise investment scheme.

Part (b) concerned a grandmother who wished to help finance the school fees of her grandchildren. It was done well by many candidates. Those who did not do so well were often too superficial in their explanations; the question required candidates to 'explain in detail'. Also, weaker candidates failed to consider the capital gains tax implications of the gifts and/or the possibility of the exemption in respect of normal expenditure out of income being available in relation to inheritance tax. Of those who did address capital gains tax, many thought, incorrectly, that gift relief would be available in respect of the proposed gift of quoted shares.

#### **Question Five**

This question concerned the incorporation of a business and the provision of a number of employee benefits. It was in three parts.

Part (a) concerned the capital allowances implications of incorporating the business and the allowances available in respect of a false ceiling to be installed in a supermarket. It was not done particularly well. Many candidates thought that on incorporation the assets would be transferred to the company at tax written down value whereas the correct position is that a balancing charge would arise unless a succession election were entered into. A number of candidates wrote that a balancing charge or a balancing allowance would arise when it was clear from the facts that it would be a balancing charge.

Part (b) required candidates to prepare calculations in order to determine the base cost of the shares received on incorporation and the subsequent gain on the sale of some of the shares. Common errors here included calculating a capital loss on the equipment (not available due to the availability of capital allowances) and giving entrepreneurs' relief on the incorporation (not available as the business had not been owned for a year). The quality of the answers to this part of the question depended on the clarity of the candidates' knowledge. There were many candidates who knew how to perform the necessary calculations and whose only common error was the failure to deduct the gain relieved on incorporation from the base cost of the shares. There was then another group of candidates who had no clear knowledge of the rules and consequently did not score well.



Candidates were asked to suggest a minor change in relation to the sale of shares that would reduce the chargeable gain. Suggestions needed to be sensible and commercial and not, as put forward by a number of candidates, 'reduce the selling price of the shares'.

The final part of the question concerned the provision of bicycles and other related benefits to employees. Candidates were asked to outline the tax implications for the company and its employees of the various benefits. There were three benefits, so all answers should have consisted of six brief elements. Unfortunately, most answers were not that well organised with candidates addressing the issues in what was often a haphazard manner such that they did not score as well as they could have done.