



Examiner's report

P6 Advanced Taxation (UK)

December 2010

General Comments

There were many very good scripts and it was pleasing to note that the vast majority of candidates attempted all of the parts of four questions. In addition, there was a good amount of answers that were brief and to the point. The most significant issue for weaker candidates was a tendency to address issues that were not asked for thus wasting valuable time. 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 for a total of 66 marks. In section B candidates were required to answer two of the three questions worth 17 marks each. In section B, questions 3 and 4 were equally popular; question 5 was the least 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 capital gains tax reliefs to be available in question 4 or the precise rules regarding the remittance basis in question 2.
 - This knowledge must be up to date. Candidates sitting the exam in 2011 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 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 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 and coherent calculations.

On the whole, the performance of candidates in this area was good with the majority of candidates producing correctly formatted documents in a style that was easy to follow. However, many candidates failed to maintain the correct style of a document throughout their answer such that, for example, the letters written in response to question 2 often referred to the client correctly as 'you' to begin with but then reverted to using the client's name later in the answer.

Specific Comments

Question One

Question 1 was a substantial question in two parts. Part (a) required candidates to write a report concerning a number of issues relating to a group of companies. Part (b) required a summary of the information to be obtained and the action that needs to be taken before becoming tax advisers to a new client.

Part (a) was in three parts and, on the whole, was done well by many candidates. The vast majority of candidates prepared their answer in the correct report format although a minority wasted time producing a long and unnecessary introduction.

Part (i) required candidates to explain the alternative reliefs available in respect of a company's trading losses, the tax treatment of a loss arising on the sale of a company and the upper and lower limits for all of the companies for the purposes of calculating the rate of corporation tax.

Candidates' knowledge of the reliefs available in respect of trading losses was often very good but many let themselves down by addressing the issue in the abstract rather than in relation to the companies in the question. This resulted in detailed explanations of reliefs that were simply not applicable (in particular the offset of losses against current and previous years' profits) such that candidates then had too little time to explain the relevant points properly.

As always, candidates benefited if they paused to allow themselves to identify the issues within the question. There was to be a change of ownership of the loss making company and an apparent major change in the manner in which it would carry on its activities going forward. Accordingly, it is likely that it would be unable to carry forward its losses beyond the date of the change of ownership. There were also arrangements in force for the company to be sold such that it would leave the group relief group prior to the legal transfer of the shares. Many candidates spotted both of these points but those that did not need to think about how they would do things differently such that they would spot them in the future. Finally, a surprising number of candidates thought, incorrectly, that Knuckle Ltd was a member of the group relief group.

The capital loss on the sale of the company was not available for offset due to the substantial shareholding exemption. Somewhat surprisingly, many candidates missed this and, of those that spotted the point, many thought that whilst a gain would not be subject to tax, a loss would still be allowable.

For the final element of this part of the question candidates were asked to explain the upper and lower limits of the companies. Many candidates simply stated the number of associates and the consequent limits; but that was not an explanation. What was needed were the reasons for the limits being what they were including references to the companies being controlled by the same person and the effect of companies joining and leaving the group. The limits were not the same for each of the companies. Candidates needed to consider each of the companies and apply their knowledge of the rules to that company's particular circumstances.

Part (ii) concerned the planned disposal of a number of buildings. The capital gains were reasonably straightforward with just an added complication of a gain rolled over into the cost of one of the buildings. However, many candidates missed the fact that one of the buildings would be transferred at no gain, no loss as the vendor and the purchaser were in a capital gains group. Others made errors in connection with the indexation allowance (increasing a capital loss with indexation or applying the indexation factor to the unindexed gain rather than the cost) and the treatment of the held over gain. There was a sense here that some candidates had switched off in that some of the errors were very basic and were perhaps an indication of not paying sufficient attention as opposed to a lack of knowledge.

Candidates were told in the question that there was a pre-entry element to the capital loss arising on the sale of one of the buildings. The calculation of the pre-entry element was done reasonably well by many candidates but only a small minority had a clear understanding of the manner in which the pre-entry element could be used. A minority of candidates wasted time on this part of the question explaining, often in some detail, how the gains and losses should be offset. This was not part of the requirements and there was insufficient information in the question to arrive at sensible conclusions. Candidates will always benefit from taking the time to read each requirement carefully and then taking care not to deviate from the tasks set.

The VAT and stamp duty land tax elements were handled well by many candidates. Those who did not do so well need to apply their knowledge to the facts as opposed to simply writing what they know. For example, the prices at which the buildings were to be sold meant that, where duty was payable, the rate would be 3%. Yet some candidates answered in the abstract and gave the various rates of duty for all possible prices that could be charged. Only a small number of candidates considered the possibility of there being a VAT group; slightly more identified that there would be no stamp duty land tax on the property transferred within the group.

Part (iii) concerned the VAT implications of selling goods overseas. There were many excellent answers to this part that, whilst being brief, often scored almost full marks. Weaker candidates either had not learned the rules or confused their terminology using the phrase 'no VAT will be charged' as opposed to 'zero rated'; the two terms do not mean the same thing.

The majority of candidates scored well in part (b). Many took the sensible approach of starting the question with this part in order to ensure that they had sufficient time available to prepare an appropriate answer. A minority had not taken the time to learn this area of the syllabus with the result that they were unable to obtain some very straightforward marks.

Question Two

Question 2 concerned the taxation of individuals and was in two parts.

Part (i) concerned inheritance tax and, in particular, the relevance of domicile to an individual's tax position. The level of knowledge here was good with some very strong, thorough answers. However, many candidates who scored well for this part of the question often did so in an inefficient manner which may have left them short of time for the remainder of the exam. As always, there was a need to pause; this time in order to determine the best way to say what needed to be said. Weaker candidates simply kept writing, often repeating themselves, until they finally got to where they wanted to be. Stronger candidates wrote short, precise phrases which earned all of the marks despite using very few words. Candidates should practise explaining areas of taxation making sure that their explanations are concise and clear.

There was a need to address the position of both the mother and the daughter but many candidates simply addressed 'inheritance tax' rather than the situation of the individuals. Candidates will be more successful in the exam if they think in terms of providing advice to individuals and companies rather than addressing technical issues as this will help them to stick to the point and to satisfy the questions' requirements.

A substantial minority of candidates produced muddled explanations confusing the importance of domicile with residence and ordinary residence. This confusion was also evident in answers to part (ii). The three factors of residence, ordinary residence and domicile all have various implications depending on the taxes concerned and candidates need to know where to start such that they can then avoid writing about all of the factors at once.

A somewhat surprising error made by a significant minority of candidates was to state that the inheritance tax position on the death of Sushi's mother depended on the domicile status of Sushi as opposed to that of her mother. It is, of course, the status of the person whose estate has fallen in value that is relevant.

A final thought on this part of the question is that many candidates wasted time calculating inheritance tax, despite not having sufficient information, whilst others provided a considerable amount of detail regarding the taxation implications of making a potentially exempt transfer, despite being specifically told not to in the question.

Part (ii) concerned overseas income and the remittance basis. The performance of candidates for this part was mixed. To begin with there was much confusion regarding the conditions that must be satisfied in order for the remittance basis to be available with candidates mixing up domicile, residence and ordinary residence with the seven out of nine years rule (and the 17 out of 20 years rule in respect of inheritance tax deemed domicile). The application of the £2,000 rule was also misunderstood by many. There is no doubt that there is plenty to be confused about in this area but that is why candidates need to learn it rather than acquire a hopeful understanding of it.

Candidates were asked to explain the meaning of 'remittance' and the 'remittance basis'. Most candidates attempted to do this, which was very encouraging, but few had much knowledge beyond the absolute basics. Similarly, most candidates were aware of the £30,000 remittance basis charge but a significant number were confused as to the situation in which the charge would be levied.

On the plus side, the vast majority of candidates provided a conclusion (as requested) and many produced neat and reasonably accurate calculations.

Question Three

This question concerned the purchase by a company of its own shares and the provision of a benefit to a shareholder in a close company. It was in three parts.

Part (a) required candidates to explain whether two of the conditions necessary to enable the amount received to be treated as capital were satisfied. Many candidates answered this part well but others, with similar knowledge levels, did not perform well because they failed to answer the question. Rather than addressing the two particular conditions set out in the question, this latter group attempted to address all of the conditions despite the majority of them being irrelevant.

Candidates had a good knowledge of the five-year rule and the 30% rule but were much less comfortable with the condition relating to the shareholder's interest in the company following the purchase. The rules require the shareholder's interest to be no more than 75% of the interest prior to the purchase – this is not the same as the shareholder selling 25% of his shares because the shares sold are cancelled thus reducing the number of issued shares.

Only a minority of candidates were aware that the ownership period of the husband could be added to that of the wife. Even fewer knew that the usual five-year ownership period is reduced to three where the shares are inherited.

Part (b) required calculations of the after tax proceeds depending on the tax treatment of the sum received. This part was answered well by the vast majority of candidates. The only point that many candidates missed was the availability of entrepreneurs' relief. It was particularly pleasing to see the majority of candidates correctly identify the after tax proceeds as the amount received less the tax liability (as opposed to the taxable amount less the tax liability).

The final part of the question was more difficult and, unsurprisingly, caused more problems. The question concerned the loan of a motorcycle to a shareholder in a close company who was not an employee. Candidates had no problem recognising that the company was a close company but many then decided that this was a loan to a participator as opposed to the loan of an asset.

Another relatively common error was to state, correctly, that the benefit would be treated as a distribution but to then give an incorrect tax rate of 40%. Candidates would benefit from slowing down and ensuring that they apply their basic tax knowledge correctly in the exam.

Question Four

This question concerned the capital gains tax and inheritance tax implications of the destruction of an asset and the exchange of assets between two individuals together with the penalties that may be charged in respect of an error in a tax return. The question was in three parts.

Part (a) required candidates to consider both the capital gains tax and inheritance tax implications of the destruction of an asset and the exchange of one asset for another. This required some clear thinking as to who was disposing of what together with the ability not to confuse the two capital taxes. This part of the question was answered reasonably well by many candidates. However, some candidates would have benefited from addressing each of the taxes separately under clear headings as this would have helped them to organise their thoughts and prevent confusion.

The calculations of the capital gains were done well as were the implications of the potentially exempt transfer. However, the deferral of the gain on the asset destroyed was usually dealt with, incorrectly, by reference to business asset rollover relief.

The reliefs available in respect of capital gains involve a fairly tricky bunch of rules and definitions. Candidates would be well advised to learn the conditions that must be satisfied in order for each of the reliefs to be available. Part (b) was very small but still required thought; it involved the disposal of a boat. For one of the two available marks candidates simply had to state that a boat is an exempt asset for the purposes of capital gains tax. However, the vast majority did not pause for thought and instead talked about the capital loss that would occur on disposal.

The final part of the question tested candidates' knowledge of the penalties that may be charged in respect of an error in a tax return. This is a current issue as the rules have changed recently but a minority of candidates were not aware of the new rules. Candidates should ensure that they keep up to date with the changes to the tax system and that they read the Finance Act articles published in Student Accountant.

Question Five

This question concerned VAT, and in particular partial exemption, together with the rules relating to personal service companies. It was in three parts.

Part (a) required candidates to determine the cost of buying in services from three possible suppliers. Candidates were told that the purchasing company was partially exempt for the purposes of VAT and the vast majority realised that the key to the question was the impact of irrecoverable VAT on the cost.

There were minor errors in determining the percentage of input tax that could be recovered involving the need to include the zero rated supplies on the top and bottom of the fraction and also the requirement to round up the fraction to the nearest whole percentage; more care here could have earned some candidates an extra mark. A more common error was a failure to realise that the purchasing company would need to account for output tax on the purchase of the services from overseas thus increasing the cost by the amount of irrecoverable VAT. Having said that, this was a tricky point and it was very pleasing that a large number of candidates identified this issue. The calculation of the maximum salary that could be paid such that the total cost would be no more than the cheapest service provider was done well with the majority of candidates identifying the need to include employer's national insurance contributions in their calculations.

Part (b) required three examples of specific contractual arrangements that would indicate an employer/employee relationship. This was a simple test of knowledge and was done well by most candidates. Having said that, candidates were asked to give examples that related to the facts of this particular question as opposed to the first three that they thought of; the question made it clear that a fixed fee would be paid for the work so it was not appropriate to write about the payment of holiday pay or sick pay.

The final part of the question was more difficult. It required candidates to recognise that the personal service company rules would apply and to explain the implications for the various parties. Candidates' performance here was mixed. Many candidates identified that the issue related to personal service companies but got confused as to which of the companies would be regarded as making the deemed salary payment. Weaker candidates assumed that the question was still about VAT and repeated matters already covered in part (a).